

Client Alert

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New Jersey Appellate Court Rules Consequential Damages Are Covered by General Liability Policy Even When Direct Damages Are Not

The Appellate Division of the Superior Court of New Jersey recently ruled in *Cypress Point Condominium Association, Inc. v. Adria Towers, L.L.C.*¹ that consequential damages to the common area and units of a condominium complex caused by a subcontractor's defective work constituted "property damage" and an "occurrence" under the building developer's standard-form CGL policies, even though the policies were unlikely to cover direct damages like replacement costs. The case serves as a reminder that not all damages are treated alike by insurance policies, and policyholders therefore should not assume that an adverse determination as to one type of loss will apply to all resulting loss.

Background

Cypress Point involved damage to a condominium complex that occurred after subcontractors failed to properly install key building components, including the roof, gutters, façade, windows, doors and sealants. This faulty workmanship caused damage to parts of interior and exterior common areas (e.g., steel supports, sheetrock, insulation) and owners' units (e.g., water infiltration through windows and roof, and damage to wall sheathing, insulation, sheetrock, finishes and flooring).

The condominium association sought coverage for the common area and unit damage under the building developer's commercial general liability policies.² The policies, which contained the same insuring agreement wording, afforded coverage for "property damage" (i.e., physical injury, including loss of use) during the policy period that was caused by an "occurrence" (i.e., "an accident, including continuous or repeated exposure to substantially the same general harmful conditions").³

The trial court held that there was no "property damage" or "occurrence" that would trigger coverage, and ruled in favor of the insurers. The association appealed.

Holding

The appellate court reversed, distinguishing between direct and consequential damages and emphasizing an important change to the standard general liability coverage form that occurred subsequent to the precedent relied upon by the trial court.

The court noted that consequential damages are "distinct from the cost of correcting the work itself."⁴ The construction industry considers the latter a business risk, since the cost of correcting defective work is

¹ No. A-2767-13T1, 2015 WL 4111890 (N.J. Super. Ct. App. Div. July 9, 2015).

² The association did not argue that the cost to replace the faulty workmanship constituted "property damage" or an "occurrence" under the policy. *Id.* at *2.

³ *Id.* at *3.

⁴ *Id.* at *4.

within the subcontractor's control. Consequential damages, however, are distinguishable, since they are remote to the work of the subcontractor and beyond what the insured developer or general contractor can control through its own skill and expertise. The court determined that interpretive material concerning the policy language at issue suggested that these differences are reflected in the policy underwriting and, therefore, are indicative of the parties' reasonable expectations of coverage.

As such, the court held that the subcontractor's faulty workmanship caused "physical injury to tangible property" when interior structures were damaged by water infiltration. This amounted to "property damage" under the policies.⁵ In addition, the court found that the subcontractors did not intend that their faulty workmanship would cause the resulting damage, such that the damages amounted to "unexpected and unintended" continuous or repeated exposure to substantially the same general harmful conditions," or an "occurrence."⁶ In reaching this conclusion, the court adopted the majority rule that "construction defects [causing consequential damages] constitute 'occurrences.'"⁷

The court also emphasized an important change to the 1986 version of the CGL form at issue in *Cypress Point*. Both the pre-1986 and 1986 versions exclude "property damage" to work performed by the developer or, importantly, on the developer's behalf.⁸ This language is broad enough that, under the pre-1986 form, damages caused by subcontractor's faulty work were excluded. The 1986 form, however, provides that the exclusion does not apply "if the damaged work or the work out of which the damage arises was performed on your behalf [for the developer] by a subcontractor."⁹ This exception to the exclusion was added to the 1986 CGL form to address demands of the policyholder community, which likely arose out of concern that the work of subcontractors is too-far attenuated to be within the control of an insured developer, general contractor or property owner.¹⁰ According to the court, this exception to the exclusion further illustrates the intent to afford coverage for consequential loss resulting from defective workmanship.

Implications

The *Cypress Point* decision is notable to policyholders for a several reasons. First, the case is a reminder that general liability insurance may cover some damages and not others, and that policyholders, therefore, should avoid assumptions and generalizations about the scope of coverage under their policy. Determining what actually caused the loss (i.e., direct act or down-stream consequences) is critical. Second, *Cypress Point* illustrates the importance of paying attention to amendments to your policy wording from year to year. Seemingly subtle changes to standard form policies can have a profound impact when viewed in the context of a particular loss. Insurers will not highlight these impacts, nor will they voluntarily disclose their internal interpretive materials, making it all the more important that policyholders fully understand their coverage or engage knowledgeable coverage counsel to assist them when a loss or claim arises.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.* at *7 (alteration in original) (quoting Christopher C. French, *Construction Defects: Are They "Occurrences"?*, 47 Gonz. L. Rev. 1, 24-26 (2011)).

⁸ *Id.* at *5-6. The policy also excluded "property damage" to "materials, parts or equipment furnished in connection with such work" *Id.* at *6.

⁹ *Id.*

¹⁰ *Id.* (quoting French, *supra* note 7, at 8-9).

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