

Alternative Dispute Resolution

The Importance of Insurance Coverage in Mediating Complex Construction Claims

Understanding commercial general liability policies is a necessity

By Thomas Pryor

In mediating complex, multiparty construction claims, analysis of available insurance coverage is paramount. Plaintiff must obtain in discovery from all developer and contractor defendants, through a comprehensive insurance demand, certified copies of all commercial general liability (CGL), umbrella and excess policies, including policy limits, payout and limits exhaustion details, and reservation of rights or coverage declination letters, at minimum. Obtaining complete policies requires tenacity in identifying missing information, as responses are often a hodgepodge of incomplete information.

The CGL policy (an average 25 pages of forms and endorsements) is the vehicle for coverage for an insured developer, general contractor, owner or subcontractor to respond to claims by a plaintiff, common interest (town home or condominium) association, residential or commercial property owner. Large-scale construction projects, given the number of parties and potential exposure

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from defective workmanship, require examination of devices for transferring risk among the parties, including contractual indemnification, with “additional insured” considerations, in addition to available insurance.

The very broad, basic coverage grant in a CGL policy provides the carrier “will pay those sums that the insured becomes legally obligated to pay as damages because of... ‘property damage’ to which this insurance applies” (ISO 1994 policy form). The policy is thus intended to provide a defense and indemnity to the insured against third-party covered claims.

The modern basic ISO CGL form, post-1986, absent virulent endorsements, affords defense and indemnity to a general contractor, in a garden variety construction defect claim for, such as (1) property damage (arising from the defective workmanship of the insured’s subcontractors) to the insured’s work, the work of other subcontractors or third-party property; (2) consequential property damage arising from the insured’s own defective work, other than to the insured’s work itself; and (3) property damage to impaired property or to property not physically injured arising out of the named insured’s work, if the loss of use of other property arises out of

the sudden and accidental physical injury to the insured’s product or work, after it has been put to its intended use.

Virtually all CGL policies are derived from ISO forms which are updated every few years, often significantly. Policy endorsements broaden and restrict coverage in dramatic ways. Umbrella policies are varied in content, narrowing or broadening underlying coverage. Construing the CGL alongside often manuscripted excess or umbrella policies is essential for an accurate and complete understanding of available coverage. Determining how the CGL coverage is modified can yield multiple interpretive arguments, (and with it ambiguity), rather than absolute clarity.

In *Weedo v. Stone-E-Brick*, 81 N.J. 233 (1979), a seminal case, decided almost 30 years ago, the New Jersey Supreme Court construed a 1973 form and held the cost to cure the insured’s own defective workmanship is not covered, absent damage caused by that work. Although it still looms large and defines the landscape, interpretive refinements of its reasoning have sought to keep pace with more modern iterations of the ISO policy form, constituting the relatively small body of N.J. case law in this area.

Once the insured’s work is integrat-

ed into other work, however, fact issues arise resulting in different coverage outcomes, depending upon the nature of the property damage wrought by the insured's defective work. Instructive are *Newark v. Acupac*, 328 N.J. Super. 385 (App. Div. 2000) and the very recent *Travelers v. Dammann*, 2008 WL 370914 (D.N.J.), both policyholder-friendly decisions where the insured's defective work was incorporated within other work or products, causing damage to other than the insured's work or products. Issues over whether the insured's defective work can be surgically removed and replaced, without damaging or disturbing the work or property of others are extremely fact sensitive and must be analyzed within the context of the word-for-word language of the policy.

CGL policies written after 1986 broadened coverage by incorporating the "Broad Form Property Damage Endorsement" ("BFPD") and through other refinements in the basic ISO policy form. Claims involving pre-1986 policies are rare but still occur, witness the recent *Firemen's v. National Union*, 387 N.J. Super. 434 (App. Div. 2006).

Deconstructing a defective work claim under an ISO form can be distilled down to approximately 10 or 15 separate questions. The basis for coverage is an "occurrence" within the policy term, resulting in consequential property damage to work other than the insured's own work. A threshold determination is whether the "occurrence" constitutes a "business risk" (not intended to be covered under a standard CGL) or whether it is "fortuitous" (happening by chance) or "accidental"; i.e., outside the insured's control, and thus, covered.

The presence and "cause" of "property damage" is often debated; including whether there has been "physical injury to tangible property" or "loss of use" of tangible property not physically injured. Each constitutes "property damage" but requires a separate analysis. Deconstructing a defective work claim under an ISO form requires matching the facts against the word-for-word policy language. This exercise is like disarming an explosive, painstakingly snipping each

wire in sequence in hopes that no unexpected provision is encountered blowing to smithereens hopes of available coverage.

Other issues include whether multiple, continuous occurrences trigger several policies in sequence or whether there are distinguishable occurrences within a given policy or policies. This warrants examination of whether the "products-completed operations aggregate" or the "general aggregate" are implicated, although the limits are often but not always the same for each. The general aggregate and the products-completed operations aggregate are satisfied separately depending upon the policy and nature of the covered claims or occurrences.

The eager policyholder or insured's attorney seeking to establish coverage will want to confirm the "subcontractor exception" is included within the "Damage to your work" exclusion (commonly included as "exclusion (I)" since 1986) and that it is not removed by endorsement from the basic ISO form. One must hold one's breath in hopes of not finding the dreaded endorsement CG 22941001 ISO 2000, or a mutation thereof, which is intended to eliminate the subcontractor exception.

This insidious endorsement replaces the "Damage to your work" ISO boiler plate by leaving out the one-sentence "subcontractor exception," thereby potentially significantly curtailing available coverage for an unsuspecting insured defendant. This raises the spectre of a possible viable claim against the developer insured's insurance agent, assuming the agent has not explicitly alerted the insured to the danger that the endorsement "guts" or eviscerates available coverage and to insure the developer builds the project with its eyes open as to its diminished ability to manage its risk.

Commonly encountered land mines include EIFS exclusions; endorsements which reverse the subcontractor exception to the insured's own "workmanship" exclusion (the expansive opening through which the insurance industry consciously afforded coverage for most construction defect claims since 1986 when the Broad

Form Property Damage Exclusion (BFPD) was formally incorporated into the form ISO CGL); endorsements removing "completed operations" coverage from the basic form; excluding "planned unit development, residential development, apartment, condominium, townhouse and mixed use" construction, are among the most lethal in current circulation.

Carriers blithely churn out reservation of rights and declination letters, derivative of the "business risk" framework established in *Weedo*, at times without regard to the facts of a given case or the "nuances" of specific policy language, despite having issued the policy in question. Defendants, contractor policyholders and motivated plaintiffs challenge the carriers' positions, informally and through declaratory judgment actions, armed with post-*Weedo* refinements and post-1986 ISO policy provisions.

The effective construction mediator must possess a full command of policy construction, to confine the discussion within legitimate policy interpretation. Policy language is parsed and dissected by all sides — each boldly certain of its mutually exclusive interpretive position. Underlying and excess/umbrella adjusters jostle for a spot on the proverbial "back burner." Much depends upon how well the facts have been solidified through ongoing discovery. Battle lines are drawn and skirmishes fought.

With so much at stake, (claims often exceed \$10 million) and so little nailed down, the mediator is freed from the bounds of binding certainty. With less than universal agreement among reviewing courts in construing all policy terms and conditions, things will be kept interesting. The mediator must emphasize to recalcitrant adjusters, and eager plaintiffs alike, each covetous of policy proceeds, the vicissitudes and costs of trial. Parties should also be reminded of the risk of an anomalous result or bad precedent, disturbing the delicate construct of shared risk which creates a favorable climate for resolving these complex cases through mediation. ■