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Insurance Coverage Decisions: Issued Today - Impact Tomorrow
White and Williams LLP
Randy J. Maniloff
maniloffr@whiteandwilliams.com

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If You Build It, He Will Come (And Sue You)

3rd Circuit Addresses Construction Defect Coverage Under New Jersey Law

The recent construction of New Meadowlands stadium in New Jersey – home of the Giants and Jets – has brought back talk of the longstanding urban legend that Teamsters Union President Jimmy Hoffa – who went missing during construction of The (old) Meadowlands -- was buried under one of its end zones. Of course, if Hoffa had disappeared during construction of the New Meadowlands, and was buried under one of *its* end zones, it would not have stayed a secret. Because if that had happened, it surely would have resulted in a construction defect suit.

Such is the state of construction defect litigation in 2010. I could sit here and tell you that construction defect litigation (and the consequential coverage litigation) is spiraling out of control. But if I did, I couldn't put it as well as the California Court of Appeals did in a case issued earlier this year. Characterizing a construction company's view of the current state of construction defect affairs issue, the court stated:

"It is not too much of an exaggeration to say that as soon as the last nail in a project is hammered and the keys are handed over to the homeowners, the ink on the first lawsuit over the construction of the homes is starting to dry."

Forecast Homes, Inc. v. Steadfast Ins. Co., 181 Cal. App. 4th 1466, 1482 (2010).

Putting aside a lot of collateral issues, the entire kerfuffle over construction defect coverage can be described as follows.

The issue at the center of it all is whether faulty workmanship, to an insured's own work, constitutes an "occurrence" under a CGL policy. Interestingly, despite this battle royale over the "occurrence" issue, a CGL policy does not provide coverage for the cost to repair or replace an insured's own work that is faulty. After all, even if an insured succeeds in establishing that faulty workmanship to its own work qualifies as an "occurrence," coverage would still be precluded by the policy's "your work" exclusion. The staunchest policyholder counsel would have a hard time disputing this.

And, except for a few exceptions, states are uniform in their conclusion that, if faulty workmanship *caused* property damage, to something *other than* the insured's work product, such injury or damage was caused by an "occurrence" and coverage exists.

So if there is general agreement on these issues, why is so much time and money being spent in litigation over the "occurrence" issue? Because, while damage to the insured's own completed work product is not covered, the rationale a court employs to reach this conclusion – no "occurrence" or the "your work" exclusion -- can make a world of difference. The reason is that the "your work" exclusion also contains what is commonly referred to as the "subcontractor exception," which restores coverage for "property damage" to the insured's own work, that would otherwise be excluded by the "your work" exclusion, if the cause of the damage to the insured's work was the operations of the insured's subcontractor.

However, many courts hold that, if damage to an insured's defective workmanship is not covered, because it does not qualify as an "occurrence," then the insured has not satisfied the requirements of the insuring agreement. As a result of the insured's failure to satisfy the insuring agreement, coverage is excluded and the court's analysis ends there, without any need for the court to address the potential applicability of policy exclusions. In other words, by resting its decision on the insured's failure to satisfy the insuring agreement, it becomes unnecessary for the court to reach the "your work" exclusion. Translation—policyholders are therefore denied the opportunity to invoke the "subcontractor exception" to such exclusion to restore coverage for damage to their own work that was caused by the operations of a subcontractor. In its simplest terms, the "occurrence" battle is all about whether the "subcontractor exception" to the "your work" exclusion comes into play.

This was the issue before the Third Circuit in its decision handed down on Friday in *Pa. Nat. Mut. Cas. Ins. Co. v. Parkshore Development Corp*. (interpreting New Jersey law). The decision is short and simple (like your author), but sends an important message.

Parkshore was the developer and general contractor of the Catalina Cove Condominiums in Linwood, New Jersey. Parkshore hired subcontractors to perform all of the work and construction at the site including roofing, framing, installing windows and doors, caulking and sealing, installing vent hoods, implementing an irrigation system, grading, setting the foundation, and installing gutters and leaders. The project was finished in 1998 and in July 1999, the Catalina Cove Condominium Association ("CCCA") notified Parkshore that stucco around some of the windows had not been caulked properly, causing water leakage. Parkshore hired someone to re-caulk the windows. *Id.* at 2.

Several years later, CCCA filed suit against Parkshore alleging the usual panoply of construction defect claims. CCCA's expert opined that there were multiple deficiencies in the site grading and drainage which allowed water to enter the crawl space and cause damage. The expert also identified deficiencies in the roofing, siding, window installation, framing, wood trim and irrigation which resulted in water penetration and caused damage to the framing, sheathing, windows, casings and stucco finish. *Id.* at 3.

Parkshore sought coverage from Penn National, which had issued CGL policies to Parkshore for several years. Penn National filed a declaratory judgment action in the District Court seeking a declaration that it had no obligation to provide insurance coverage to Parkshore in the CCCA lawsuit. The District Court concluded that the allegations at issue did not qualify as an "occurrence."

The Third Circuit agreed that the claims against Parkshore did not qualify as having been caused by an "occurrence." While the court's rationale for its decision was sparse, a reading between the lines demonstrates how it went down.

The court observed that, while subcontractors did all of the work at the condominium project, the whole project nonetheless was Parkshore's "own work" because Parkshore was the general contractor. *Id.* at 6, n.3. Parkshore maintained that defective workmanship performed by its subcontractors, which caused damage to its non-defective work, qualified as "property damage" caused by an "occurrence," and, thus, was covered under its CGL policy. *Id.* at 4.

In other words, even if Parkshore couldn't get away from the fact that no coverage was owed for the faulty workmanship of its subcontractors, Parkshore was at least seeking coverage for damage to its non-defective work that was caused by sub-contractors. Thus, while the decision does not say so, in so many words, there is little doubt that Parkshore was seeking coverage, for its non-defective work, under the sub-contractor exception to the "your work" exclusion.

However, because the Third Circuit held that the claims against Parkshore did not qualify as having been caused by an "occurrence," the decision ended there and the court never had a reason to reach the "your work" exclusion," and, more importantly, its sub-contractor exception.

Lastly, the court also rejected Parkshore's attempt to supports its position by relying on the commentary of the Insurance Services Office's 1986 edition of the CGL coverage form and by evaluating the CGL exclusions to determine the intent of the coverage. The court stated: "We have considered these arguments and find that they are not persuasive in establishing an 'occurrence' under the CGL policy." *Id.* at 5, n.2. While Parkshore addresses New Jersey law, this pronouncement could be relevant in construction defect cases that come before the Third Circuit under Pennsylvania and Delaware law.

A copy of the Third Circuit's December 10th decision in *Pa. Nat. Mut. Cas. Ins. Co. v. Parkshore Development Corp*. can be accessed here:

http://www.ca3.uscourts.gov/opinarch/093821np.pdf

Please let me know if you have any questions.
Randy

Randy J. Maniloff
White and Williams LLP
1800 One Liberty Place | Philadelphia, PA 19103-7395
Direct Dial: 215.864.6311 | Direct Fax: 215.789.7608
maniloffr@whiteandwilliams.com