

Insights: Alerts

Defective Construction Can Be a Covered Occurrence in New Jersey – the End of Weedo?

July 23, 2015

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Perhaps no case has generated as many citations and commentary (more than 1,880 citations, including 440 cases) on the subject of liability coverage for “construction defects” as *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788 (1979). For more than 35 years, courts in many jurisdictions have relied on *Weedo* in ruling that improper, non-conforming, defective construction (faulty workmanship by contractors) is a normal, construction-related “business risk” that is not covered by a contractor’s general liability policy. However, courts slowly began to recognize that *Weedo* and its progeny construed policy language that was replaced in 1986 by a new policy form providing products completed operations hazard (“PCOH”) coverage for damage caused by a negligent subcontractor. Now, two new decisions in New Jersey have limited *Weedo* to its facts (and the form of policy at issue then) by recognizing that defective construction is an insured “occurrence” that can be covered by a general liability policy. These cases signal the “death knell” for *Weedo*.

In two, straight-forward, clear decisions, the Appellate Division of the Superior Court of New Jersey issued rulings that appropriately limited the outcome in *Weedo*. The New Jersey cases are *Cypress Point Condo. Ass’n, Inc. v. Adira Towers, L.L.C.*, Docket No. A-2767-13T1, 2015 WL 4111890, (N.J. App. Div. July 9, 2015) and *Belmont Condo. Ass’n, Inc. v. Arrowpoint Capital Corp.*, Docket No. A-4187-12T4, 2015 WL 4416582 (N.J. App. Div. July 21, 2015). Both appellate courts recognized that the standard form of CGL policy in effect when *Weedo* was decided (ISO’s 1973 policy form) contains a broad exclusion for the defective construction “work” of both general contractors and subcontractors, which the New Jersey Supreme Court characterized as an uninsured “business risk.” Unlike the 1973 ISO form, the 1986 policy form contains a “subcontractor” exception to the “your work” exclusion that extends coverage when the insured is sued for property damage caused by a negligent subcontractor.

While these are the first two New Jersey appellate decisions holding that defective construction can be a covered “occurrence,” these certainly are not the first cases to recognize that *Weedo*, when properly considered in light of the 1973 policy form at issue in that case, does not stand for the proposition that faulty workmanship, a/k/a “defective work,” can never be a covered “occurrence.” Nevertheless, as noted by a Texas court in construing the PCOH coverage of the 1986 policy form, many courts have “continually misapplied *Weedo* to hold that defective construction cannot constitute an occurrence resulting in some ‘regrettably overbroad’ generalizations about CGL policies.” *Lennar Corp. v. Great Am. Ins. Co.*, 200 S.W. 3d 651, 671 (Tex. App. 2006) (citing and quoting in part *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 268 Wis.2d 16, 673 N.W.2d 65, 74 (2004)).

For instance, in a leading PCOH decision, the Florida Supreme Court concluded that the outcome in *Weedo* was “not due to the insuring provisions [of the policy], but because faulty workmanship by a contractor was specifically excluded based on the clear and unambiguous ‘business risk’ exclusionary clauses” contained in the 1973 policy form. *United States Fire Ins. Co., v. J.S.U.B., Inc.*, 979 So.2d 871, 881-82 (2007). Indeed, the *Weedo* court itself specifically noted that the coverage limitations it applied “are set forth in the exclusion clauses of the policy, *whose function it is to restrict and shape the coverage otherwise afforded.*” 405 A.2d at 790 (emphasis added). As recognized in *J.S.U.B.* and by *Cypress Point* and *Belmont*, if those coverage exclusions do not apply, *Weedo* does not answer the question of whether or not defective construction, *i.e.*, faulty, negligent workmanship, can be a covered “occurrence.”

As noted simply in *Cypress Point*, “[i]n *Weedo*, the Court did not resolve whether consequential damages resulting from subcontractors’ faulty workmanship constituted ‘property damage’ or an ‘occurrence.’” 2015 WL 4111890, at *4. Most importantly, unlike the 1973 policy form construed in *Weedo*, the “plain language” of the 1986 policy form at issue in *Cypress Point* contained a critical difference in the exclusionary language for damage to “your work.” Unlike the policy form at issue in *Weedo*, the policy construed in *Cypress Point* contains an “exception” that eliminates the “your work” exclusion “*if the damaged work or the work out of which the damage arises was performed on your [the insured’s] behalf by a subcontractor.*” *Id.* at 6 (quoting policy form) (emphasis in original). The court ruled that the “addition of the subcontractor’s exception is of critical importance when determining whether the subcontractors’ faulty workmanship causing consequential damages amounts to ‘property damage’ and an ‘occurrence’ under the policy.” *Id.* at 6. Citing *J.S.U.B.*, among other authorities, the *Cypress Point* court noted that the proposition that “construction defects” can be insured “occurrences” was now the “majority rule” in cases construing the 1986 policy form when post-completion property damage is caused by a negligent subcontractor. *Id.* at 7. Citing the commonly-used definition of an “accidental occurrence” as an event neither expected nor intended by the wrongdoer, the court noted that the “insurers do not contend, and we cannot reasonably believe, that the subcontractors either expected or intended for their faulty workmanship to cause ‘physical injury to tangible property.’” *Id.* at 4.

Both *Cypress Point* and *Belmont*, which followed *Cypress Point*, involved claims of consequential property damage caused by water intrusion. In *Cypress Point*, the water intrusion had been caused by negligent workmanship (“defective work”) of subcontractors in installing the roof, gutters, a brick and EFIS facade, and windows. This faulty workmanship had caused consequential damages to the “common areas” of the project, the unit owners’ property, and other interior areas of the building, including sheetrock, wall finishes, flooring and trim. The court concluded that the plaintiff’s claim for “consequential damages flowing from defective work [is] vastly different than the costs associated with replacing the defective work,” which the court decided was the nature of the uninsured, “business risk” property damage at issue in *Weedo*. In *Belmont*, while the plaintiff association argued that water intrusion had caused “consequential” damages, the plaintiff also argued that “it can recover the cost of repairing the defective work.” *Belmont*, 2015 WL 4416582, at *2. The *Belmont* court did not address this issue. Neither *Cypress Point* nor *Belmont* resolved the scope of coverage available for the claimed damages, as both courts noted that the carriers had raised other exclusions and defenses to the claims being pursued that had to be considered by the trial courts on remand.

The *Cypress Point* and *Belmont* decisions now align New Jersey (one of the last holdouts) with a majority of recent decisions ruling that when the liability policy at issue contains PCOH coverage that includes the

“subcontractor exception,” property damage arising out of or “to” the work of the negligent subcontractor can be insured. However, neither case addresses the issue of when and under what circumstances coverage may be available for the cost of repairing the “defective work” of the subcontractor, an issue that has sharply divided other courts. As noted above, the *Cypress Point* court suggested that such cost remains an uninsured “business risk.” *But see* Edmund M. Kneisel & Betsty Cooke, *The Products-Completed Operations Hazard: When Coverage Exists, Just What is Covered?*, 2009 Construction Law Update, Chap. 6 (N. Sweeney, ed. 2009) (discussing *Pozzi Window v. Auto-Owners Ins. Co.*, 984 So.2d 1241 (Fla. 2008), in which the Florida Supreme Court sanctioned coverage for the cost of repairing negligently installed windows that caused water intrusion). In a decision issued nine years after the *Lennar Corp.* ruling cited above, the Texas Supreme Court also allowed recovery of the cost of remediating “defective use of EFIS in home construction” that had caused water intrusion damage to completed homes. *Lennar Corp. v. Markel Am. Ins. Co.*, 413 S.W.3d 750, 753 (Tex. 2013). This issue remains an open question in New Jersey and many other states.

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