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How Different Design-Build Contracts Impact Your Bottom-line, and a Comparison of the New Design-Build Agreement from ConsensusDocs, DBIA, & AIA

Brian Perlberg, ConsensusDocs

This May 4th WebEd will analyze the essential elements of design-build contracts and point out differences and similarities in standard design-build contracts. This chart lays out major differences. Register here with the code CD100 for a 20% discount of $79.

Who Pays For Delay? How Enforceable Is A No Damage For Delay Clause?

Eugene Polyak, Smith Currie & Hancock, LLP

Delays are an all too common occurrence on construction projects. And they almost always cost money. So who pays for the increased costs caused by delays? This is one of the most durable issues in all of construction contract law. The answer is—it depends. It depends first on whether the risk of delay is addressed in the parties' contract. Owners and contractors frequently use No Damage for Delay clauses to push down the risk of delay costs. It may also depend on the law of the state where the project is performed. No Damage for Delay clauses are not uniformly enforced in different jurisdictions.

Construction delays are not only common, they are also complicated. Some would argue that the cost of delay should always be paid by the party causing the delay. Unfortunately, causation is not always clear. Two or more parties may be responsible for independent, concurrent delays. How to analyze responsibility for delay is an issue we will address in a future edition. In this article we will focus on No Damage for Delay clauses. Properly drafted in the right jurisdiction, a No Damage for Delay clause can make an expensive fight over responsibility unnecessary. Contractors and subcontractors faced with No Damage for Delay clauses can adjust their prices to account for increased risk or, in some cases, elect to pursue other opportunities.

Contracts Matter

Allocating risk for delay caused costs can be part of the contracting process. Construction contracts frequently include some type of No Damage for Delay clause. For example:

> No payment or compensation of any kind shall be made to the Contractor for damages because of hindrance or delay from any cause in the progress of the work, whether such hindrances or delays are avoidable or unavoidable; or,
>
> Contractor agrees that it may be subject to delay in the progress of the work and that the sole remedy for such delay shall be an extension of time; or,
>
> In the event the subcontractor's performance of this subcontract is delayed by acts or omissions of the owner, contractor or other subcontractors, subcontractor may request an extension of time for the performance of this subcontract, but shall not be entitled to any increase in the subcontract price or to damages or additional compensation as a consequence of such delays.

Subject to some exceptions, the more typical of which are discussed below, courts generally enforce No Damage for Delay clauses. One way for contractors and subcontractors to avoid such clauses is to use an unmodified industry form agreement such as ConsensusDocs 200 - Agreement and General Conditions Between Owner and Constructor or ConsensusDocs 750 - Agreement Between Constructor and Subcontractor which do not have No Damage for Delay clauses. But many owners and contractors will use their own form which will frequently include a No Damage for Delay clause.

Even if the contract includes a No Damage for Delay clause, the clause may prove to be unenforceable.

Understanding The Legal Exceptions To No Damage For Delay Clauses

Most jurisdictions throughout the country recognize the validity of No Damage for Delay clauses. Some states however have enacted statutes limiting such clauses. For example, in public construction contracts in California, Colorado, Kansas, Louisiana, Minnesota, Missouri, New Jersey, North Carolina, Oregon, and Virginia, under certain circumstances, if the delay is caused by the public entity, No Damage for Delay clauses are void.[i] In Kentucky, Ohio, and Washington, under certain circumstances, No Damage for Delay clauses are void in both private and public construction contracts.[ii]

Most jurisdictions where No Damage for Delay clauses are enforced have also developed several judicially created exceptions to the clause's enforceability. The most common exceptions typically involve delays caused by:

(i) active interference, fraud, misrepresentation, other bad faith; or gross negligence by the party seeking to enforce the No Damage for Delay clause;

(ii) delay which has extended such an unreasonable length of time that the party delayed would have been justified in abandoning the contract;

(iii) delay that was not contemplated by the parties; and

(iv) delay resulting in a breach of a fundamental obligation of the contract.

These exceptions are generally based on the implied obligation of good faith and fair dealing in all contracts including the implied promise not to hinder or impede performance. They are highly fact specific and their application, as well as the availability of additional exceptions, varies from jurisdiction to jurisdiction.

Active interference, fraud, misrepresentation, or other bad faith or grossly negligent conduct.

Courts have not provided a uniform definition as to what constitutes active interference. In most jurisdictions, proving active interference requires a showing of some affirmative, willful conduct which is greater than ordinary negligence or passive omission. A simple mistake, oversight, error in judgment, lack of effort, or lack of diligence will generally not suffice to invalidate the clause.[iii]

For example, one court found that active interference can be established where a party issues a notice to proceed to the contractor despite knowledge of delay-causing conditions which increased costs because of the contractor's premature commencement of the work.[iv] Conversely, a claim of active interference was not supported where the party issuing the notice to proceed was unaware of the delay-causing conditions.[v]

Bad faith typically involves a conscious doing of a wrong.[vi] For example, a design professional's knowledge of a defect in the plans and failure to apprise contractor of the problem while simultaneously agreeing to investigate the issue during the value engineering process was sufficient to submit the issue of delay damages to the jury.[vii] However, mere mistakes in judgement or mismanagement of the project are not typically sufficient to establish bad faith.[viii]

Similarly, gross negligence typically differs from ordinary negligence and involves a showing of conduct that evinces a reckless disregard for the rights of others or smacks of intentional wrongdoing.[ix]

Delay justifying abandonment of the contract.

Courts have not identified a minimum quantity of delay which is necessary to qualify as delay justifying abandonment of the contract. A 90-day delay has been found not unreasonable[x] while a 2 ½ year delay was deemed sufficiently unreasonable to submit the issue to the jury.[xi] This exception is highly fact specific and the length of delay is not dispositive. Rather, oftentimes courts examine if the delay was so unreasonable as to signal a relinquishment of the contract by the party now seeking to enforce the No Damage for Delay clause.[xii] Thus, evidence that the party seeking to enforce the No Damage for Delay clause was working in good faith to complete the project could potentially support enforcement of a No Damage for Delay clause.

Delay uncontemplated by the parties.

There is a split among the various jurisdictions as to the viability of this exception.[xiii] While some courts recognize this exception, others have found that uncontemplated delays are the main reason for including a No Damage for Delay clause. Where the exception is recognized, the party seeking to establish delay damages must show that the delays were not reasonably foreseeable by both parties to the contract.[xiv] To that end, courts have held that, for example, poor planning by the owner, a general contractor's inept administration of its contract, other prime contractors' inaction and faulty performance are all contemplated delays.

Delay resulting in a breach of a fundamental obligation of the contract.

This exception is fairly rare. To establish this exception, a party must prove that the other party violated a provision going to the very heart of the contract thereby depriving the other party of its ability to perform under the contract. One example would be an owner's failure to obtain title to the work site or make it available to the contractor so that it may commence construction.[xv]

Acting With A Purpose

The final step in minimizing risk of paying for delays involves being proactive during the project to protect your rights. Understand the law in your jurisdiction with respect to No Damage for Delay claims and you can put yourself in a favorable position to prosecute or avoid a claim.

For example, if you are the owner, do not wrongfully withhold payment. Agree to consider all properly supported claims. At the same time, be sure to not to waive your No Damage for Delay defense by paying the contractor for delays covered by the No Damage for Delay clause during the project or promising the contractor that you will not seek to enforce the No Damage for Delay clause. Similarly, if the contract requires you to provide an extension of time be sure you actually do so after proper requests under the contract have been made. Even if delays have occurred, be sure that you have documentary evidence showing that you are continuing to diligently work toward completing the project.

If you are the contractor or subcontractor, it is important to meticulously document, and provide timely notices of, the nature and cause of the delay, active interference, fraud, misrepresentation, gross negligence or bad faith by the other party. In the event of litigation such documentation will frequently make the foundation of a winning case.

No Damage for Delay clauses and related jurisprudence are fraught with traps for the unwary. Project participants can gain an advantage by having competent counsel at their side throughout the process.

Smith, Currie & Hancock LLP is a national boutique law firm that has provided sophisticated legal advice and strategic counsel to our construction industry and government contractor clients for fifty years. We pride ourselves on staying current with the most recent trends in the law, whether it be recent court opinions, board decisions, agency regulations, current legislation, or other topics of interest. Smith Currie publishes a newsletter for the industry "Common Sense Contract Law" that is available on our website: **www.SmithCurrie.com**.

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Insurance Coverage for Property Damage Caused by Defective Workmanship

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The New Jersey Supreme Court has joined a growing number of jurisdictions holding that commercial general liability (CGL) insurance policies may provide insurance coverage to insured general contractors when property damage is the result of defective work performed on the general contractor's behalf by a subcontractor. *Cypress Point Condo. Ass'n v. Adria Towers, L.L.C.*, 226 N.J. 403, 143 A.3d 273 (N.J. 2016). To put the holding in *Cypress Point* in perspective, some background will be helpful.

Standard ISO CGL Forms

Since 1971, the Insurance Services Office, Inc. (ISO) has published standard forms of insurance policies. ISO is an organization of insurance companies that provides, among other things, policy-writing services to its member insurers for various lines of insurance, including CGL insurance. The CGL policy form was published by ISO in 1973 and revised in 1986, 1988, 1993, 1998, 2001, 2004, 2007 and 2013. The most significant changes occurred between the 1973 form and the 1986 form. For this reason, all of the revisions in and after 1986 are generally referred to as the 1986 form or the "post-1986" form. When evaluating insurance coverage for defective construction, it is important to be cognizant of the evolution of the ISO forms because cases decided under the 1973 form generally will not be applicable to cases arising under the 1986 form.

Insuring Agreement

The ISO CGL policy form contains a broad "insuring agreement" that, in the first instance, grants coverage. See, for example, ISO CGL Policy Form (CG 00 01 12 07) (December 2007):

> **SECTION 1 – COVERAGES**
> **COVERAGE A BODILY INJURY AND PROPERTY DAMAGE COVERAGE**
> **1. Insuring Agreement**
> **a.** We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. [*emphasis added*]
>
> * * *
>
> **b.** This insurance applies to "bodily injury" and "property damage" only if:
> (1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory"; [e*mphasis added*]
>
> * * *

The insuring agreements in the 1973 form and the 1986 form are substantially similar. Both provide that the insurer will pay "those sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage" caused by an "occurrence." It should be noted that there is nothing on the face of the insuring agreement that limits the insurer's obligation to pay to sums that the insured is legally obligated to pay for claims sounding in tort (as opposed to claims sounding in contract).

The insuring agreement is followed by a number of exclusions that operate to limit the otherwise broad coverage granted by the insuring agreement. Some of the exclusions are subject to exceptions (which are stated in the exclusion itself). It is well-established that an exception to an exclusion does not create coverage, however. *See Auto-Owners Ins. Co. v. Home Pride Cos.*, 684 N.W.2d 571, 575-76 (Neb. 2004) (holding that an exception to an exclusion does not provide insurance coverage and that an exception to an exclusion is irrelevant until two conditions are met: (1) there is an initial grant of coverage and (2) the exclusion to which the exception applies operates to preclude coverage).

What Triggers Coverage (an Occurrence)

The definitions of "occurrence" in the 1973 form and the 1986 form are similar but not identical. The 1973 form defines occurrence as "as an accident . . . which results in . . . property damage neither expected nor intended from the standpoint of the insured," while the 1986 form defines occurrence as "an accident," including "continuous or repeated exposure to substantially the same general conditions." In both policy forms, the bodily injury or property damages cannot have been expected or intended by the insured. In the 1973 form, this is part of the definition itself. In the post-1986 form, the exclusion of expected or intended injury is made part of Exclusion (a), but the result is the same.

Defective Work as an Occurrence

One of the principal points of contention between insurers and insureds is whether defective construction work is, or can be, an occurrence, thereby triggering coverage. Some courts hold, as a matter of law, that defective construction cannot be an occurrence because the performance of construction work is a volitional act, intentionally performed by the insured. *See Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888 (Pa. 2006). The insurance policy at issue in *Kvaerner* contained a broad form property damage endorsement[1] (Endorsement 16) that provided that the "your work" exclusion "does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor." Nonetheless, the *Kvaerner* court held that:

> the definition of "accident" required to establish an "occurrence" under the policies cannot be satisfied by claims based on faulty workmanship. Such [faulty workmanship] claims simply do not present the degree of fortuity contemplated by the ordinary definition of "accident" or its common judicial construction in this context. To hold otherwise would be to convert a policy of insurance into a performance bond. We are unwilling to do so, especially since such protections are already readily available for the protection of contractors. 908 A.2d at 899.

Exclusions Generally (and Exceptions to Exclusions)

As noted above, exclusions limit the otherwise broad grant of insurance coverage contained in the insuring agreement. Exclusions, however, are subject to certain exceptions that, in effect, restore the coverage that would have been eliminated by the exclusion.

We begin by examining several of the exclusions under the 1973 form. Exclusion (k) of the 1973 form provided that "this insurance does not apply . . . (k) to property damage to (1) property owned or occupied by or rented to the insured, (2) property used by the insured, or (3) property in the care, custody, or control of the insured or as to which the insured is for any purpose exercising physical control . . . ." [*emphasis added*]. Thus, Exclusion (k) effectively, by its terms, precluded coverage for damage to property being worked on by a contractor.

[1] From 1976 until 1986, ISO offered a "broad form property damage" endorsement, for an additional premium, that provided coverage for property damage arising from work performed on behalf of the insured contractor, by subcontractors. This feature is now an integral part of the post-1986 form. See discussion below.

In addition, Exclusion (o) in the 1973 form also excluded coverage for "property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts, or equipment furnished in connection therewith." [*emphasis added*].

Therefore, in practical effect, under the 1973 form, there was no coverage for property damage to property in the care, custody or control of the insured and no coverage for damage to the work arising out of the work, regardless of whether the work was performed directly by the named insured or performed on behalf of the named insured by a subcontractor.

Broad Form Property Damage Liability Coverage

In 1976, the ISO issued an endorsement known as the Broad Form Comprehensive General Liability Endorsement. Part VI of the endorsement provided for Broad Form Property Damage Liability (Including Completed Operations) (the BFPD Endorsement). The BFPD Endorsement replaced Exclusion (k) and Exclusion (o) with new language. Specifically, the damage to property Exclusion (k) was limited to damage to "that particular part" of any property on which operations were being performed by, or on behalf of, the named insured. Thus, with the BFPD Endorsement in place (for the payment of an additional premium), it was only the property damage to "that particular part" of the property that had defective work performed on it that was excluded from coverage. Property damage to other property was, by operation of the BFPD Endorsement, now covered. Similarly, with respect to Exclusion (o), the BFPD Endorsement deleted the phrase "or on behalf of [the named insured]," thereby providing coverage for damage to work performed by subcontractors of the named insured.

A number of cases construed the 1973 ISO form with the BFPD Endorsement to provide coverage when the defective work was performed by subcontractors. In 1988, the leading case to construe the "work performed" exclusion in light of a BFPD Endorsement was decided by the U.S. Court of Appeals for the Ninth Circuit. *Fireguard Sprinkler Sys., Inc. v. Scottsdale Ins. Co.*, 864 F.2d 648 (9th Cir. 1988) (applying Oregon law). Fireguard entered into a contract to upgrade a fire protection system at a sawmill in Washington state and hired a subcontractor to design and construct a water tank (including site preparation). After the project was completed and accepted by the owner, a landslide destroyed the tank and other parts of the project, and the owner sued Fireguard. The court held that the modified "work performed" exclusion did not exclude coverage under Fireguard's general liability insurance because the damages arose out of work performed by a subcontractor. The court reached this conclusion, in part, on the basis of an insurance industry publication known as a "Fire, Casualty and Surety Bulletin," published by the National Underwriters Association in 1982, that explained the intent of the BFPD Endorsement as follows:

> [A]n insured has coverage for his completed work when the damage arises out of work performed by someone other than the named insured, such as a subcontractor. And the insured has coverage for damage to the work of others that arises from the named insured's work. The usual Completed Operations coverage (no Broad Form Property Damage endorsement attached) flatly excludes property damage to work performed by or on behalf of the named insured arising out of the work. Under the usual coverage, then the insured has no insurance whatsoever, for damage to a subcontractor's work or for damage to his work resulting from

> a subcontractor's work. Therein lies the advantage of Broad Form Property Damage coverage including Completed Operations. Consequently, if an insured does not anticipate using subcontractors, the value of purchasing Broad Form Property Damage Coverage with Completed Operations is questionable, in view of the additional premium required for it. 864 F.2d at 652.

Other jurisdictions followed *Fireguard* in interpreting the 1973 form with the BFPD Endorsement. *See M. Mooney Corp. v. USF&G*, 136 N.H. 463, 618 A.2d 793 (N.H. 1992) (construing the 1973 form, where, as a result of subcontractor's faulty work, fire occurred in one condominium, costs to repair all condominiums and resulting loss of use were covered under general contractor's insurance); *McKellar Dev. of Nevada, Inc. v. N. Ins. Co.*, 837 P.2d 858 (Nev. 1992) (damage to apartment buildings that were "falling apart" as a result of improper soil compaction performed by a subcontractor was covered under general contractor's liability insurance with BFPD Endorsement).

That is the way things stood from 1976 until 1986, when the ISO issued a revised standard CGL policy. Starting in 1986 and continuing to the present, the standard policy has included the Broad Form Property Damage coverage as part of the completed operations hazard. Exclusion (l) in the current form provides as follows:

> This insurance does not apply to:
>
> l. "Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard."
>
> <u>This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor</u>. [*emphasis added*].

Note that, by its express terms, in the 1986 form, the "your work" exclusion will not apply to claims arising from work performed by subcontractors.

In light of this background, we turn now to the *Cypress Point* decision.

<u>The *Cypress Point* Decision</u>

The case arose from the construction of Cypress Point, a luxury condominium complex in Hoboken, New Jersey. The project developer also served as the general contractor and hired subcontractors to perform most of the work. The developer as general contractor obtained a total of seven CGL policies modeled after the 1986 ISO policy form — four policies covering a four-year period and three covering a subsequent three-year period. After completion of the complex, residents began experiencing problems, such as roof leaks and water infiltration around windows in units and common areas.

The condominium association brought an action against the developer and several subcontractors, alleging faulty workmanship during construction and claiming various consequential damages. The association alleged that the subcontractors' faulty workmanship during construction — including, but not limited to, defectively built or installed roofs, gutters, brick facades, EIFS (exterior insulation and finish system), windows, doors and sealants —

caused consequential damage to steel supports; exterior and interior sheathing, sheetrock and insulation; the common areas; interior structures; and residential units. The complaint asserted claims of negligence, breach of express warranties, breach of implied warranties, negligent misrepresentation, and breach of contract.

The complaint was eventually amended to include a claim by the association seeking a determination (a declaratory judgment) as to whether the association's claims against the developer were covered by the developer's CGL policies. The insurers moved for summary judgment, arguing that they were not liable because the subcontractors' faulty workmanship did not constitute an "occurrence" that caused "property damage" under the policies. The trial court granted summary judgment because the damages arose entirely from faulty work performed by, or on behalf of, the developer.

The Appellate Division reversed the trial court's grant of summary judgment in favor of the insurers:

> We hold that the unintended and unexpected consequential damages caused by the subcontractors' defective work constitute "property damage" and an "occurrence" under the policy. We base this holding in part on 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. We reach that conclusion by viewing the policy as a whole and distinguishing *Weedo v. Stone-E-Brick, Inc., 81 N.J. 233, 405 A.2d 788 (1979)*, and *Firemen's Insurance Co. of Newark v. National Union Fire Insurance Co.*, *387 N.J. Super. 434, 904 A.2d 754 (App.Div.2006)*, two opinions construing ISO's 1973 standard CGL form (the "1973 ISO form"). *Cypress Point Condo. Ass'n v. Adria Towers, L.L.C.*, 441 N.J. Super. 369, 373, 118 A.3d 1080, 1083 (N.J. App. Div. 2015).

The Appellate Division distinguished *Weedo* and *Fireman's Insurance* "because they (1) involved only replacement costs flowing from a business risk, rather than consequential damages caused by defective work; and (2) interpreted different language than the policy language in this appeal." *Id*. at 441 N.J. Super. 369, 378, 118 A.3d 1080, 1085.

The New Jersey Supreme Court affirmed the Appellate Division and held that "the term 'accident' in the policies at issue encompasses unintended and unexpected harm caused by negligent conduct. That construction of the term 'accident' as relates to an 'occurrence' in a CGL policy aligns with both the commonly accepted definitions of 'accident' and the legal import given to the term by both this and other jurisdictions," citing, among other cases, *American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W. 2d 65, 70 (Wis. 2004) (finding an "accident" and therefore an "occurrence" when "neither the cause nor the harm was intended, anticipated or expected"). *Cypress Point Condo. Ass'n*, 226 N.J. 403, 427, 143 A.3d 273, 287.

Applying that definition, the court then turned to the question of whether the consequential water damage to the completed, nondefective portions of Cypress Point resulting from the subcontractors' poor workmanship was foreseeable. The court summarized the argument of the insurers as follows:

> Here, no one claims that the subcontractors intentionally performed substandard work that led to the water damage. Rather, relying on *Weedo*, the insurers assert that damage to an insured's work caused by a subcontractor's faulty workmanship is foreseeable to the insured developer because damage to any portion of the completed project is the normal, predictable risk of doing business. Thus, in the insurers' view, a developer's failure to ensure that a subcontractor's work is sound results in a breach of contract, not a covered "accident" (or "occurrence") under the terms of the policies. 226 N.J. 403, 427,143 A.3d 273, 287.

The court disagreed and held that the argument that a breach of contract cannot give rise to a covered "occurrence" is not consistent with the express policy language, citing *American Family Mut. Ins. Co. v. American Girl, Inc.*, and *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 971 (Fla. 2007) (rejecting CGL insurer's "argument that a breach of contract can never result in an 'accident,'" because such an assertion "is not supported by the plain language of the policies"). *Cypress Point Condo. Ass'n*, 226 N.J. 403, 427,143 A.3d 273, 287.

The court then turned to the final two steps of its analysis "in which we examine the policies' pertinent exclusions, and then, if applicable any exceptions to those exclusions." *Id*. In concluding that consequential water damage to the competed portions of the Cypress Point project were covered losses, the court held that the subcontractor exception to the "your work" exclusion provided coverage:

> The policies at issue here, like those in *Weedo* and *Firemen's*, contain numerous exclusions eliminating coverage for a variety of business risks including the cost of repairing damage to the contractor's own work--the "your work" exclusion. As outlined above, the "your work" exclusion precludes coverage under the policies for " 'property damage' to 'your work' arising out of it or any part of it." Thus, under the second step of our three-part analysis, and viewing that exclusion in isolation, the policies would seem to eliminate coverage for the water damage to the completed sections of Cypress Point.
>
> However, the "your work" exclusion contains an important exception that "narrow[s] the exclusion by expressly declaring that it does not apply 'if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.' " This exception to the "your work" exclusion was not contained in the [1973] ISO CGL form, but unquestionably applies in this case. Accordingly, the third and final step of our inquiry compels the conclusion that, because the water damage to the completed portions of Cypress Point is alleged to have arisen out of faulty workmanship performed by subcontractors, it is a covered loss. 226 N.J. 403, 429-30,143 A.3d 273, 289 (internal citations omitted).

With its decision in *Cypress Point*, the New Jersey Supreme Court joins a growing trend in the state and federal courts. In the next section, we review the cases in Wisconsin and Florida cited by the court in *Cypress Point*.

Wisconsin (*American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004))

The Supreme Court of Wisconsin was among the first to address CGL coverage for damage caused by defective construction in accordance with the terms of the post-1986 policy form. In *American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004), the court held that, when defective soil compaction performed by a subcontractor caused structural damage to a large warehouse facility that rendered the building unsafe and resulted in the demolition of the entire building, the contractor had coverage under its CGL policy. The court summarized the three steps in its analysis as follows:

> Our procedure follows three steps. First, the court examines the facts of the insured's claim to determine whether the policy's insuring agreement makes an initial grant of coverage. If it is clear that the policy was not intended to cover the claim asserted, the analysis ends there. If the claim triggers the initial grant of coverage in the insuring agreement, the court next examines the various exclusions to see whether any of them preclude coverage of the present claim. Exclusions are narrowly or strictly construed against the insurer if their effect is uncertain. The court analyzes each exclusion separately; the inapplicability of one exclusion will not reinstate coverage where another exclusion has precluded it. Exclusions sometimes have exceptions; if a particular exclusion applies, the court then looks to see whether any exception to that exclusion reinstates coverage. An exception pertains only to the exclusion clause within which it appears; the applicability of an exception will not create coverage if the insuring agreement precludes it or if a separate exclusion applies. *Id.* at 73.

The insurer argued that, because the claims against the insured contractor arose from its contract, the economic loss doctrine precluded recovery in tort. The court held that the language of the CGL policy can provide coverage for claims sounding in breach of contract in some instances, noting that "the question here is not whether [the building owner] is confined to a contract remedy rather than a tort remedy in its claim against the contractor (we assumed for the purposes of this opinion that it is), but whether [the contractor's] insurance policy covers the loss." *Id.* at 75, n. 4. The court held that the contracting parties allocated their risks by contract, and the contractor insured against that risk when subcontractor fault gives rise to liability under the warranty, because the underlying insurance policies contained a subcontractor exception to the business risk exclusion. *Id.* The court acknowledged that CGL policies do not generally cover contract claims arising out of the insured's defective work or product, "but this is by operation of the business risk exclusions, not because a loss actionable only in contract can never be an occurrence within the CGL's initial grant of coverage." *Id.* at 76.

The court held that there had been an occurrence because "no one seriously contends that the property damage to [the building] was anything but accidental (it was clearly not intentional), nor does anyone argue that it was anticipated by the parties." *Id.*

The court then turned to the exclusions. The court held that Exclusion (a), which eliminates coverage for "'property damage' expected or intended from the standpoint of the insured," did

not apply, as there was no evidence that the extreme settlement that occurred was expected or intended. The court held that Exclusion (b), the exclusion of contractually assumed liability, applies only to the assumption of the liability of a third party, as in an indemnification or hold-harmless agreement. *Id*. at 81. Finally, the court evaluated the business risk exclusions and held that the contractor's work plainly fell within the policy definition of "your work" and that under Exclusion (l) the subcontractor exception applied. After summarizing the changes to the CGL policy in 1986, the court held that:

> Cases in Wisconsin and in other jurisdictions have consistently recognized that the 1986 CGL revisions restored otherwise excluded coverage for damage caused to construction projects by subcontractor negligence. In *Kalchthaler [v. Keller Constr. Co., 591 N.W.2d 169 (Wis. App. 1999)]*, the court of appeals concluded that 'the only reasonable reading of [the 1986 exception] is that it restores coverage for damage to completed work caused by the work of a subcontractor. 673 N.W.2d at 83.

Florida (*U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 971 (Fla. 2007))

The Supreme Court of Florida has held that defective construction performed by a subcontractor can be an occurrence under a post-1986 CGL policy, regardless of whether the resulting damages is to a third party or the property of a third party or to the completed project itself. *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 971 (Fla. 2007). There, J.S.U.B., as general contractor, contracted for the construction of several homes. After completion and delivery of the homes, damage to the foundations, drywall and other interior portions of the homes appeared. It was undisputed that the damage was caused by a subcontractor's use of poor soil and improper compaction of the soil beneath the foundations.

The issue before the court was "whether a post-1986 standard form commercial general liability policy with products-completed operations hazard coverage, issued to a general contractor, provides coverage when a claim is made against the contractor for damage to the completed project caused by a subcontractor's defective work." *Id.* at 877. The insurer did not argue that any of the policy exclusions apply to bar coverage. *Id*.

U.S. Fire argued that a subcontractor's faulty workmanship that damages the contractor's own work can never be an "accident" because its results in foreseeable damages. In rejecting any distinction between faulty workmanship that damages the contractor's work from faulty workmanship that damages the property of a third party, the court held that:

> we fail to see how defective work that results in a claim against the contractor because of injury to a third party or damage to a third party's property is "unforeseeable," while the same defective work that results in a claim against the contractor because of damage to the completed project is "foreseeable." This distinction would make the definition of "occurrence" dependent on which property was damaged. For example, applying U.S. Fire's interpretation in this case would make the subcontractor's improper soil compaction and testing an "occurrence" when it damages the homeowners' personal property, such as the wallpaper, but not an

> "occurrence" when it damages the homeowners' foundations and drywall. *Id.* at 883.

The appropriate consideration, the court held, is whether the damage was expected or intended from the point of view of the insured, not whose property was damaged. *Id.* at 885.

The court also rejected the insurer's argument that a breach of contract can never result in an accident based on the plain language of the policy, citing with approval *American Family Mut. Ins. Co.*, and held that, if U.S. Fire intended to preclude coverage based on the nature of the cause of action asserted against the insured, it was incumbent on U.S. Fire to include clear language to accomplish this result. 979 So.2d at 884.

The court summarized its holding as follows:

> We conclude that faulty workmanship that is neither intended nor expected from the standpoint of the contractor can constitute an "accident" and thus an "occurrence" under a post-1986 standard form CGL policy. We further conclude that physical injury to the completed project that occurs as a result of the defective work can constitute "property damage" as defined in a CGL policy. Accordingly, we hold that a post-1986 standard form commercial general liability policy with products completed-operations hazard coverage, issued to a general contractor, provides coverage for a claim made against the contractor for damage to the completed project caused by a subcontractor's defective work provided that there is no specific exclusion that otherwise excludes coverage. *Id.*

Conclusion

With its decision in *Cypress Point*, the New Jersey Supreme Court joins a growing number of state and federal courts holding that defective construction work performed by a subcontractor, on behalf of an insured contractor, is an "occurrence" and that resulting consequential damage to nondefective portions of the insured contractor's work, including nondefective work performed by other subcontractors of the insured contractor, is "property damage" for which there is coverage under the post-1986 CGL policy form.

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Trump Administration Immigration Policies May Impact the Construction Industry

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In February of this year, immigrants nationwide took part in a strike referred to as a "Day Without Immigrants." The strike, organized largely through social media, was a protest of the Trump Administration's immigration policies. Those participating in the protest refused to work or spend money. Some businesses closed their doors for the day. The goal was to demonstrate what an American economy without immigrants would look like and how the absence of immigrants would impact the goods, services, and industries Americans rely on.

One American industry that relies heavily on immigrant labor is construction. While the exact number of businesses and individuals that participated in the Day Without Immigrants strike is not known, some contractors reported labor shortages and construction project delays or temporary shut downs as a result of the protest. The project delays that resulted from the single day of protests highlight the impact that a reduction in immigrant labor would have on a construction industry already starving for workers.

The construction labor pool saw a major decline during the recent "Great Recession" from which it has never recovered. Some estimates peg the overall reduction in the construction labor pool at 23% when compared to 2007. According to a 2017 survey conducted by the Associated General Contractors, nationally, 66% of contractors report already having difficulty filling positions for hourly workers. And, 45% of the survey respondents expect continued difficulty in finding qualified construction professionals over the next 12 months. Meanwhile, 72% of those surveyed expect to increase their headcount in 2017. The supply of qualified construction workers is already insufficient to meet the industry's demand.

Unsurprisingly, worker shortages result in project delays. Indeed, some contractors report having to turn down projects because of insufficient workforce, especially where the projects come with a financial penalty for failing to complete on schedule. The risk of labor shortages is too great.

The U.S. construction industry depends on immigrants—both legal and undocumented. According to research from the National Association of Home Builders, nearly 30% of construction workers are foreign-born. A 2014 Pew Research Center survey found that undocumented immigrants account for 15% of all construction workers in the United States.

Changes to U.S. immigration policy and enforcement by the Trump Administration may exacerbate the existing construction labor shortage. President Trump's 2018 budget calls for the mandatory nationwide implementation of the E-Verify system, which checks an employee's Employment Eligibility Verification form (known as an I-9 form) against U.S. government records and facial image data to determine whether the individual is authorized to work in the United States. While a budget request does not by itself have legal effect on immigration policy, it serves as an indication of the President's legislative priorities. Indeed, legislation has already been proposed in the Senate that would make E-Verify mandatory for all employers, increase penalties (up to $25,000) for employers that hire undocumented workers, require employers to check the status of all employees not previously screened through E-Verify, and require employers to terminate unauthorized employees. The expansion of the E-Verify system would almost certainly result in a significant decrease in the employment of undocumented workers.

While the expansion of the E-Verify program has yet to be enacted, some new immigration policies are already in force. In January, President Trump signed two executive orders related to immigration. The orders include provisions for 5,000 additional Border Patrol agents and an additional 10,000 immigration officers who will be trained to search for, interrogate, detain, and arrest undocumented immigrants. One of the orders also directs the Department of Homeland Security to "to immediately construct, operate, control or establish contracts to construct, operate or control facilities to detain aliens at or near the land border with Mexico." Although President Trump had promised during his campaign to focus deportation efforts on criminals, the wording of his executive order is broad and provides for deportation of immigrants "convicted of any criminal offense" which could include misdemeanors. It also provides for the deportation of deportable immigrants that have been charged with, though not convicted, of any criminal offense and those who "in the judgment of an immigration officer, otherwise pose a risk to public safety or national security." This has caused significant cause for concern within the immigrant communities.

Given the construction industry's heavy reliance on immigrant labor, an increase in deportations has a strong likelihood or making existing labor shortages worse, which will most likely delay projects and increase costs. In a state like Texas, for example, where about 50% of the construction labor force is made up of undocumented workers, a crackdown on immigration could cripple the construction industry. Even the threat of increased enforcement may impact labor availability and cause project delays. Fears or rumors that deportation forces may show up at a jobsite could drive workers away or cause them to suddenly walk off a jobsite. Workers may also be less willing to speak up against unsafe or unfair conditions and may instead simply leave the current job at the first sign of trouble and move on to the next.

While the long term effects of these policies on the availability of construction labor remain to be seen, sudden labor reductions may have important short-term consequences for contractors. Those in the building trades should be aware that project delays resulting from labor shortages may trigger contractual rights to seek extensions of time or increases to the contract sum/consideration as a result of the unavoidable delay. For example, section 6.3 of Consensus Docs 200 Standard Agreement and General Conditions between Owner and Constructor provides that "[i]f Constructor is delayed at any time in the commencement or progress of the Work by any cause beyond the control of Constructor, Constructor shall be entitled to an equitable extension of the Contract Time". While this provision does not specifically identify labor shortages and strikes as an "unavoidable delay" entitling the contractor to an equitable extension, a good argument exists that such impacts qualify. When negotiating these contracts, contractors in high-risk markets may want to insert language to confirm that labor shortages, unavailability and strikes entitle the contractor to an equitable extension of the Contract Time.

Please also note that section 6.3 requires that "[i]f delays to the Work are encountered for any reason, Constructor shall provide prompt written notice to Owner of the cause of such delays after Constructor first recognizes the delay." Many contracts have similar requirements for prompt notice of any event that may result in a claim for additional time or an increase to the contract sum/consideration. Failure to give prompt notice as required by the contract may result in a waiver of such claims. Contractors impacted by sudden labor shortages, unavailability or strikes should review their contracts and give immediate notice of any potential claims.

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[i] Cal. Pub. Cont. Code § 7102; Colo. Rev. Stat. Ann. § 24-91-103.5; Kan. Stat. Ann. § 16-1907; La. Stat. Ann. § 38:2216; Minn. Stat. Ann. § 15.411; Mo. Ann. Stat. § 34.058; N.J. Stat. Ann. § 2A:58B-3; N.C. Gen. Stat. Ann. § 143-134.3; Or. Rev. Stat. Ann. § 279C.315; Va. Code Ann. § 2.2-4335.

[ii] Ky. Rev. Stat. Ann. § 371.405; Ohio Rev. Code Ann. § 4113.62; Wash. Rev. Code Ann. § 4.24.360.

[iii] *C & H Elec., Inc. v. Town of Bethel*, 312 Conn. 843, 858, 96 A.3d 477, 487 (2014); *Tricon Kent Co. v. Lafarge N. Am., Inc.*, 186 P.3d 155, 161 (Colo.Ct.App. 2008).

[iv] *U. S. Steel Corp. v. Missouri Pac. R. Co.*, 668 F.2d 435, 439 (8th Cir. 1982); *Dennis Stubbs Plumbing, Inc. v. Travelers Casualty & Surety Co. of America*, 67 Fed. Appx. 789, 792–93 (4th Cir. 2003).

[v] *C & H Electric, Inc. v. Town of Bethel*, 312 Conn. 843, 862 (2014).

[vi] *Pellerin Construction., Inc. v. Witco Corp.*, 169 F. Supp. 2d 568, 585 (E.D. La. 2001).
[vii] *Triple R Paving, Inc. v. Broward County*, 774 So. 2d 50, 56 (Fla. 4th DCA 2000).
[viii] *North American Mechanical, Inc. v. Walsh Construction Co. II, LLC*, 132 F. Supp. 3d 1064, 1077 (E.D. Wis. 2015).
[ix] *Tougher Industries, Inc. v. Dormitory Authority of State*, 15 N.Y.S.3d 262 (N.Y. App. Div. 2015).
[x] *McPhee Elec. Ltd., LLC v. Konover Construction Corp.*, CV075009694S, 2009 WL 4846555, at *33 (Conn. Super. Ct. Oct. 22, 2009).
[xi] *Bovis Lend Lease LMB Inc. v. GCT Venture, Inc.*, 6 A.D.3d 228, 229, 775 N.Y.S.2d 259, 260 (2004).
[xii] *Corinno Civetta Construction Corp. v. City of New York*, 67 N.Y.2d 297, 313, 493 N.E.2d 905, 912 (1986).
[xiii] Some jurisdictions recognize the exception. *See e.g. Corinno Civetta Construction Corp. v. City of New York*, 67 N.Y.2d 297, 493 N.E.2d 905 (1986) (New York); *Macomb Mech., Inc. v. LaSalle Group, Inc.*, 319357, 2015 WL 1880189, at *3 (Mich. Ct. App. Apr. 23, 2015), appeal denied, 498 Mich. 949, 872 N.W.2d 456 (2015) (Michigan). Other jurisdictions do not recognize delays not contemplated by the parties as an exception to the enforcement of the No Damage for Delay clause. *See e.g. State Highway Admin. v. Greiner Eng'g Scis., Inc.*, 577 A.2d 363, 372 (Md. Ct. Spec. App. 1990) (Maryland); *J.A. Jones Construction Co. v. Lehrer McGovern Bovis, Inc.*, 120 Nev. 277, 288, 89 P.3d 1009, 1016 (2004) (Nevada); *U.S. for Use & Benefit of Williams Elec. Co., Inc. v. Metric Constructors, Inc.*, 325 S.C. 129, 136, 480 S.E.2d 447, 450 (1997) (South Carolina); and *Gregory and Son, Inc. v. Guenther and Sons*, 147 Wis.2d 298, 432 N.W.2d 584 (1988) (Wisconsin).
[xiv] *White Oak Corp. v. Dept. of Transportation.*, 217 Conn. 281, 291, 585 A.2d 1199, 1204 (1991).
[xv] *Corinno*, 67 N.Y.2d 297, 313 (1986).