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Beware the Subcontractor - Consequential Damage Caused by Subcontractor's Faulty Workmanship Covered under Standard Form CGL Policy

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It is an established principle in many US jurisdictions that CGL insurance does not cover an insured contractor's faulty workmanship or poor contractual performance, as such risk is considered an expected cost of doing business and, therefore, not the subject of CGL insurance. While the coverage provided by standard form GCL policies typically is very broad, specific exclusions are designed to limit their scope.

In a very recent decision, issued on August 4, 2016 (Cypress Point Condominium Association, Inc. v. Adria Towers, LLC, et al., (A-13/14-15)(076348)), one such exclusion was a subject of first impression by the Supreme Court of New Jersey. Based on the wording of a "Your Work" exclusion, the Court decided that damage that resulted from subcontractors' shoddy work would be covered under the terms of an ISO-issued 1986 standard form CGL policy.

The dispute arose in relation to the construction of a luxury condominium complex. After completion of the construction phase, several residents began to experience water damage to their units as well as the common areas of the condo complex. As a result, the Condominium Association filed suit against the developer and several subcontractors, alleging faulty workmanship, and the developer's insurance coverage became an issue in the litigation.

Insurance was provided under a number of CGL policies which were modeled after the 1986 version of the standard form CGL policy promulgated by the Insurance Services Office, Inc. ("ISO"). The policies provided coverage "for those sums that the insured becomes legally obligated to pay as damages because of … 'property damage'… caused by an 'occurrence'…". "[P]roperty damage" was defined to include "[p]hysical injury to tangible property including all resulting loss of use of that property." "Occurrence" was defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The policies also included an exclusion "Damage To Your Work", which excluded from coverage "'property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard'". However, the exclusion did not operate "if the damaged work or the work out of which the damage arises was performed on [the insured's] behalf by a subcontractor."

The Court decided that the water damage that was caused post-construction to completed and non-defective portions of the condo complex was consequential damage, which it considered as "accident(s)" – "unintended and unexpected harm caused by negligent conduct" - under the policies' definition of "occurrence". The consequential damages were therefore covered under the policies. Interestingly, the Court rejected the insurers' argument that a breach of contract cannot result in an "accident" and, therefore, cannot give rise to a covered "occurrence". The Court explained that, if coverage was to be denied, it would have to be by operation of the CGL policies' business risk exclusions.

As an issue of first impression, the Court then moved on to the interpretation of the "Your Work" exclusion. The exclusion applied to the cost of repairing damage to the contractor's own work, except, "if the damaged work or the work out of which the damage arises was performed … by a subcontractor." The Court decided that the exception applied to the damage that was caused as a result of subcontractors' faulty work and was therefore covered by the policies.

The decision provides valuable insight into the interplay between the insuring clause and the application of "Your Work" exclusions in CGL policies under New Jersey law.

If you would like to discuss this decision or its subject matter with one of Chartwell's lawyers, please contact Michael Alivernini at (215) 972-5421 or via e-mail at malivernini@chartwelllaw.com