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INSURANCE RECOVERY GROUP

NATIONAL TREND CONFIRMING INSURANCE COVERAGE FOR GENERAL CONTRACTORS IN CONSTRUCTION DEFECT LAWSUITS CONTINUES

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With its decision in *Cypress Point Condo. Ass'n v. Adria Towers, LLC*, the New Jersey Supreme Court has joined a clear national trend requiring insurance companies to provide immediate coverage to their insured general contractors (GCs) when they are sued for allegedly faulty workmanship performed by subcontractors. *See* — A.3d —, 2016 WL 4131662 (N.J. Aug. 4, 2016).

In *Cypress Point*, a condominium association sued GCs for consequential damages allegedly caused by faulty workmanship performed by subcontractors. The GCs sought defense and indemnity coverage under their commercial general liability (CGL) policies, which insured "property damage" caused by an "occurrence," *i.e.*, an accident. The insurers refused to accept their coverage obligations, claiming instead that the construction defect lawsuit did not involve "property damage" and that faulty workmanship was not an "occurrence."

Consistent with the majority rule followed in Alaska, Florida, Georgia, Indiana, Kansas, Minnesota, Mississippi, South Carolina, South Dakota, Tennessee, Texas, and Wisconsin, the New Jersey Supreme Court rejected the insurers' disclaimer. In doing so, the Court held "that the consequential damages caused by the subcontractors' defective work constitute 'property damage,' and the event resulting in that damage … is an 'occurrence' under the plain language of the CGL policies."

To arrive at that holding, the Court conducted a three-step analysis: (i) whether the construction defect lawsuit triggered the initial grant of coverage, (ii) if so, whether any policy exclusions bar coverage, and (iii) whether an exception within an exclusion restores coverage.

Analyzing the plain language of the general liability policies, the Court held that the condominium association's claims triggered the CGL policies' coverage grant. The allegations of "mold growth and damage to other property," which "resulted in loss of use of the affected areas," unambiguously constituted "property damage," defined as "physical injury to tangible property including all loss of use of that property." The Court also held that the construction defect lawsuit alleged an "occurrence" because the subcontractors did not intend to cause property damage. Instead, the "consequential harm caused by negligent work is an 'accident.'"

Next, the Court considered and rejected the application of the Your Work exclusion. The Your Work exclusion bars coverage for "'property damage' to 'your work' arising out of it or any part of it …." However, there is also a *critical exception*, which states that the exclusion "does not apply if the damaged work or work out of which the damage arises *was performed on your behalf by a subcontractor*." While the Your Work exclusion would initially "seem to eliminate coverage," the Court confirmed that the plain language of the subcontractor exception established that, in fact, there is coverage for construction defects caused by subcontractors.

Moreover, the Court noted that the insurance industry publicly represented and confirmed an intention to provide coverage for subcontractor negligence through the inclusion of the subcontractor exception: the Insurance Services Office, Inc. (ISO) "itself addressed the addition of the subcontractor exception in a July 1986 circular, which 'confirmed' that the 1986 revisions to the standard CGL policy specifically covered damage caused by faulty workmanship to other parts of work in progress; and damage to, or caused by, a subcontractor's work after the insured's operations are completed." The Court also cited an industry expert, who noted that insurers and the ISO were motivated to offer coverage for subcontractor faulty workmanship because it made the CGL policy more attractive for GCs to purchase.

Cypress Point represents a significant victory for GCs and reinforces insurance principles generally applicable to all policyholders:

- **Insurers must defend early.** *Cypress Point* eliminates the insurers' primary reasons for refusing to defend GCs in construction defect lawsuits (i.e., their erroneous claims that "faulty workmanship" is never covered and/or the entire construction project is the GCs' "work"). Instead, *Cypress Point* reinforces that "prompt and proactive" involvement by insurers is necessary to provide insureds with a "vigorous defense" in litigation so that "meritless claims can be challenged by motion

and substantial claims can be more effectively defended." *See Potomac Ins. Co. v. Pa. Mfr. Ass'n Ins. Co.*, 73 A.3d 465, 475 (N.J. 2013).

- **Insurers have the burden.** With construction defect lawsuits plainly falling within the insuring agreement of CGL policies, insurers cannot avoid their coverage obligation unless they meet a high burden to show that each and every alleged defect falls within a policy exclusion.
- **Plain language matters.** In wrongfully withholding coverage for construction defect claims, insurers had to ignore the policy's plain language. *Cypress Point* confirms that the definitions of "property damage" and "occurrence" are easily satisfied when consequential damages are alleged to flow from unintended faulty workmanship.
- **Coverage confirmed through exceptions to exclusions.** Because of the inclusion of the subcontractors' exception to the Your Work exclusion, the Court confirmed that the parties' intended for the policy to cover subcontractors' faulty work.

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