THE INSURANCE MAZE: STRATEGY TO MAXIMIZE INSURANCE PROCEEDS IN FAULTY WORKMANSHIP CASES

The vast majority of my time practicing law in New Jersey has been dedicated to issues arising in environmental law, including environmental insurance coverage. However, I have also been involved in pursuing insurance coverage related to other subject matters, including so-called faulty workmanship insurance claims. While my desire in this article is to leap to what I see as the great "open issue" concerning faulty workmanship coverage (are clients really limited to consequential damages?), I should not do that. In order to address this "open issue" practitioners must carefully make their way through the maze to the target.

Before a practitioner will be positioned to make any of the arguments I present below, she needs to follow this path: First, file suit against the insurer in a jurisdiction in which the substantive law of that jurisdiction is in her client's favor for coverage--for example, New Jersey, not Pennsylvania; Second, bring and win a choice of law motion arguing that the substantive law of New Jersey applies to the resolution of the insurance coverage issues (follow Continental Insurance Company v. Honeywell International, Inc., 234 N.J. 23 (2018)); Third, seek, as part of that complaint, to recoup her attorney's fees, as a successful claimant, pursuant to N.J.Ct.R. 4:42-9(a)(6).

If successful in connection with steps one and two, step three can be used in connection with attempts to settle the matter short of trial and maximize insurance recovery. Moreover, if successful in connection with steps one and two, the substantive discussion in the following paragraphs should be of particular interest.

The development of the case law in the faulty workmanship arena in New Jersey parallels that of environmental law. Only in the past two years, however, has the New Jersey Supreme Court been willing to take the wind out of the sails of Weedo v. Stone-E-Brick, 81 N.J. 233 (1979) and its progeny based, in large part, on the Court's prior precedent in the environmental arena. In Cypress Point Condominium Association, Inc. v. Adria Towers, L.L.C., et al., 441 N.J. Super. 369 (App. Div. 2015), affirmed, 226 N.J. 403 (2016), the Court ruled that faulty workmanship constituted an "occurrence" pursuant to the standard comprehensive general liability ("CGL") policy in question, thus bringing the claim within the insuring agreement of the policy. It further found that there was "property damage." The Court held that consequential damages (which were the only damages requested by plaintiff) were covered if no policy exclusions applied.

Before Cypress Point insurers in New Jersey routinely denied coverage on all faulty workmanship cases stating that Weedo held that these types of risks could not be insured against. Lower courts were split on the issue and the Federal District Court of New Jersey was embracing Pennsylvania law and overlooking the fact that between Weedo and today, the business risk exclusions had been replaced for the express purpose of providing coverage.

Bolstered by Cypress, the Appellate Division in Air Master & Cooling, Inc. v. Selective Ins. Co. of Am., 452 N.J. Super. 35 (App. Div. 2017), overturned decades of precedent in New Jersey and held that every policy in effect when the work was performed by the named insured or any contractors or subcontractors working directly or indirectly on the named insured's behalf, up until the essential nature and scope of damage became known, would be triggered. Before Air Master courts in New Jersey generally found that the policy in effect when the damage manifested itself would be the only one to respond.

To put Air Master in perspective, this decision means if work was performed on a building in 2003 and damage from water infiltration was not "discovered" until 2010, each policy issued between 2003 and 2010 would be exposed, not just the 2010 policy. This is a tremendous boon to insureds and additional insureds alike and maximizes coverage.

Where things stand today after Cypress and Air Master is that insurance companies which issued these types of CGL policies should pay their share of consequential damages based on this "continuous trigger."

A share of consequential damages is insufficient.

It is unfortunate that the plaintiff in Cypress either could not or did not press the issue as to whether it was entitled to recoup all of its damages, not just consequential damages. Perhaps a decision was made not to "push the envelope." In any event, in the construction context, consequential damages generally comprise 25% of the damages actually incurred. So, the question remains, how can insureds seek to recoup the remaining 75%.

The answer lies, where all of the answers lie, in the policy language itself and its amendments over time. Caution: Before making an argument that all damages can be recouped, you need to (a) obtain an entire copy of the policy, and (b) as painful as it is, read the entire policy. If the policy is a standard CGL policy, it should not mention the phrase "consequential damages" anywhere in it, not even in the so-called "business risk exclusions." Moreover, if the named insured's subcontractors performed all of the work in question, then the insurance company does not have any hook under any current business risk exclusions to argue that any costs should be carved out unless specific exclusions such as mold exclusions are relevant.

There is, in short, nothing in a standard CGL policy which limits recovery to consequential damages or carves out repair and replacement costs where subcontractors are utilized for the work. Clever insurance company lawyers have simply sold a fable. (See Weedo). Do we really believe that a contractor expects or intends to damage a house when its subcontractor places the stucco on the house improperly? Why do we carve out repair and replacement of that stucco from coverage when it must be taken out and replaced to fix the house?

Fortunately for insureds, in what can only be described as an attempt to snatch defeat from the jaws of victory, some insurers decided to make it very clear that they will only pay for "consequential damages." How did they do this? By adding an endorsement amending the term "property damage" to state as follows: "Property damage does not include any loss, cost or expense to correct any defective, faulty or incorrect work performed by you or by any contractors or subcontractors working directly or indirectly on your behalf."

This language was added to some policies beginning in at least 2009, not to carve out consequential damages from coverage, but to carve out actual repair and replacement damages (i.e. the 75%). There was, and is, no reason for the language to exist except to exclude that which must have previously been covered. Therefore, this language should be used to argue that absent this language or other language expressly excluding repair and replacement damages, all damages associated with faulty workmanship performed by subcontractors of the named insured are covered, not just consequential damages.

This is an argument yet to be made, but ripe for the picking.

This article was written by Martha N. Donovan, a Member of the law firm Norris McLaughlin, P.A., and Co-Chair of its Environmental Practice Group. For more information, please feel free to contact Martha Donovan at mndonovan@norris-law.com.