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Supreme Court Affirms Coverage for Construction Defects

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The New Jersey Supreme Court has affirmed the Appellate Division's pro-policyholder decision in *Cypress Point Condominium Association v. Adria Towers, L.L.C.* confirming broad coverage for construction defects.[1] In a scholarly decision, the Supreme Court traced the development of the relevant provisions of the general liability insurance policy, examined decisions from other jurisdictions, and reviewed law review articles and dictionaries in order to find coverage for the consequential damages arising out of construction defects.

The underlying facts of this case are sadly very typical. Roof, facade, and window construction defects caused water infiltration and resulting damage to the condominium complex's interior structure, to interior window jambs and sills of the owners' units, and to common areas. The condominium association sued the developers and several subcontractors for faulty workmanship during construction, including, but not limited to, defectively built or installed roofs, gutters, brick facades, exterior insulation and finishing system siding, windows, doors, and sealants. The association claimed consequential damages, consisting of, among other things, damage to steel supports, exterior and interior sheathing and sheetrock, and insulation, and also to Cypress Point's common areas, interior structures, and residential units.[2]

One of the developers sued its insurance company, Evanston Insurance Company, which denied any coverage obligation, resulting in the coverage action. It is noteworthy that the association sued under four consecutive insurance policies in place during the four years of construction. Moreover, Evanston then sued another insurance company for contribution. Thus, *sub silentio,* the Supreme Court acknowledged that the continuous trigger theory of insurance coverage applied not just to toxic tort and environmental actions, but also to construction defect actions.

Evanston asserted that coverage did not exist because: 1) there was no "occurrence," which the insurance policy defined in relevant part as an accident, and 2) no "property damage."[3] Evanston asserted that since there was no occurrence, the court could not reach the exclusions, and particularly the subcontractor exception to the "your work" exclusion. The trial court adopted Evanston's arguments, but the Appellate Division reversed.[4]

The New Jersey Supreme Court began its discussion of the law with an examination of the rules of insurance policy construction. Most importantly, the Court stressed that "if the controlling language of a policy will support two meanings, one favorable to the insurer and the other to the insured, the interpretation favoring coverage should be applied."[5] The Court noted that if there was an ambiguity, a court could turn to extrinsic evidence.

After a detailed review of authorities and case law from other jurisdictions, the Supreme Court first tackled the issue of property damage:

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Here, the Association alleged that water infiltration, occurring after the project was completed and control was turned over to the Association, caused mold growth and other damage to Cypress Point's completed common areas and individual units. Those post-construction consequential damages resulted in loss of use of the affected areas by Cypress Point residents and, we hold, qualify as "[p]hysical injury to tangible property including all resulting loss of use

of that property." Therefore, on the record before us, the consequential damages to Cypress Point were covered "property damage" under the terms of the policies.[6]

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It is of interest that the Court concentrated on the "loss of use" aspect of property damage, and not on the issue of physical damage to tangible property.

The Court next examined whether an "occurrence" had taken place, which the policy defined, in relevant part, as an accident. The Court found the term accident "encompasses unintended and unexpected harm caused by negligent conduct."[7] The Court found the consequential property damage was not foreseeable, and that no one claimed the subcontractors intentionally caused the property damage.

Evanston argued the damage was a normal, predictable risk of doing business, relying on *Weedo v. Stone-E-Brick, Inc.*[8] and *Firemen's Insurance Co. of Newark v. National Union Fire Insurance Co.*[9] The Court held that *Weedo* and *Firemen's* were inapposite for two reasons—first, because both cases involved an earlier Insurance Services Office, Inc. (ISO) form of the general liability policy from 1973, and not the newer 1986 ISO policy form that was at issue, and second, because the developer in *Cypress Point* was seeking insurance coverage for consequential damages resulting from faulty workmanship instead of for the cost of replacing the faulty workmanship, as was the case in *Weedo* and *Firemen's*.[10]

The 1973 form contained a "your work" exclusion that specifically excluded coverage for "property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith."[11] The 1986 form, however, contained a crucial exception to the "your work" exclusion, such that the exclusion would "not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor."[12] The Court explained that the insurance industry began selling the 1986 ISO form with the intent to "provide coverage for defective construction claims so long as the allegedly defective work had been performed by a subcontractor...both because of the demands of the policyholder community (which wanted this sort of coverage) and the view of insurers that the CGL [policy] was a more attractive product that could be better sold if it contained this coverage."[13] Accordingly, in light of the new language in the 1986 form, and the clear intent of the insurance industry in promulgating this form to cover a subcontractor's faulty workmanship, the Court was able to distinguish *Weedo* and *Firemen's*.

The Court then concluded by holding that the association's claims of consequential water damage resulting from defective workmanship performed by subcontractors constituted both an "occurrence" and "property damage" under the terms of the policies.[14]

Going forward, it will be interesting to see how New Jersey courts handle faulty workmanship insurance claims. *Cypress Point* held that consequential damages resulting from a subcontractor's faulty workmanship will be covered under a developer's CGL policy, provided the developer purchased the 1986 ISO form policy. On the other hand, the Court appears to have endorsed the holdings in *Weedo* and *Firemen's* that the cost of replacing faulty workmanship (not necessarily the consequential damages resulting from the faulty workmanship) is excluded from coverage under the 1973 ISO form policy.

What remains to be seen is whether New Jersey courts will start to find that the cost to the developer of replacing a subcontractor's faulty workmanship will be covered under the 1986 ISO form.

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Endnotes

1. *Cypress Point Condo. Ass'n v. Adria Towers, L.L.C.*, (A-13/14-15) (076348), 2016 N.J. LEXIS 847 (Aug. 4, 2016).
2. *Id.* at *16.
3. *Id.* at *38.
4. *Cypress Point Condo. Ass'n, Inc. v. Adria Towers, L.L.C.*, 441 N.J. Super. 369 (App. Div. 2015).
5. *Cypress Point Condo. Ass'n*, 2016 N.J. LEXIS 847, at *23 (citations omitted).
6. *Id.* at *37-38.
7. *Id.* at *40.
8. *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233 (1979).
9. *Firemen's Ins. Co. of Newark v. Nat'l Union Fire Ins. Co.*, 387 N.J. Super. 434 (App. Div. 2006).
10. *Cypress Point Condo. Ass'n*, 2016 N.J. LEXIS 847, at *16-19, 23-28.
11. *Id.* at *26 n.9.
12. *Id.* at *26.
13. *Id.* at *26, *45-46 (citations omitted).
14. *Id.* at *48.