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Case Denying Coverage Has Limited Relevance

Recent appellate decision did not shore up erosion of *Weedo's* current relevance

A 2006 Appellate Division decision, *Firemen's Insurance v. National Union*, has garnered attention among insurance claims representatives. The Firemen's court denied coverage for repair and replacement of faulty workmanship, finding the insured did not satisfy the insuring clauses because it could not show property damage and thus, a covered occurrence under the policies. Even though it represents a slavish homage to *Weedo*, the enthusiasm some have shown for this opinion is unwarranted.

The *Firemen's* case stemmed from a lawsuit by the Society Hill Condominium Association Inc. against various defendants for defects in construction of the condominiums. In 2000, a jury awarded the association \$935,776 against several defendants in the underlying construction defect litigation. In the related insurance coverage action, however, the trial judge held that the defendants' various commercial general liability policies did

not require the insurers to indemnify the defendants for the claims at issue. The essence of the decision is that faulty workmanship, in itself, does not constitute "property damage" or an "occurrence" under the applicable insurance policies.

The appellate court affirmed, for reasons relegating the decision to a rehash of *Weedo v. Stone-E-Brick*, 81 N.J. 233 (1979), itself of waning significance in construing insurance coverage for construction defects under "modern day" post-1986 ISO form policies.

By not emphasizing Society Hill's failure to prove consequential property damage, i.e., physical injury to tangible property beyond the work of the developer's subcontractors, as the singular dispositive consideration – the court has inadvertently spawned the ensuing amplification of the ruling's import.

Prior to the damages trial, the judge ruled the carriers had no duty to indemnify defendants for damages arising from the "seven construction defects," absent proof of "property damage which would trigger coverage." The appeals court determined

Society Hill did not satisfy the "insuring clauses" because it could not show "property damage" or a covered "occurrence" in the policies. An "occurrence" requires "property damage during the policy period."

The policies were derivative of the 1973 ISO policy form, and included the Broad Form Property Damage Endorsement (BFPD). Thus, given the nearly 35-year-old vintage of the policy forms, the court's analysis is narrowly circumscribed to increasingly rare pre-1986 ISO forms written before the advent of the "modern" CGL ISO form in 1986. Importantly, the form includes: (1) a "subcontractor exception" to the "work performed" exclusion and (2) a real property carve-out in the "your product" exclusion, both essential in determining coverage.

The court hailed *Weedo* as the "seminal case" regarding coverage for a contractor's defective work. (*Weedo* interpreted the identical 1973 ISO policy form, although *without* the Broad Form Property Damage Endorsement.) It summarized the *Weedo* distinction as: where the "damages claimed are the cost of correcting the work itself" the "business risk" exclusions would bar coverage; but recognized that there is coverage for "the risk of injury to people and damaged property caused by faulty workmanship." The "key distinction is the predictability of the harm."

The trial judge found "no property damage" because the alleged damage was the "cost of replacing sub-standard firewalls"; not that the firewalls "caused damage to the rest of the

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building or to any other person or property.”

The *Firemen's* opinion thus hinges entirely on plaintiff not having established among the “seven specific construction defects,” consequential property damage in the form of physical injury to tangible property, requiring repairs other than replacement of, in this case, the insured’s subcontractors’ work.

Firemen's merely follows *Weedo* because conveniently, although it only narrowly applies in “rare” pre-1986 policy form cases without discernable property damages, *Firemen's* fits that description. The New Jersey Supreme Court has not overruled *Weedo* in favor of the emerging view in cases decided over the past thirty years, it has simply eroded its importance as appropriate, through a series of policyholder-friendly refinements, as fact patterns arise, calling for analysis under modern policy forms. See *Newark Insurance v. Acupac*, 328 N.J. Super. 385 (App. Div. 2000); *Hartford Insurance v. Marson*, 186 N.J. Super. 253 (App. Div. 1982); *Aetna v. Ply-Gem*, 343 N.J. Super. 430, (App. Div.), *certif denied*, 170 N.J. 390 (2001).

In *Weedo*, the claim was for faulty workmanship. The damages were the cost of correcting the insured’s work (replacing cracked stucco). Of critical importance to the court’s holding, and the larger implications of the case now almost 30 years later, is that there was no property damage to the plaintiff’s property or to work completed by others.

Importantly, even the *Weedo* court explicitly recognized coverage for *accidental injury to property or persons* caused by the insured’s faulty workmanship. The court said “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 costs of such risks as a matter of insurance underwriting.” *Weedo* merely upholds the basic proposition that a CGL policy covers tort liability for physical damages to others, and excludes coverage for repair and replacement of only the insured’s faulty

workmanship.

A basis to distinguish *Weedo* from post-1986 policy cases, is that it did not construe either the BFPD endorsement modification to the “work performed” exclusion or the “subcontractor exception.” Courts which have blindly followed *Weedo* in favor of construing actual policy language, are increasingly among the “minority of cases” which have denied coverage for completed operations losses involving property damage caused by subcontractors. P. Wielinski, “Selected Coverage Issues In a Construction Defect Claim,” *Coverage* (1998) page 25.

Analysis of the *Firemen's* facts under derivative 1973 ISO policy forms (with a Broad Form Endorsement), results in an entirely different analysis than would apply under a post-1986 ISO form including, inter alia, the subcontractor exception and the modified definition of the insured’s “product.” Both of these modifications *broadened coverage*, as freely acknowledged by the insurance industry in promoting these coverage enhancements.

The current CGL policy form contains the following exclusion and exception to that exclusion:

‘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.

The “subcontractor” exception, introduced in 1969 in the optional BFPD endorsement, was incorporated into the 1986 revision to the basic ISO CGL policy form. It constitutes a mighty “antidote,” to counter the fabled “business risk” doctrine relied on by insurers, and given voice in *Weedo*.

Those cases which have addressed the actual policy language of more current CGL forms have generally upheld coverage in favor of a general contractor for the faulty work of its subcontractors. Consistent with the “business risk” rationale, property damage resulting from a subcontractor’s defective

workmanship is arguably “fortuitous,” i.e., not entirely within the insured general contractor’s knowledge or control. Hence, logic dictates that coverage should exist in favor of the insured general contractor.

The *Firemen's* trial court’s holding was *not* based on a determination under the “your product” exclusion, as some have “read into” the opinion. Confusion stems, in part, from mention in the appellate opinion to both *Knutson v. St. Paul*, 396 N.W. 2d 229 (Minn. 1986), and *Blaylock v. AIU*, 796 S.W. 2d 146 (Tenn. Ct. App. 1990), to suggest that a subcontractor’s mere involvement does not “resurrect” coverage under the BFPD’s “work performed” exclusion. The appellate court did not need to reach this issue, because physical injury to tangible property had not been shown, and might have left “well enough” alone.

Ironically, the trial judge’s opinion included a hypothetical example (based on the BFPD endorsement) which *results in coverage*. In predicting how he would undertake the analysis, the judge found that if a subcontractor were to install all the windows on a project, blocking the weep holes, thus causing the windows to deteriorate, *there would be coverage* for the general contractor, as intended when the words “or on your behalf” were omitted through the BFPD endorsement. ISO (the body creating the endorsement) acknowledges the BFPD endorsement language broadened coverage by *restricting* the exclusion only to the insured’s own work; and thereby not barring coverage for work performed by the insured’s subcontractors. Absent Society Hill establishing physical injury to tangible property, the trial court did not undertake a more formal BFPD analysis.

The appeals court’s reliance upon *Knutson* demonstrates vividly the danger in grafting a 1973 ISO form analysis onto a 1986, or later, ISO form – a temptation carriers find hard to resist, for obvious reasons. Reliance on *Knutson* is particularly disconcerting since it was later rejected as inapplicable to post-1986 ISO policy analysis where a subcontractor exception is included. The notion of “merger” of the subcontractor’s work into the general contractor’s “product”... is a stale con-

cept. In the post-1986 ISO policy the “your product” exclusion explicitly carves out real property, removing the temptation from those inclined to misinterpret the 1973 ISO form.

In *O’Shaughnessy v. Smuckler Corp.*, 543 N.W. 2d 99 (Minn. App. 1996), the court *upheld coverage* in favor of a general contractor insured arising from property damage resulting from its subcontractor’s work. In analyzing the 1986 policy form, drawing a

distinction between its analysis and the *Knutson* analysis earlier applied, the court keenly observed “*it would be willful and perverse for this court to simply ignore the exception that has now been added to the exclusion.*”

This specific reference to the “subcontractor exception” highlights the Minnesota Supreme Court’s recognition (equally valid in New Jersey) that a 1973 ISO policy analysis is antithetical to a post-1986 ISO policy interpretation

when determining coverage for construction defects, caused by the insured contractor’s subcontractor.

The limited reach and relevance of *Firemen’s* is thus brought into a proper focus. The pains to which some have resorted, in parsing the *Firemen’s* opinion, belies a desperate nostalgia for a time before the modern ISO form. Even the slavish *homage* to *Weedo*, which *Firemen’s* represents, can’t slow the receding shadow it now casts. ■