

## **PRELIMINARY STATEMENT**

Amicus Curiae, the Community Association Institute ("CAI"), is a non-profit educational organization designed to serve as a national voice for community associations. CAI is an advocate for the nearly 65 million Americans who live in community associations such as condominium communities and other planned developments.

The purchase of a home is one of, if not the, biggest investment in a person's life. Condominium living is an especially attractive form of home ownership where maintenance and repair of common property such as roofs, exterior walls, lawns, and streets is routinely performed by an association. Most buyers who purchase condominium units at a premium and who fall in love with the allure of "new construction" have no idea that costly problems lay hidden inside the walls.

Unlike individual purchasers who contract with a developer for the construction and/or sale of a home and who have a choice about the builder they choose or the property they acquire, condominium associations never have such a choice, yet nevertheless become liable for maintaining and repairing the common property endowed by the developer. By the time individual condominium and townhouse owners gain control of the governing association and learn of construction defects, the developer has already sold all the units in the development,

disbursed profits to its members, and left the developer entity without any assets.

After discovering defects and property damages, an association has limited options: it can negotiate with the builder in an attempt to reach a mutual settlement, special assess the owners for the cost of the repairs, or file suit against the developer and its contractors for negligence.

When multimillion-dollar repairs are at stake, settlement negotiations are highly unlikely to yield any meaningful results and no reasonable board is going to special assess its members for tens of thousands of dollars per unit. Therefore, litigation is usually the most viable option, and insurance proceeds are unquestionably the only real source of recovery. Accordingly, the availability of insurance proceeds, especially from a main tortfeasor's carrier, are of unrivaled importance to condominium associations and the estimated one-third of New Jersey residents (about 3 million inhabitants) that live in condominiums and townhouses.

Whether claims of consequential property damage caused by subcontractors' negligence amounts to "property damage" and an "occurrence" under a general contractor's commercial general liability policy profoundly affects the interests and subsistence of condominium associations and their members. Condominium homeowners faced with million dollar repairs rely on

the availability and viability of insurance policies procured by the developer and contractors whose negligent workmanship necessitates the repairs.

In the instant case, the Appellate Division correctly interpreted New Jersey insurance law in concluding that consequential property damage resulting from a subcontractor's deficient work is "property damage" caused by an "occurrence" under a general contractor's commercial general liability insurance policy. The Appellate Court properly distinguished Weedo, Fireman's, and Parkshore in finding that damage to a subcontractor's finished work product caused by another subcontractor's faulty workmanship is the type of "accident" and "unexpected" injury that CGL insurance policies were designed to cover. It is not the type of uninsurable business risk damages inherent in replacing the defective workmanship itself.

The Appellate Division aptly recognized the distinction between the cost to repair consequential damages flowing from defective work and the costs associated with replacing the defective work, with only the former triggering insurance coverage under a CGL policy. Not only did Weedo and Fireman's deal with outdated policy language not at issue here, but both cases concerned business risk damage to the defective work itself, not insurance triggering consequential property damage caused by the defective work.

As such, the Appellate Division's unerring decision below must be affirmed and upheld by this Court.

#### **PROCEDURAL HISTORY**

CAI adopts and incorporates by reference herein the procedural history submitted by Appellants and Respondents in their respective briefs.

#### **STATEMENT OF FACTS**

CAI adopts and incorporates by reference herein the factual background submitted by Appellants and Respondents in their respective appeal briefs.

#### **LEGAL ARGUMENT**

Insurance coverage in construction defect cases is always hotly contested and results in vigorous fighting over a carrier's duty to defend and indemnify its insured. One of the more ubiquitous coverage battles occurs over a general contractor's policy where a general contractor is hired to facilitate construction of an entire construction project or development.

Generally speaking, a contractor's commercial general liability ("CGL") policy is designed to cover personal injury or property damage caused by an accident resulting from the contractor's work. The policy is not meant to be a guarantee of the contractor's work and therefore does not cover damages to the work itself - which are known as "business risk" damages.

The idea is that inherent in every agreement for the performance of construction work is the risk that the work will be done improperly.

By selecting a particular contractor, the owner has to make a business judgment as to the qualifications and reliability of the selected contractor and therefore assumes the risk that the work will be done incorrectly. If the work is done improperly and needs to be corrected, the contractor, and ultimately the owner, bears the burden of repairing or fixing that faulty work. The contractor's insurance is not a performance bond guaranteeing the work; instead, the commercial liability insurance is designed to cover any unexpected damages that arise from the contractor's work, such as damage to other property caused by the faulty work.

The concept that construction defects necessitating repairs to the defective work itself will not trigger coverage under a CGL policy is embodied in a policy exclusion known as "Your Work." Typical CGL policies, including the one at issue here, contain the following exclusionary language:

**Damage to Your Work**

"Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard."

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

This language is extremely important in the case of a large construction project, such as the Cypress Point condominium development, where the developer acts as the general contractor and engages subcontractors to perform all phases of construction from foundation to framing to exterior envelope installation and interior finish work.

The threshold coverage question is therefore: what is considered the general contractor's "work" for insurance coverage purposes - is it the entire project, including all buildings and their exterior and interior components, and if so, what is the effect of those components having been installed by various subcontractors? Are allegations of interior water damage caused by improper exterior envelope installation excluded under the general contractor's policy because they are "business risk" damages to the general contractor's "work," or, are they considered coverage triggering "consequential" damages having resulted from the deficient work of the general contractor's subs?

Different judges see it differently. Some find that there are no consequential damages, finding that since the entire project is the general contractor's "work," allegations of property damage to interior building components do not trigger coverage under the general contractor's policy, whereas others rely on the subcontractor exception to the "Your Work" exclusion

to find that where the work is performed by subcontractors, allegations of interior damage do in fact trigger coverage under the general contractor's CGL policy. The Appellate Division correctly adopted the latter analysis in holding that where a subcontractor's work causes damage to another subcontractor's work, the general contractor's policy is triggered and may potentially provide coverage for the alleged consequential damages.

The Appellate Division's conclusion is certainly not novel or unique, but in line with the insurance principles recognized by this Court many decades ago in the seminal decision Weedo v. Stone-E-Brick, Inc., 81 N.J. 233, 249 (1979): "the [CGL] policy in question does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident." (Emphasis added.) Thus, in so many words, this Court has already determined that general liability coverage is available for consequential property damage that flows from an insured's faulty workmanship:

Unlike faulty workmanship on its own, where the tradesman commonly absorbs the cost attendant upon the repair of his faulty work, the accidental injury to property or persons substantially caused by his unworkmanlike performance exposes the contractor to almost limitless liabilities. While it may be true that the same neglectful craftsmanship can be the cause of both a business expense of repair and a loss represented by damage to persons and property, the two consequences are vastly different in relation to sharing the cost of such risks as a matter of insurance underwriting. The

risk intended to be insured is the possibility that the goods, products, or work of the insured, once relinquished or completed, will cause bodily injury or damage to property other than to the product or completed work itself, and for which the insured may be found liable.

[Id. at 239-40 (quoting Henderson, Insurance Protection for Products Liability and Completed Operations: What Every Lawyer Should Know, 50 NEB. L. REV. 415, 441 (1971) (emphasis added).]

### POINT I

#### **FAULTY WORKMANSHIP WHICH CAUSES CONSEQUENTIAL PROPERTY DAMAGE SATISFIES A CGL POLICY'S DEFINITIONS OF "OCCURRENCE" AND "PROPERTY DAMAGE"**

Our courts have repeatedly held that "faulty workmanship" which causes damage to property is an "accident," and therefore, an "occurrence" covered by general liability policies. While CGL policies do not define the term "accident," this Court has held 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 Mut. Ins. Co., 128 N.J. 165, 183 (1992).

"Unless the wrongdoer intended to cause an injury, the injury is considered accidental even if the act that caused the injury was intentional." Ibid. Moreover, unless there are exceptional circumstances, courts look to the insured's subjective intent to determine the intent to injure. Id. at 185. Not finding any evidence of intent to cause the damages complained of, the Appellate Division correctly concluded that

neither the general contractor nor the subcontractors intended or expected their work to result in water intrusion and consequential property damages. The same would be true in virtually all condominium construction cases.

The insuring agreement in typical CGL policies provides for coverage of "property damage" caused by an "occurrence." The Definitions section defines "property damage" as "physical injury to tangible property" and an "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Recognizing the accidental and unexpected nature of damage causing water infiltration resulting from faulty workmanship, the Appellate Court had no trouble finding that consequential property damage flowing from defective construction satisfies those policy definitions.

Carriers will nevertheless undoubtedly argue that the preeminent insurance coverage cases in New Jersey - Weedo and Firemen's - mandate a contrary result in that faulty construction does not constitute "property damage" or an "occurrence" under the standard CGL form. Both Weedo and Firemen's concluded that damages to an insured's faulty work, arising out of that work, are excluded from CGL coverage because those damages are for the cost to replace the defective work

itself, an uninsurable business risk to be borne by the contracting parties.

The argument goes as follows: since the work of a general contractor is the entire finished condominium building or completed residential development, any alleged damages to any portion of the buildings would constitute damage to the general contractor's faulty work, and therefore, excluded from coverage in accordance with the holdings in Weedo and Firemen's.

The fatal flaw in that analysis, however, is that the damage to the general contractor's work does not arise from its work, but rather from the work of its subcontractors. Thus, the critical distinction is that a contractor's work resulting in damage solely to that contractor's work is excluded, as in Weedo and Firemen's, but a contractor's work that causes damage to another contractor's work would trigger coverage.

In fact, Weedo recognized this distinction and discernably noted the difference between uninsurable "business risks" and coverage triggering occurrences:

An illustration of this fundamental point may serve to mark the boundaries between "business risks" and occurrences giving rise to insurable liability. When a craftsman applies stucco to an exterior wall of a home in a faulty manner and discoloration, peeling and chipping result, the poorly-performed work will perforce have to be replaced or repaired by the tradesman or by a surety. On the other hand, should the stucco peel and fall from the wall, and thereby cause injury to the homeowner or his neighbor standing below or to a passing automobile, an occurrence

of harm arises which is the proper subject of risk-sharing as provided by the type of policy before us in this case. The happenstance and extent of the latter liability is entirely unpredictable -- the neighbor could suffer a scratched arm or a fatal blow to the skull from the peeling stonework. Whether the liability of the businessman is predicated upon warranty theory or, preferably and more accurately, upon tort concepts, injury to persons and damage to other property constitute the risks intended to be covered under the CGL.

[Weedo v. Stone-E-Brick, Inc., 81 N.J. 233, 240-241 (1979) (emphasis added).]

Weedo involved homeowner allegations of faulty workmanship performed by the masonry contractor hired to pour concrete and install stucco cladding on the exterior of plaintiffs' home. Id. at 235. The poor workmanship resulted in cracks in the stucco, which plaintiffs' replaced. Plaintiffs' alleged damages, therefore, were for the costs to replace the negligently installed stucco, i.e. the masonry contractor's defective work. Id. at 236.

Distinguishing between non-covered costs to replace the insured's faulty work and insurance triggering consequential damage to other property caused by the insured's faulty work, the Weedo Court concluded that the replacement cost damages sought by plaintiffs constituted the type of business risk expenses excluded from CGL coverage. Id. at 239-41. Implicit in Weedo's discussion of insurance principles and the coverage triggering consequences of consequential damages is the

conclusion that had plaintiffs alleged consequential damage to interior components of their home resulting from the mason's defective stucco work, insurance coverage would have ensued under the mason's CGL policy, subject of course, to any applicable exclusions and endorsements. Id. at 239-42.

In addition to Weedo, carriers routinely cite to Firemen's for the proposition that construction defects do not amount to an "occurrence" under a CGL policy. See generally Firemen's Insurance Co. of Newark v. National Union Fire Insurance Co., 387 N.J. Super. 434 (App. Div. 2006). As in Weedo, Firemen's concerned the 1973 ISO form, not the 1986 form analyzed by Cypress Point, but more importantly, Firemen's involved the cost of repairing the insured's defective workmanship (sub-standard firewalls), not insurance triggering allegations of consequential property damage caused by the insured's substandard work. Id. at 441.

Thus, like Weedo, Firemen's involved business risk damages rather than the type of unexpected consequential damages that would satisfy a CGL policy's definitions of "property damage" and "occurrence." In discussing Weedo, Firemen's expressly recognized that unlike replacement cost damages, damage to other property caused by faulty workmanship is the kind of insurable risk that "*is intended to be covered*" by a CGL policy. Id. at 443. Accordingly, in finding no "property damage," Firemen's

relied on the fact that the only alleged damage was for the cost of replacing the defective firewalls, i.e. the insured's work product: "[t]he complaint did not allege that the firewalls caused damage to the rest of the building or to any other person or property." Id. at 445 (emphasis added).

In fact, Firemen's cited approvingly to a California case to illustrate the pivotal difference between the business risk costs of replacing an insured's defective work and the insurance triggering damages to other property caused by that defective work:

Generally liability policies, such as the ones in dispute here, are not designed to provide contractors and developers with coverage against claims their work is inferior or defective. The risk of replacing and repairing defective materials or poor workmanship has generally been considered a commercial risk which is not passed on to the liability insurer. Rather liability coverage comes into play when the insured's defective materials or work cause injury to property other than the insured's own work or products.

[Id. at 445 (citing Maryland Casualty Co. v. Reeder, 270 Cal. Rptr. 719, 722 (1990), review denied, 1990 Cal. LEXIS 4366 (Cal. Sept. 19, 1990)) (emphasis added).]

The alleged damage in Cypress Point was more than just the cost of replacing the insured's sub-standard work, rather it was "damage to the rest of the building," caused by faulty workmanship. The Appellate Court, therefore, properly distinguished Firemen's, which only involved damage to the

insured's work, in finding "property damage" and an "occurrence."

In line with the reasoning expressed in Weedo and Firemen's, our courts have consistently found an "occurrence" where a contractor's faulty workmanship causes consequential property damage to property other than the contractor's own work. See, e.g., Newark Ins. Co. v. Acupac Packaging, Inc., 328 N.J. Super. 385, 398-99 (App. Div. 2000) (holding that "damage to other property not manufactured or provided by the insured, yet caused by the insured's poor performance" is covered under a CGL policy); Aetna Cas. & Sur. Co. v. PlyGem Indus., Inc., 343 N.J. Super. 430, 450 (App. Div. 2001) (allowing coverage because complaints alleged damage to property other than the insured's defective product which was incorporated into the roofs of homes); Hartford Ins. Group v. Marson Constr. Corp., 186 N.J. Super. 253 (App. Div. 1982), certif. denied, 93 N.J. 247 (1983) (holding that coverage was available to insured whose defective construction of exterior building walls caused recurring structural leaks and damage to interior metal panels installed by another contractor, i.e., because the insured's defective workmanship caused damage to a third party); S.N. Golden Estates, Inc. v. Continental Cas. Co., 293 N.J. Super. 395, 401 (App. Div. 1996) (finding an "occurrence" where the insured's faulty construction of septic

systems caused damage to lawns and homes, as well as loss of use, when materials seeped from the systems into the homes and onto the lawns of residents); Heldor Indus., Inc. v. Atlantic Mut. Ins. Co., 229 N.J. Super. 390, 396-97 (App. Div. 1988) (holding that coverage was not available because claim was limited to replacing a pool coping product that was originally supplied by insured but recognizing that coverage would be available if claim included alleged damage to the pool decking, other property of the pool owners and/or claims for diminished property value); Unifoil Corp. v. CNA Ins. Cos., 218 N.J. Super. 461, 470-72 (App. Div. 1987) (denying coverage because source of asserted claims was the insured's own product and the nature of claimed damages was limited only to replacement of the insured's own product but recognizing that coverage would be available if the defective product caused damage to other tangible property such as other machines or equipment used during the production process).

Take the case of Port Imperial Condo. Ass'n v. K. Hovnanian Port Imperial Urban Renewal, Inc., 2010 N.J. Super. Unpub. LEXIS 2891 (Law Div. Sept. 2, 2010), which involved the typical condominium construction defect claims and attendant insurance coverage issues. In Port Imperial, a plaintiff condominium association and the defendant developer/general contractor claimed that several subcontractors were liable for water

infiltration damages to the structure of condominium units caused by alleged improper window and door framing, installation, and flashing.

The insurer for the contractors successfully moved for summary judgment on the same "occurrence" argument presented by the insurers here. The court initially held that the alleged damage was not an accident but rather constituted uncovered "faulty workmanship." Nevertheless, upon a motion for reconsideration, the Law Division vacated its grant of summary judgment. After analyzing Weedo in detail and considering the insurers' reliance on Firemen's, the court held that water infiltration damage to the common elements caused by the subcontractors' faulty workmanship triggered the CGL carriers' duty to defend:

[I]t is clear under the Weedo case that general liability coverage is available for consequential property damage that flows from an insured's faulty workmanship, and that other courts have recognized that faulty workmanship can result in accidental, unexpected, and unintended damage to third party property which satisfies the definition of "occurrence" under the standard general liability policy.

[Id. at \*31 (emphasis added).]

More recently, this Court reinforced the underpinnings of Weedo and the progeny of subsequent cases finding coverage in faulty construction lawsuits, when it confirmed the duty of general liability insurers to defend general contractors in

construction defect litigation. See Potomac Ins. Co. of Illinois ex rel. OneBeacon Ins. Co. v. Pennsylvania Mfrs.' Ass'n Ins. Co., 215 N.J. 409 (2013) (holding that all insurers on the risk, from the date the construction project began through the date the alleged property damage was discovered, must equitably participate and share in the defense costs).

The facts of Potomac are nearly identical to this matter in all material respects. In Potomac, the Township of Evesham hired Roland Aristone, Inc. ("Aristone") as the general contractor responsible for constructing its new middle school. Id. at 413. Aristone, through the subcontractors it hired, started the project in 1991 and completed it in 1993. Id. at 413-14. The following year, the school began to experience leaks and other damage related to a defect in the roof. Id. at 414. In 2001, the school filed suit against Aristone for negligence and breach of contract. Aristone notified its insurers and demanded defense and indemnity coverage under its general liability policies. Id. at 414-15.

Aristone had multiple insurers during the ten-year period between the date it was hired to perform the project and the date when the lawsuit was filed. Two of Aristone's insurers immediately accepted their defense obligation for the claim while two other insurers denied coverage. Ibid. This Court, relying on the "continues trigger" theory espoused in Owens-

Illinois Inc. v. United Insurance Co., 138 N.J. 437 (1994), addressed the insurers' respective defense obligations for the claim and recognized a direct right of contribution by one insurer against the other where participation in the defense was improperly withheld. Id. at 425-26.

Notably, this Court did not conclude that no duty to defend was owed because faulty workmanship claims are excluded from coverage under general liability policies. Id. at 424-27. To the contrary, this Court held that multiple insurers had a duty to defend and were obliged to allocate responsibility for defense costs among themselves in accordance with the fair and equitable allocation teachings of Owens-Illinois. Ibid.

Emphasizing that its decision was intended to "create[] a strong incentive for prompt and proactive involvement by all responsible carriers and promote[] the efficient use of resources of insurers, litigants, and the court," this Court inherently recognized the insurance triggering effects of consequential property damage stemming from an insured's faulty workmanship. Id. at 426.

Indeed, the opinion cannot be more clear in its message that insurers presented with construction defect claims alleging consequential property damage should acknowledge their defense obligation immediately so that the resources of the parties and

the courts may be conserved and New Jersey's "strong policy in favor of the resolution of disputes" may be promoted. Ibid.

Before Potomac, in another case involving negligently installed building materials, the Appellate Division likewise held that faulty workmanship claims involving alleged consequential property damage trigger a CGL carrier's duty to defend:

each of the eight complaints in the Maryland cases alleges damage to property other than [the insured's work product] and seek the repair and replacement costs associated with it. As a result, because '[t]he insurer's obligation to defend is triggered by a complaint against the insured alleging a cause of action which may potentially come within the coverage of the policy, irrespective of whether it ultimately does come within the coverage and hence irrespective of whether the insurer is ultimately obligated to pay,' the trial judge correctly ruled that these Maryland complaints . . . invoked [the CGL carrier's] obligation to defend.

[Aetna Cas. & Surety Co. v. Ply Gem Indus., Inc., 343 N.J. Super. 430, 439-40, 450 (App. Div. 2001) (emphasis added) (internal citations omitted).]

Similarly, in S.N. Golden Estates, Inc. v. Continental Cas. Co., 293 N.J. Super. 395, 400-01 (App. Div. 1996), the Appellate Division held that an insurer had a duty to defend a construction defect claim because the underlying complaint contained claims and allegations that the insured's faulty workmanship, negligently installed septic systems, caused damage to plaintiffs' lawns and residences. Allegations of consequential property damage fell squarely within the scope of

coverage under the CGL policy and constituted "property damage" caused by an "occurrence." Id. at 401.

The Appellate Court's decision below is therefore in accord with accepted insurance principles and long-standing coverage interpretations adopted by the courts of this State, and must be affirmed.

## POINT II

### **THE "SUBCONTRACTOR EXCEPTION" TO THE "YOUR WORK" EXCLUSION UNDERSCORES THE AVAILABILITY OF COVERAGE FOR CONSTRUCTION DEFECT DAMAGES**

Under well-settled principles, the interpretation of insurance contracts requires generous readings of coverage provisions, narrow readings of exclusionary provisions, resolution of ambiguities in favor of the insured, and construction consistent with the insured's reasonable expectations. Search EDP, Inc. v. American Home Assurance Co., 267 N.J. Super. 537, 542 (App. Div. 1993), certif. denied, 135 N.J. 466 (1994).

That said, an insurance policy is a form of contract and must always be interpreted to give effect and meaning to all terms – including both coverage grant terms and exclusionary terms. See, e.g., City Mortgage Co. v. St. Paul Fire & Marine Ins. Co., 14 N.J. Misc. 212, 216 (N.J. 1935) ("In the construction of an insurance policy, the entire policy and all its parts must be considered, so that each clause shall have

effect."); J. Josephson, Inc. v. Crum & Forster Ins. Co., 293 N.J. Super. 170, 216-17 (App. Div. 1996) ("Equally fundamental is the principle that an insurance contract must be interpreted by considering the agreement as a whole, and whenever possible, giving meaning to all of its parts.").

Coverage grants must be interpreted broadly. Villa v. Short, 195 N.J. 15, 23-24 (2008). Exclusionary clauses must be construed narrowly and may be considered specifically to understand the scope of coverage conferred through the coverage grant. See Passaic Valley Sewerage Commissioners v. St. Paul Fire & Marine Ins. Co., 206 N.J. 596, 609 (2011) ("To aid in understanding the construct of the Policy provisions, we look to the language of not only what is covered but what is excluded"); Flomerfelt v. Cardiello, 202 N.J. 432, 442 (2010) (holding that "exclusions are ordinarily strictly construed against the insurer" and in favor of coverage).

The insurer has the burden of showing that the exclusion bars coverage, and that the insured's interpretation of the exclusion is entirely unreasonable. Am. Motorists Ins. Co. v. L-C-A Sales Co., 155 N.J. 29, 41 (1998); Aetna Ins. Co. v. Weiss, 174 N.J. Super. 295, 296 (App. Div.), certif. den., 85 N.J. 127 (1980). Here, the embodiment of non-covered business risk replacement cost damages is the "Your Work" exclusion contained in the general contractor's CGL policy:

## 2. Exclusions.

This insurance does not apply to:

....

### 1. Damage to Your Work [the "Your Work" Exclusion]

"Property damage" to "your work" arising out of it or any part of it . . . .

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

[The "subcontractor exception"].

[(emphasis added).]

The "Your Work" exclusion is the written manifestation of the understanding that an insured's faulty workmanship resulting in damage to the insured's own work product is not the type of accidental damages covered by a CGL policy. There is, however, an exception. That exception, which is written into the exclusion itself, provides that where the insured's "work" is damaged as a result of work performed on its behalf by a subcontractor, the "Your Work" exclusion does not apply. That means, the costs to correct an insured's faulty "work," which are normally excluded from coverage as business risk expenses, actually trigger coverage if that "work" was performed on the insured's behalf by a subcontractor.

Take the case of a roofer who installs a shingled roof that needs to be replaced because the shingles are not properly

fastened and blowing off the roof. If the roofer used only his employees to perform the deficient work, the "Your Work" exclusion would bar coverage for any claims seeking to recover the cost of replacing the shingled roof, i.e. the roofer's "work." It would not, however, preclude coverage for claims that the shoddy roof has caused water penetration inside the building resulting in consequential damages to the roof sheathing and framing installed by others.

In the case of a general contractor, whose "work" is arguably the entire building or project, claims of damages to various building components from shoddy construction may or may not trigger coverage. If the general contractor uses only its employees to construct the entire building, including all of its interior components, then the alleged damage would constitute "property damage" to the general contractor's "work," thereby falling squarely within the plain meaning of the "Your Work" exclusion.

If, however, the general contractor hires a team of subcontractors to construct the building with different trades responsible for installing multiple building components, i.e. the framing, roofing, exterior cladding, drywall, etc., then despite the alleged damage being to the general contractor's "work," and thus excluded under the first clause, the subcontractor exception kicks in to nullify the exclusion.

Hence, "property damage" to the general contractor's "work" is no longer excluded under the policy, and alleged damages to the building are afforded coverage under the general contractor's CGL policy, subject of course to any applicable exclusions and endorsements.

That is the exact conclusion reached by Cypress Point and the only interpretation of the policy language supported by the plain and ordinary meaning of the words used. As adroitly pointed out by the Appellate Court below, if the drafters of the CGL form did not intend a general contractor's policy to be triggered where damage to the general contractor's "work" (the entire building or project) was caused by its subcontractors' faulty workmanship, then why did they include the subcontractor exception in the "Your Work" exclusion?

If the outcome below was not the intended result of introducing the subcontractor exception language into the 1986 ISO form, then what possible fact pattern could ever trigger its application? The answer would be, none. If that were the case, the language would be completely superfluous and have no practical effect. Not only would that run counter to longstanding canons of insurance contract interpretation, but it would defy reason and warp the plain, ordinary meaning of the words used beyond recognition.

Certainly, that is not the case, and Cypress Point correctly applied the subcontractor exception in determining that damages to the condominium's common elements caused by subcontractors' faulty workmanship were not excluded from coverage under the general contractor's CGL policy.

**A. Weedo and Firemen's Involved An ISO Form That Did Not Contain the Subcontractor Exception Language**

Notably, the subcontractor exception language contained in the "Your Work" exclusion only appears in the 1986 ISO form, not in the 1973 form, which was the form at issue in both Weedo and Firemen's.

In 1986, the Insurance Services Office totally revised the coverage available to general contractors for damage arising from the faulty workmanship of their subcontractors under its standard policy forms. In French v. Assurance Co. of Am., 448 F.3d 693, 701 (4th Cir. 2006), the Fourth Circuit discussed the origin of the 1986 ISO form, noting that, in response to contractor concerns about subcontractors, "beginning in 1976, an insured, . . . could pay a higher premium to obtain a broad form property damage endorsement," which effectively extended coverage to the insured's completed work when the damage arose out of the work performed by a subcontractor. Then, "[i]n 1986, as part of a major revision, the subcontractor exception . . . was added directly to the body of the ISO's [standard] CGL

policy in the form of an express exception to the 'Your Work' exclusion." Id.

Since then, courts reviewing the post-1986 ISO CGL form consistently have concluded that the ISO form provides coverage for damage to the insured's work caused by the faulty workmanship of its subcontractors. See, e.g., U.S. Fire Ins. Co. v. J.S.U.B., Inc., 979 So.2d 871, 888 (Fla. 2007) ("faulty workmanship that is neither intended nor expected from the standpoint of the contractor can constitute an 'accident' and, thus, an 'occurrence' under a post-1986 CGL policy"); Sheehan Constr. Co., v. Continental Cas. Co., 935 N.E.2d 160, 171 (Ind. 2010) (holding the business risk rule was not an initial bar to coverage, but excluded certain events from coverage under the "your work" exclusion where the policy grants coverage initially. The court reasoned that if there was no initial grant of coverage, there would be no reason for a "your work" exclusion. Further, the court reasoned that if the insurer decided that damage arising from a subcontractor's faulty workmanship was a risk it did not want to insure, it could clearly amend the policy to exclude coverage "as can be done simply by either eliminating the subcontractor exception or adding a breach of contract exclusion.").

Since Firemen's, the Appellate Division has acknowledged that the availability of coverage for construction defect claims

when evaluated under more recent ISO forms may require an outcome that is different from Weedo and Firemen's. See E. Coast Residential Assocs., LLC v. Builders Firstsource - Northeast Group, LLC, 2012 N.J. Super. Unpub. LEXIS 64 (App. Div. Jan. 11, 2012) (recognizing that the general liability policy analyzed by the Weedo court has been "frequently revised and the business risk exclusion has been amended to except damage to the contractor's work arising from the work of a subcontractor"). While offering "no view on the relevance of Weedo to a proper interpretation of the scope of that exception," the Appellate Division clearly indicated that rote application of Weedo, Firemen's, or any other case interpreting the 1973 ISO form, to determine whether an "occurrence" has been alleged under policies that contain materially different policy terms is improper. Id. at \*12.

Finally, it is worth noting that the Appellate Division's decision in Firemen's was based largely on out-of-state case law that has been legislatively overruled and/or modified by later opinions. For example, the Firemen's Court cited Knutson Constr. Co. v. St. Paul Fire and Marine Ins. Co., 396 N.W.2d 229 (Minn. 1986) to reject the policyholder's contention that general contractors are covered for the faulty workmanship of their subcontractors. Firemen's, supra, 387 N.J. Super. at 446.

In Knutson, the Minnesota Supreme Court held that the "your work" exclusion contained in the 1973 ISO form did not allow coverage for faulty workmanship claims even if they arose from faulty workmanship performed by a subcontractor. Knutson, 396 N.W.2d at 233, 237. In a later opinion, however, the Minnesota Supreme Court confirmed that its Knutson opinion was limited to the 1973 ISO form and held that the revised "your work" exclusion with a subcontractor exception in subsequent ISO forms did not bar coverage for a general contractor. See Wanzek Const. v. Employers Ins. of Wausau, 679 N.W.2d 322, 327 (Minn. 2004).

Similarly, the Firemen's Court relied on L-J, Inc. v. Bituminous Fire and Marine Ins. Co., 621 S.E.2d 33 (S.C. 2005) for the proposition that faulty workmanship could not constitute an "occurrence" causing "property damage" in the first instance. The South Carolina legislature specifically overruled that decision, passing a law to provide that "[c]ommercial general liability insurance policies shall contain or be deemed to contain a definition of 'occurrence' that includes: . . . (2) property damage . . . resulting from faulty workmanship." S.C. Code Ann. § 38-61-70.

**B. Relying on Firemen's, Which Involved the 1976 ISO Form, Parkshore Incorrectly Concluded That Faulty Workmanship Whether Performed By A Subcontractor Which Causes Damage to the General Contractor's Work Is Not An "Occurrence"**

First, it must be said that any reliance on the Third Circuit's decision in Pa. Nat'l Mut. Cas. Ins. Co. v. Parkshore Dev. Corp., 403 Fed. Appx. 770 (3d Cir. N.J. 2010) is entirely inappropriate because that opinion is specifically designated "not precedential." Under the Third Circuit's Internal Operating Procedure 5.7 this means that "[s]uch opinions are not regarded as precedents that bind the court." Thus, the Parkshore decision is not even binding law in the Third Circuit, let alone a state or appellate court in New Jersey.

In addition, the Parkshore opinion contains no analysis or discussion of the subcontractor exception to the "your work" exclusion, which is dispositive of a general contractor's carrier's coverage obligations to defend claims asserting consequential property damage. Instead, the Third Circuit briefly discussed Weedo, noting that the Supreme Court did not "determine the existence of an 'occurrence' where faulty workmanship causes damage to the completed project itself" (because the insurers in Weedo conceded that the "occurrence" definition was satisfied, see Weedo, supra, 81 N.J. at 249, n. 2) and then incorrectly adopted *dicta* contained in the Firemen's opinion. Parkshore, 403 Fed. Appx. at 772.

Essentially, the Parkshore Court latched on to verbiage in Firemen's where the court discussed out-of-state case law (which have now been overturned or superseded, see discussion supra at pp. 27-28) in opining that damage to the general contractor's work was not an "occurrence." Of course, this was based on the 1973 ISO form, which did not contain the subcontractor exception language.

Nevertheless, the *sua sponte* analysis in Firemen's that faulty workmanship cannot constitute an "occurrence" is dicta, and is not settled, binding law. Indeed, Firemen's expressly noted that its "property damage" analysis was sufficient to resolve the matter and it did not need to reach the "occurrence" question. Firemen's, supra, 387 N.J. Super. at 447 ("We need not decide the issue of whether there was an 'occurrence' because the insuring clause covers liability for 'property damage' if that damage was 'caused by an occurrence.'").

Because the "occurrence" discussion was, as acknowledged by the court, unnecessary to the Appellate Division's affirmation of the trial court's decision, it is *dicta* and does not constitute binding law in the State of New Jersey. See State v. Ruiz, 399 N.J. Super. 88, 106 (App. Div. 2008) (holding that a determination that is not "essential" to the outcome "constitutes dicta, and is not binding"). And, to that end,

several years ago the Appellate Division again acknowledged that Firemen's discussion of "whether a contractor's improper installation or use of unsuitable material is an 'occurrence' within the meaning of [a CGL] policy..." "arguably was not necessary to the court's decision and dicta", and, therefore, not precedential. E. Coast Residential Assocs., supra, 2012 N.J. Super. Unpub. LEXIS at \*5.

Therefore, Parkshore has no probative value and was rightly dismissed by the Appellate Division below.

For all of the foregoing reasons, the Appellate Division's decision finding an "occurrence" and "property damage" where a subcontractor's faulty construction work causes damage to another contractor's work, is correct, formidable, and soundly based on the long-standing coverage precepts espoused by this Court.

#### **CONCLUSION**

For the foregoing reasons, CAI respectfully requests that the Appellate Division's decision be affirmed.

Respectfully submitted,

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BY:

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GENE MARKIN

DATED: