



Insurance Coverage Alert

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NEW JERSEY CLARIFIES THAT CONSEQUENTIAL DAMAGES CAUSED BY SUBCONTRACTORS' DEFECTIVE WORK IS AN OCCURRENCE OF PROPERTY DAMAGE

In *Cypress Point Condominium Ass'n, Inc. v. Adria Towers, et al.*, 2015 WL 4111890 (July 9, 2015), --- A.3d --- (App. Div. 2015), the New Jersey Appellate Division put to rest any question that consequential damages caused by construction defects at a condominium complex constitute an occurrence of property damage under a general contractor's policy. The court also provided helpful authority that should permit insurers to better allocate between covered and uncovered costs of repairs.

Cypress Point involved the familiar scenario in which the condominium association sued defendant Atria, the developer, for defective workmanship regarding the installation of the roof, flashing, gutters and leaders, brick and EIFS façade, windows, doors, and sealants. Atria did not seek coverage for the replacement costs of these items. However, the water intrusion from the defective workmanship also damaged the common areas and individual unit owners' property, including damage to steel supports, exterior and interior sheathing, sheetrock, and insulation.

Decisions such as *Pennsylvania National Mut. Cas. Ins. Co. v. Parkshore Development Corp.*, 403 Fed.Appx. 770 (3d Cir. 2010), and *Firemen's Ins. Co. of Newark v. National Union Fire Ins. Co.*, 387 N.J. Super. 434 (App. Div. 2006), previously injected a measure of uncertainty into New Jersey law by finding that the defective workmanship was not an occurrence, regardless of whether the damages sought were the "business risk" of repairing a defect to the work itself, which *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233 (1979) held was not an occurrence, or consequential damage to other parts of the project caused by the defective work.

Reversing the trial court's grant of summary judgment to Atria's insurers, the Appellate Division found that the consequential damages constituted property damage caused by an occurrence. The court held that earlier decisions relied on by the trial court were distinguishable because of differences in the nature of the damages sought, and because of the "subcontractor's exception" to the "Your Work" exclusion in the 1986 ISO form at issue in *Cypress Point*, which was not contained in the 1973 ISO form addressed in *Weedo* and *Fireman's*.

The “subcontractor exception” provides that the exclusion does not apply “if the damaged work or the work out of which the damages arises was performed on your behalf by a subcontractor,” in reaching its conclusion. *Cypress Point* found that the exception gave rise to the general contractor’s reasonable expectation that consequential damages caused by the subcontractor’s defective workmanship constituted an occurrence of property damage.

Cypress Point also offers perhaps the clearest expression yet on the delineation of coverage where a construction defect claim alleges both uninsured “business risk” defective work and consequential damages. Only the consequential damages, and not the defective work that allowed the water intrusion that caused such damages, were insured. The court emphasized that “the consequential damages here are not the cost of replacing the defective work...but rather the cost of curing the ‘property damage’ arising from the subcontractors’ faulty workmanship.”

The Takeaway

Cypress Point should eliminate any confusion under New Jersey law as to the occurrence of property damage issue. More importantly, in many construction defect scenarios the repair work includes not only repairing the defective work, but also tearing off siding, roofing, and similar exterior layers to reach the water-damaged areas. *Cypress Point* clearly states that the insurer’s obligation is limited to the consequential damages only, and that the insurer need not absorb the total cost of such repairs. Rather, under New Jersey law the insurer should be permitted to apportion between covered and uncovered costs in defending its insured under such circumstances.

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