NEW JERSEY SUPREME COURT ISSUES IMPORTANT RULING FOR DEVELOPERS (CYPRESS POINT)

By: Carlton T. Spiller, Esq., Ellen A. Silver, Esq. and Steven B. Gladis, Esq.

The New Jersey Supreme Court's August 4, 2016 holding in *Cypress Point Condominium Association, Inc. v. Adria Towers, LLC* is the latest decision to fall in line with the "strong recent trend" by state and federal courts to recognize that standard commercial general liability (CGL) insurance policies provide coverage for property damage caused by the faulty work of the insured's subcontractor.

In *Cypress Point*, a condominium association filed suit against the developer and general contractor who had built the condominium project using subcontractors. The suit alleged that water infiltration, such as roof leaks and infiltration at interior window jambs and sills, had caused damage to steel supports, exterior and interior sheathing and sheetrock, and insulation. The association claimed that this water infiltration was caused by faulty construction work, including defectively built or installed roofs, gutters, brick facades, exterior insulation and finishing system siding, windows, doors, and sealants.

The question in *Cypress Point* was whether there was coverage under the relevant CGL policies issued to the developer, which were based on the 1986 standard CGL form prepared by the Insurance Services Office, Inc. (ISO). The policies contain the standard form policy language providing coverage for "those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' . . . caused by an 'occurrence' that takes place in the 'coverage territory' . . . [and] . . . occurs during the policy period." The policies define "property damage" as "[p]hysical injury to tangible property including all resulting loss of use of that property." "[O]ccurrence" is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The policies also contain an exclusion that eliminates coverage for "'[p]roperty damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operation hazard'" (the "Your Work Exclusion"). But the policies also specifically provide that the Your Work Exclusion "does not apply if the damaged work or the work out of which the damage arises was performed on [the insured's] behalf by a subcontractor" (the "Subcontractor Exception").

The trial court initially granted summary judgment in favor of the insurers, holding that there was no coverage under the insuring agreement because faulty work does not qualify as an "occurrence" and consequential damages caused by faulty work are not "property damage" as defined in the policy. The Appellate Division reversed, holding that "unintended and unexpected consequential damages [to the common areas and residential units] caused by the subcontractors' defective work constitute 'property damage' and an 'occurrence' under the [CGL] polic[ies]." The Supreme Court granted certification to consider the question of whether the standard form CGL policies provide coverage to a developer/general contractor when a subcontractor's faulty work causes consequential damage to the project.

The Supreme Court affirmed the Appellate Division, holding that "the consequential damages caused by the subcontractors' faulty workmanship constitute 'property damage,' and the event resulting in that damage—water from rain flowing into the interior of the property due to the subcontractors' faulty workmanship—is an 'occurrence' under the plain language of the CGL policies at issue here."

The Court rejected the insurers' argument that faulty work can never be an "accident" because it is one of the normal, frequent, and predictable consequences of the construction business. The Court also rejected a frequent argument made by insurers that breach of contract claims are not within the CGL policy's initial grant of coverage. The Court explained that "accident" as used in the policies "encompasses unintended and unexpected harm caused by negligent conduct." Thus, the Court

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Carlton T. Spiller and Ellen A. Silver are partners in the Litigation Department of Greenbaum, Rowe, Smith & Davis LLP. Mr. Spiller's practice focuses on commercial general liability insurance coverage and litigation involving environmental, construction defect, and professional liability claims. Ms. Silver's experience encompasses a wide variety of insurance coverage matters, including those related to environmental contamination, construction defect claims (general liability and homebuilders' warranty insurance), professional liability claims, asbestos property damage and personal injury claims, D&O liability claims, comprehensive general liability claims, employment claims, automobile dealers liability claims, property insurance, and fidelity bond claims. Steven B. Gladis, an associate in the Litigation Department, focuses his practice on commercial litigation, including construction, employment, insurance-coverage, and environmental matters.

RULING CLARIFIES INTERPLAY

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of the RMP build-out growth projections. Twenty percent referred to COAH's set aside requirement for affordable for-sale units. The build-out projection for the Borough was 9 units, and the motion sought to reduce the Borough's obligation to 2 units.

The Court rejected the Borough's argument that the RMP build-out report alone should determine its affordable housing need. Adopting such reasoning, the Court found, would effectively revise the Prior Round methodology, in contravention of the *Mount Laurel IV* mandate. The Court established that the RMP could be considered only as an allocation factor in evaluating the Borough's affordable housing compliance plan.

This marks the first time a court has held that the Highlands RMP must accommodate affordable housing obligations and prohibited a municipality from relying exclusively on RMP build-out reports to limit its affordable housing obligation.

Consequently, the RMP must be modified to accommodate the Court's determination of regional affordable housing need. One "unintended consequence" of such a reevaluation may finally lead to a workable Highlands Transfer of Development Rights program which thus far has not addressed regional affordable housing needs.

COMPUTER SECURITY

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CYPRESS POINT

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held that "consequential harm caused by negligent work is an 'accident.'" "Therefore, because the result of the subcontractors' faulty workmanship here—consequential water damage to the completed and non-defective portions of *Cypress Point*—was an 'accident," it is an 'occurrence' under the policies and is covered so long as the other parameters set by the policies are met."

The Court went on to explain that, when viewed in isolation, the Your Work Exclusion would seem to eliminate coverage—after all, to the developer or general contractor, the entire condominium is "your work." However, the Court further explained that the Subcontractor Exception "unquestionably applies," holding that "because the water damage to the completed portions of *Cypress Point* is alleged to have arisen out of faulty workmanship performed by subcontractors, it is a covered loss."

While the Supreme Court's decision left outstanding issues that will have to be resolved through future litigation (such as whether there is coverage for the cost of repairing or replacing the defective work) *Cypress Point* is an important victory for developers and general contractors. Under the 1986 ISO standard form CGL policy, when a subcontractor's faulty work causes consequential damage to other, non-defective portions of a project, the developer or general contractor's insurance must respond with coverage.

The authors of this Alert – Carlton T. Spiller, Ellen A. Silver and Steven B. Gladis – filed a brief in the *Cypress Point* matter on behalf of amici curiae the New Jersey Builders Association, the National Association of Home Builders, and Leading Builders of America, arguing in favor of the conclusion adopted by the Supreme Court.

STATUS OF MOUNT LAUREL

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numerous additional counties.

The DJ cases in the other counties have, by and large, lagged behind Middlesex and Ocean counties. Trials in certain Union County cases were scheduled to start during the last couple of months, but those cases settled. No Union County trials are scheduled as of this writing. Trials in other counties are not likely to occur before sometime next year.

Conclusion

The pace of adjudication of the contested *Mount Laurel* DJ cases throughout the State has been quite disappointing. In its March 2015 opinion returning exclusionary zoning disputes to the trial courts, the Supreme Court envisioned that all issues would be addressed by the end of 2015. Despite that disappointing pace, a fair number of settlements favorable to developers and lower income households have occurred throughout the State, although principally in Middlesex County. Moreover, opportunities remain for builders to seek intervention in the pending DJ cases, with rezonings for higher density product typically being sought. Further, many towns have not taken the steps required to become immunized from builder's remedy suits, and such suits can be filed against such towns. Builders seeking rezonings are well-advised to explore the possibilities provided by the *Mount Laurel* doctrine.