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NJ Supreme Court Ruling Addresses Enforceability of Arbitration Clauses in Construction Defect Disputes Involving Direct Claims Against a Judgment Debtor's Insurer

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What You Need to Know

- The issue at hand in this case involved an interpretation of the statutory construction of New Jersey's Direct Action Statute, which permits a judgment creditor holding an unsatisfied judgment to file a direct action against the debtor's insurance company under certain circumstances.
- The New Jersey Supreme Court's ruling expressly recognizes the viability of direct actions for damages from construction defect claims against a judgment debtor's insurer.
- The case is also significant in that it held that mandatory arbitration provisions in the underlying insurance policies will be equally enforceable to such claims.

The Supreme Court of New Jersey recently ruled that a condominium association may bring a direct action to recover damages based upon construction defect claims against an insolvent judgment debtor's insurer. The Court further held, however, that a mandatory arbitration provision in the underlying insurance policy will be applicable to such claims. The case is *Crystal Point Condominium Association, Inc. v. Kinsale Insurance Company*, decided on July 18, 2022.

The Crystal Point Condominium Association had obtained judgments against two allegedly insolvent entities in a construction defect lawsuit. Thereafter, Crystal Point brought direct claims against the judgment

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debtors' insurer, Kinsale Insurance Company, based upon New Jersey's Direct Action Statute, which permits a judgment creditor holding an unsatisfied judgment to file a direct action against the debtor's insurance company under certain circumstances.

Kinsale argued that the Direct Action Statute did not apply to Crystal Point's construction defect claims, and that even if it did, such claims would have to be brought in an arbitration proceeding under the terms of its insurance policies. The trial court agreed, granted the insurer's motion to compel arbitration, and dismissed the complaint finding that there was no evidence that the insured entities were insolvent or bankrupt as required by the Statute.

The Appellate Division subsequently reversed the trial court, holding that the Statute did in fact apply after permitting Crystal Point to supplement the record with evidence of insolvency, but further held that the construction defect claims were not subject to the arbitration provision of the insurance policies.

The issue before the Supreme Court involved an interpretation of the statutory construction of the Direct Action Statute. In its opinion, the Court resolved three important issues: (1) whether the Statute permitted an action against the insurer based upon damages obtained based on a construction defect claim; (2) whether Crystal Point had made a prima facie showing of "the insolvency or bankruptcy of the person insured" as required by the Statute; and (3) whether the action would be subject to the arbitration provisions of the insurance policies, thereby precluding a court action.

As to the first issue, the Court dismissed the insurer's argument that the Statute only applied to bodily injury claims. The Statute provides for actions arising from "loss or damage resulting from accident to or injury suffered by an employee or other person, or against loss or damage to property caused by animals or by any vehicle drawn..." The insurer's counsel argued that the Statute was inapplicable because there was no accident or injury suffered by Crystal Point. The Court, however, found that the claims at issue fell into the former category and were "clearly" loss or damage resulting from accident or injury, and that there was no intent in the Statute to limit coverage. Thus, the Supreme Court expressly recognized the viability of direct actions for damages from construction defect claims against a judgment debtor's insurer.

With regard to the second issue, the Court found that Crystal Point's supplemental record on appeal containing returned and unsatisfied writs of execution constituted prima facie evidence that the judgment debtors were insolvent.

As to the last issue, the Court held that the arbitration provisions of the insurance policies applied to Crystal Point's direct claims against a judgment debtor's insurer because the Statute mandates that the claim is to be brought "under the terms of the policy for the amount of the judgment in the action not exceeding the amount of the policy." Because Crystal Point's claims were "purely derivative" of the insured, the Court held that the mandatory arbitration provision was enforceable, explaining that Crystal Point can have no greater rights than the insured would have had.

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Please contact the author with questions concerning the issues discussed in this Alert.

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