

Insurers of General Contractors Can No Longer Hide Behind Business Risk in Refusing to Defend Their Insureds in Construction Defect Litigation

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Generally speaking, a contractor's **commercial general liability ("CGL")** policy is designed to cover personal injury or property damage caused by an accident resulting from the contractor's work. The policy is not meant to be a guarantee of the contractor's work and therefore does not cover damages to the work itself – instead, these are known as "business risk" damages. The concept that is inherent in every agreement for the performance of construction work is the risk that the work will be done improperly.

By selecting a particular contractor, the owner has to make a business judgment as to the qualifications and reliability of the selected contractor, and therefore assumes the risk that the work will be done incorrectly. If the work is done improperly and needs to be corrected, the contractor, and ultimately the owner, bears the burden of repairing or fixing that faulty work. The contractor's insurance is not a performance bond guaranteeing the work; instead, the commercial general liability insurance is designed to cover any unexpected damages that arise from the contractor's work, such as damage to other property caused by the faulty work.

Consider a roofer hired to install a new roof on a building. Once completed, the roof is the roofing contractor's "work." If the roofer installs the wrong type of shingles, but does everything else correctly, the only "damage" to speak of would be to the roof shingles themselves, *i.e.* the roofer's work. The cost of replacing the shingles is therefore that "business risk" not covered by insurance.

If, on the other hand, the roofing contractor improperly installs the roof, and as a result water gets behind the shingles causing damage to the roof framing and interior ceilings – which would be considered as property not installed by the roofer – the consequential damages to the building flowing from the defective roof installation work would trigger the roofer's CGL insurance policy.

However, the concept that construction defects necessitating repairs to the defective work itself will not trigger coverage under a CGL policy is embodied in a policy exclusion known as "Your Work." The exclusion typically contains an exception, which renders the exclusion inapplicable when the "work" is performed by "subcontractors." This exclusion becomes extremely important in the case of a large construction project, such as a multi-building condominium development, where a general contractor is engaged to oversee the subcontractors it hires to perform all phases of construction

(foundation, framing, roofing, cladding, etc.).

Courts struggle with the question of what is considered the general contractor's "work" for insurance coverage purposes – is it the entire project, including all buildings and their exterior and interior components, and if so, what is the effect of those components having been installed by various subcontractors? Factor in allegations of interior water damage caused by improper installation of the exterior envelope and you have a fight over whether the alleged damages are solely to the general contractor's "work," and therefore, "business risk" damages not covered under the general contractor's policy, or consequential damages triggering the carrier's duty to defend.

A recent decision from the Appellate Division, however, has put that issue to rest, at least for the time being. Holding that allegations of damage to interior building elements (building sheathing, framing, etc.) caused by subcontractors' defective work constitute consequential damages under the general contractor's CGL policy, the Cypress Point Court rejected application of the business risk exclusion ("Your Work") and found that the carrier's duty to defend was triggered. ***Cypress Point Condo. Ass'n, Inc. v. Adria Towers, L.L.C.***, 2015 N.J. Super. LEXIS 114 (App. Div. July 9, 2015). The Appellate Court found that alleged damages to the common elements and unit interiors of a condominium building were consequential third party damage falling squarely within the policy's insuring agreement.

Key to the court's determination was "the developer's reasonable expectation that, for insurance risk purposes, the subcontractors' faulty workmanship is to be treated differently than the work of a general contractor." Ibid. Thus, consequential damages flowing from a subcontractor's work requiring repairs to property other than that subcontractor's work are separate and distinct from the cost of correcting the faulty work itself and therefore do not fall within the category of uninsurable business risks (*i.e.*, the business expense of repairing or replacing the defective work itself). Id. at 10-12.

Accordingly, as it stands, where a general contractor hires subcontractors to perform the actual construction work at a project, the general contractor's policy is triggered when a subcontractor's defective work causes damage to another subcontractor's work. While the general contractor's "work" may be the entire project, the business risk exclusion (damage to the deficient work not covered) is not triggered where that "work" is made up of the different work of subcontractors.

This does not mean, however, that coverage necessarily exists. Exclusions and other exclusionary provisions may ultimately apply to bar coverage and relieve the carrier of its indemnification obligations. Ultimate coverage determinations vary greatly and turn on the individual facts of each case as well as the specific exclusions contained within the policy.

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