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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

NJ Court Tees Up Fights On Building Defect Coverage Trigger

By **Jeff Sistrunk**

Law360, Los Angeles (October 17, 2017, 10:09 PM EDT) -- A New Jersey appeals court set the stage for high-stakes battles between policyholders and their insurers over insurance for construction defect liability claims by ruling last week that coverage extends until the nature and scope of the property damage becomes apparent.

In an Oct. 12 opinion, a panel of the state Appellate Division vacated a trial court's ruling that Selective Insurance Co. has no obligation to defend or indemnify HVAC subcontractor Air Master & Cooling Inc. in litigation over alleged defects at a condominium building. The lower court had ruled in Selective's favor based on its conclusion that the purported damage predated the insurer's policy period.

The appellate panel applied the so-called "continuous trigger" theory, under which a policyholder can access coverage for gradual damage under every policy in effect from the dates it worked on a construction project through the time the alleged damage materialized. To set boundaries, the panel held that the "last pull" of the trigger — that is, the ending or manifestation point — is the date on which the "essential nature" and scope of the property damage first becomes known, or should have become known.

From a practical standpoint, though, insurance attorneys say it is not entirely clear what sort of evidence will satisfy the Appellate Division's standard for the "last pull" in construction defect coverage cases. As a result, it will be more difficult for either policyholders or their insurance carriers to quickly obtain summary judgment on the trigger issue, according to attorneys.

"It is an interesting ruling because it all but assures you are not going to have summary judgment motion practice on trigger, because the issue is so fact-intensive," said Lynda Bennett, chair of Lowenstein Sandler LLP's insurance recovery group. "It is a 'we'll know it when we see it' type of standard."

And as Anderson Kill PC shareholder Robert Chesler explained, the determination of the property damage's manifestation date can have major financial implications for policyholders.

"This is a critical issue," Chesler said. "If you push the manifestation date back, you would lose some valuable coverage."

The case stems from Air Master's HVAC work on a 101-unit condominium building in Montclair, New

Jersey, between November 2005 and April 2008. Several years after the project's completion, the condominium owners association and a pair of individual residents launched litigation against the developer and others, alleging property damage from water infiltration tied to shoddy workmanship. Air Master was later hit with a third-party complaint accusing it of failing to properly install condensers on the building's roof.

According to court papers, Selective had issued Air Master an "occurrence-based" general liability policy that covered bodily injury and property damage taking place during the policy period of June 2009 through June 2012. The insurer disclaimed coverage on the grounds that the alleged property damage had occurred prior to the inception of its policy.

In the ensuing coverage case, a New Jersey judge ultimately found that the continuous trigger applied to the claims against Air Master, but still held that Selective had no coverage obligations because the damage had in fact manifested before June 2009.

On appeal, Air Master pressed what the Appellate Division panel deemed a "novel conceptual argument": that the end date for the continuous trigger doesn't occur until an expert report or some other proof definitively establishes that the policyholder's faulty work caused the alleged damage.

But the panel agreed with the lower court that it would be "unwise" to delay the coverage trigger date while waiting on such proof, saying that approach could put insurers that write occurrence-based policies on the hook for more risk than they signed up for.

"Adopting such an approach would likely escalate premiums, or, even worse, deter insurers from writing new [commercial general liability] policies altogether, lest they be entangled in covering losses that had manifested long ago," Judge Jack M. Sabatino wrote.

Instead, the appellate panel took a decidedly down-the-middle approach with its standard for determining the "last pull" of the continuous trigger. While "merely tentative" evidence such as a tenant's observation of a water leak is insufficient to establish that end point, "definitive or comprehensive" evidence such as an expert report assigning fault for the damage to the policyholder isn't required either, the panel said. Citing a lack of evidence on the timing of the damage at the Montclair building, the panel vacated the lower court's judgment for Selective and remanded the case.

According to attorneys interviewed by Law360, the Appellate Division's guidance on what constitutes the "last pull," or manifestation, in the continuous trigger analysis raises as many questions as it answers. That ambiguity may make it tough for insurance carriers to assess whether — and to what extent — they must provide coverage for policyholders facing third-party claims over construction defects, attorneys say.

"The Appellate Division's definition of 'manifestation' is somewhat amorphous and creates a gray area," said Clark & Fox partner Michael Savett, who represents insurers. "On one hand, the court states that manifestation must be something more than ‘merely tentative,' yet it need not be ‘definitive or comprehensive.’ That still makes it difficult to pinpoint where that middle ground lies for allocation purposes. If discovery doesn’t allow the insurers to identify that manifestation cutoff, the carriers may very well attempt to share costs and indemnity on an equal basis rather than an equitable one.”

Indeed, said Anderson Kill's Chesler, deciphering at what point the "essential nature" and scope of the claimed damage becomes known will now be a key point of contention in similar coverage disputes.

"It would be some type of report, just short of an expert's report, but you would need something fairly solid," Chesler said. "It wouldn't be some tenant or owner saying they have seen water coming in."

According to Lowenstein Sandler's Bennett, one common type of evidence found in construction defect cases that may fulfill the Appellate Division's manifestation standard is a "transition report" requested by a condominium association's board as it is transitioning to unit owner control.

"The unit owner-controlled board always brings in an engineer to do a high-level 'kick the tires' analysis to see if any problems exist," Bennett said.

If the engineer does identify potential defects in a building, the date of that discovery could serve as the manifestation point for the continuous trigger analysis, attorneys say. The transition report would then become the "baseline," with insurers "trying to move the dates either earlier or later," according to Bennett.

"The insurers that are on the hook for the later period of time will pursue discovery to try to establish a last pull prior to the transition, while insurers in the earlier period may try to argue that the transition report was vague and attempt to place it in the later period to add more insurers to the allocation pool," Bennett said.

Attorneys who represent policyholders expressed concerns that the Appellate Division's decision is inconsistent with the spirit of the New Jersey Supreme Court's landmark 1994 ruling in Owens-Illinois Inc. v. United Insurance Co., which applied the continuous trigger in a dispute over coverage for asbestos-related bodily injury claims. As noted by the appellate panel in Air Master's case, the New Jersey justices endorsed the continuous trigger in the asbestos context in Owens-Illinois because it maximized coverage.

By tying the "last pull" of the trigger to the date that anyone — not just the policyholder — knew about the alleged property damage, the Appellate Division's ruling could prematurely cut off coverage for third-party construction defect claims, some attorneys say.

"If these residents knew about this and didn't sue the insured for four years, why should the insured lose coverage for the four years when it is going to be held liable for alleged damage for those years?" Bennett said. "The decision is not maximizing coverage — which Owens-Illinois says it should — and it's cutting off coverage for damage before the insured even knew about it."

The case is Air Master & Cooling Inc. v. Selective Insurance Co., case number A-5415-15T3, in the Superior Court of the State of New Jersey, Appellate Division.

--Editing by Kat Laskowski and Breda Lund.