INSURANCE LAW

Faulty Work Can Constitute an 'Occurrence' Under a Modern CGL Policy

By Thomas Pryor

In a decision that should reverberate with percussive force through the general liability insurer community, the New Jersey Appellate Division recently silenced decades of insurance carrier posturing by holding the unintended and unexpected consequential damages caused by a subcontractor's defective work constitutes "property damage" and an "occurrence" under a developer's commercial general liability (CGL) policy.

An "occurrence" is commonly defined in a modern form CGL policy as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions." The court recognized that "the accidental nature of an occurrence is determined by analyzing whether the alleged wrongdoer intended or expected to cause an injury." *Voorhees v. Preferred*, 128 N.J. 165, 183 (1992)

In *Cypress Point v. Adria Towers*, 2015 N.J. Super., Lexis. 114 (App. Div. 2015) A-2767-13T1, the court construed several CGL policies, finding that damages arising from faulty, defective workmanship by subcontractors in installing roofs, flashing, gutters and leaders, brick and EIFS façade, windows, doors and other building exterior features on a condominium development project fell within the basic risks assumed under a modern-day 1986 ISO standard form CGL policy.

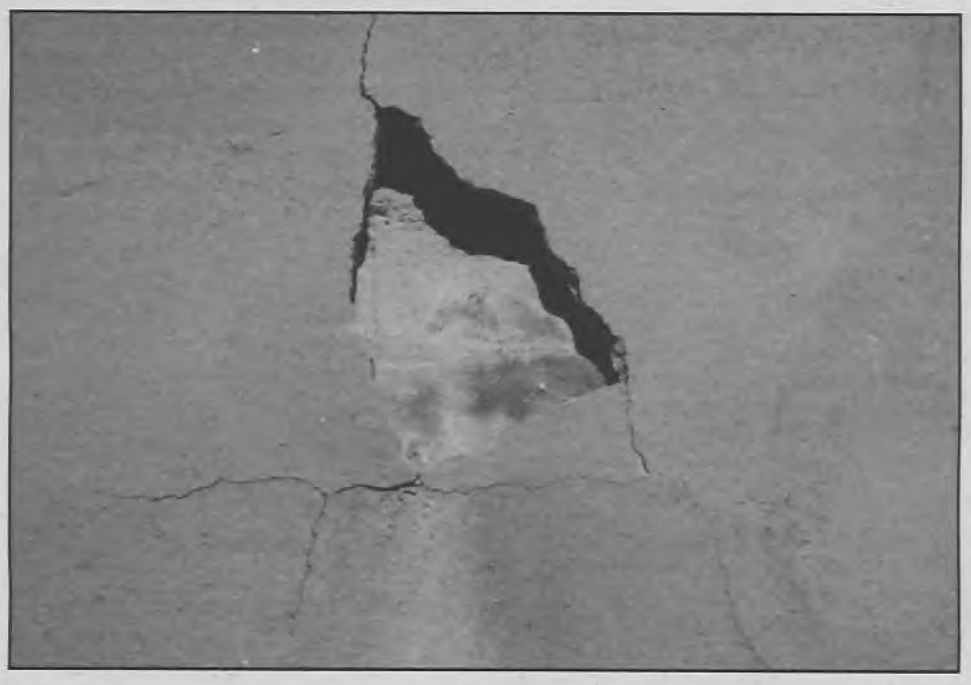
The damages alleged were to the common areas of the condominium complex, including steel supports, exterior and interior sheathing, and other areas of the building, as well as to unit owners' property.

The court fairly distinguished holdings in the fabled *Weedo v. Stone-E-Brick*, 81 N.J. 233 (1979), and *Firemen's Insurance v. National Union*, 387 N.J. Super. 434 (App. Div. 2006), decisions, both now largely relegated to limited contextual relevance. In each, the court analyzed claims of poor workmanship, absent consequential property damages to other work, under antiquated 1973 ISO CGL policy forms.

Although neither case addressed squarely whether consequential damages resulting from a subcontractor's faulty workmanship constituted "property damage" or an "occurrence," both opinions hinted at outcomes logically consistent with the *Cypress* holding. Also, as the current court noted, the definition of "occurrence" has changed since 1973, at which time it was defined as "an accident … which results in … property damage neither expected nor intended from the standpoint of the insured." The modern form eliminates reference to "property damage" in the definition of an occurrence.

The *Cypress* court similarly resoundingly rejected the fatally flawed reasoning in the oft-cited but unreported 2010 *Pennsylvania National v. Parkshore Development Corp*. trilogy of opinions, now properly unmasked by the appellate panel as inaccurate interpretations of New Jersey law by the District Court and Third Circuit. Also rejected was the notion that physical injury to the "completed project" is somehow an impediment to coverage as not constituting "property damage."

Instead, the court embraced soundly



reasoned opinions in other jurisdictions, notably the *U.S. Fire Insurance v. J.S.U.B.*, 979 So. 2d 871 (Fla. 2007), opinion by the Florida Supreme Court, which in 2007 cogently interpreted modern-day CGL policy forms, rejecting fanciful arguments built around an interpretation of the so-called "business risk" exclusions, misinterpreted in some jurisdictions to eviscerate coverage existing for decades under the CGL policy form.

The court found persuasive the reasoning in *U.S. Fire*, which concluded that "faulty workmanship that is neither intended nor expected … can constitute an 'accident' and thus an 'occurrence' under a post-1986 standard form CGL policy."

The court also acknowledged two prior New Jersey opinions, *Hartford Insurance v. Marson*, 186 N.J. Super. 253 (App. Div. 1982), and *Newark Insurance v. Acupac*, 328 N.J. Super. (App. Div. 2000), both of which acknowledged that defective work causing damage to other property is not a noncovered business risk.

The court was unpersuaded that by interpreting an "occurrence" under the policies at issue to include unexpected and unintended consequential damages caused by the subcontractor's faulty workmanship, would convert a CGL policy into a "performance bond," as some have warned against in challenging this interpretation of the CGL form.

The *Cypress* opinion is a long-anticipated breath of fresh air. It brings New Jersey firmly within the growing legion of jurisdictions who have applied cogent reasoning and sound logic to policy interpretation of forms and endorsements allocating construction defect claim risks among sponsor developers, subcontractors and their insurers. This opinion also has a profound effect upon aggrieved plaintiffs, notably including common interest associations forced to bring a significant number of these actions, given the ubiquity of condominiums and town homes in New Jersey, as elsewhere.

Generally speaking, a party (developer or contractor) purchases CGL coverage to secure a defense and indemnity against claims for property damage caused by an "occurrence" resulting from the defective work of those it hires to build out a project. Inherent in every agreement for the performance of construction work is the risk the work will be done improperly, thus causing unintended consequential property damage.

It is generally recognized that construction defects necessitating repairs, confined solely to the defective workmanship itself, (absent any consequential property damage), will not ordinarily trigger coverage under a CGL policy. This is based in part on the "Your Work" policy exclusion, common in the ISO form, which excludes coverage for damage to the insured's own work.

The modern-day exclusion typically, however, contains an "exception" to this provision, which renders the exclusion inapplicable when the "work" at issue is performed by the insured's "subcontractor." This part of the policy featured prominently in the *Cypress* court's opinion, and had not been addressed directly in any prior reported New Jersey opinion to my knowledge.

The *Cypress* court acknowledged the "subcontractor exception" was added to the ISO form after 1986 at the behest of the policyholder community, to make the CGL policy a more attractive product with this language included.

As the opinion recognizes, an ISO circular from 1986 went so far as to acknowledge that the subcontractor exception was intended to apply to "damage to, or caused by, a subcontractor's work after the insured's operations [essentially the work performed in building out the project at issue] are completed." Naysayers who have clung to an outdated interpretation built around what are known as the "business risk" CGL exclusions, have ignored the evolution of the language of the form, its underwriting history, the reasonable expectations of an insured, and policy language interpretations grounded in common sense and logic.

The ISO form has evolved over time, through numerous word changes, lurching back and forth between policyholder-friendly and carrier-friendly forms, endorsements, exclusions and language modifications. The industry has developed and offers for sale an "exception" to the CGL form, the intent of which is to eliminate the subcontractor exception; a further acknowledgment that coverage is afforded by means of the subcontractor exception, given there would be no need to develop an endorsement to remove language unless it extended coverage in the first place.

The "subcontractor exception" is implicated in large-scale condominium or town home construction, where a sponsor developer or general contractor hires various subcontractors to perform all phases of construction. The *Cypress* opinion recognizes that allegations of damage to building elements caused by a subcontractor's defective workmanship constitutes the precise type of consequential damage covered under a sponsor developer or general contractor's CGL policy.

Accordingly, as the court has affirmed, where a party (here the developer acting as the general contractor) hires subcontractors to perform construction work on a project, the general contractor's CGL policy is triggered when a subcontractor's defective work causes consequential property damage, beyond damage confined exclusively to the subcontractor's own work.

This decision advances the analysis of CGL coverage immeasurably, beyond stale concepts perpetuated by slavish devotion to outdated case law interpreting antiquated policy forms. It brings New Jersey into logical consistency with a majority of states whose courts have properly interpreted and applied modern ISO CGL policy forms to construction defect claims.

It recognizes that the unintended consequences of faulty work are compensable under CGL policies as an "occurrence," and refutes arguments by carriers over the last several decades, as unsupported by logic, reason and the express terms of the policies at issue.

This opinion should facilitate resolution of construction defect litigation claims by eliminating extraneous arguments distracting counsel from the real issues in controversy. Although other policy grants and exclusions will impact the larger analysis of these claims, this decision sets in place a clear framework for analysis of other relevant policy provisions impacting a full coverage determination. At a minimum, it effectively eliminates fanciful arguments over what constitutes an "occurrence."

While not central to its holding, the court identified the recoverable consequential damages as "the cost of curing the 'property damage' arising from the subcontractor's faulty workmanship." Courts in many states recognize "rip and tear" or "get to" damages as included within the cost of curing property damage caused by a subcontractor's defective work. These courts acknowledge the removal and replacement of the subcontractor's or other's work as a necessary cost of accessing the areas of property damage requiring repair.

Here, the plaintiff's counsel apparently chose not to seek "replacement costs" as within "property damage" constituting an "occurrence" under the policy. Therefore, unless the issue is somehow addressed further on remand, we may need to await future opinions for guidance as to the proper inclusion of removal and replacement costs as an element of damages recoverable under a CGL policy, under these circumstances. Regardless, this opinion advances measurably the overall analysis, under New Jersey law, of policy language routinely encountered in these cases. ■

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