

Construction Defects, Faulty Workmanship & Risk Management Implications

Aaron S. Evenchik, Esq., Hahn Loeser

Matthew K. Grashoff, Esq., Hahn
Loeser

Dale A. Kaprosy, Oswald Companies

June 27, 2019

oswald

Design | Construction

Risk Management • Insurance • Surety

HAHN  LOESER®
attorneys at law

Topics

- **CGL Coverage in a Nutshell**
- **The Anatomy of the *Ohio Northern v. Charles Construction* Decision and the Importance of the “Occurrence” Requirement**
- **Overview of the Policy Interpretation Applied in *Charles Construction***
- **Best Practices after *Charles Construction***

CGL Coverage in a Nutshell

- “Property damage” or “bodily injury” caused by an **“occurrence”**



CGL Coverage in a Nutshell

- Many **exclusions**, and **exceptions to exclusions**, based on the cause, type, or nature of damage/injury, as well as who caused it

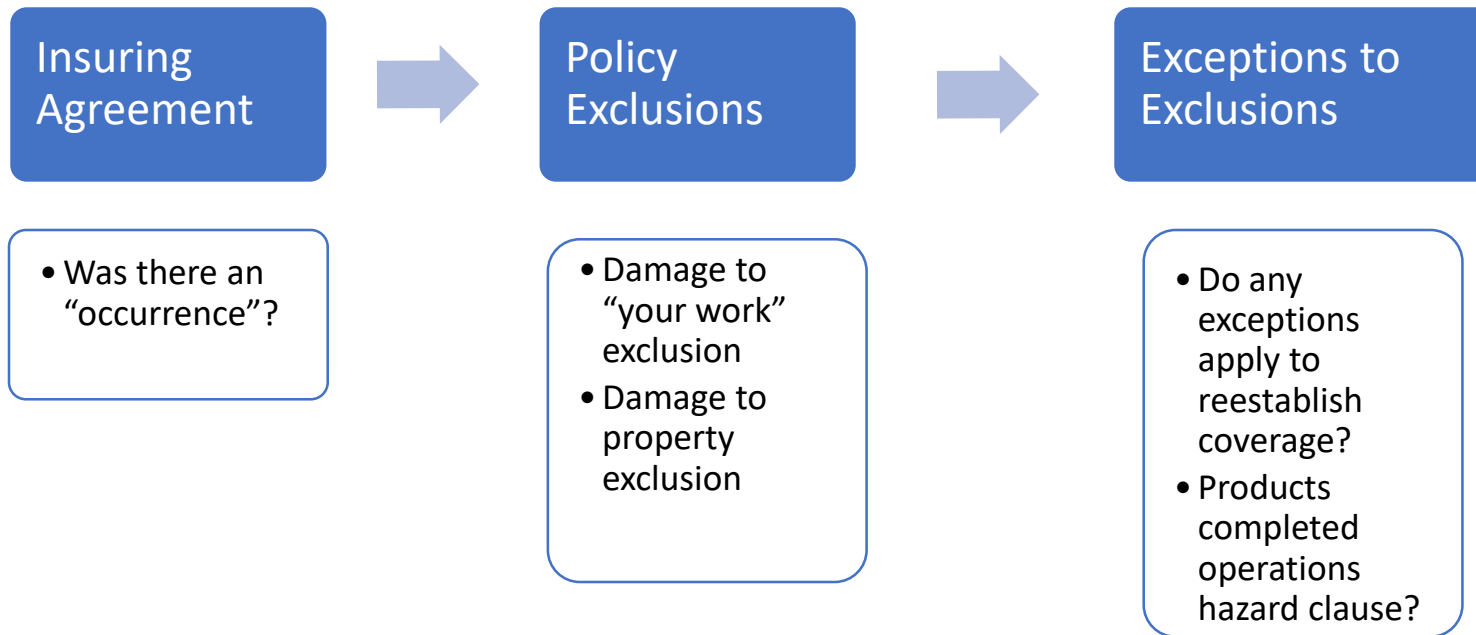


CGL Coverage in a Nutshell

- All about the definitions – **every word has a meaning.**



CGL Coverage in a Nutshell



The Definition of “Occurrence”

- “An accident, including continuous or repeated exposure to substantially the same general harmful conditions”



The Definition of “Occurrence”

- “Accident” is not defined, so courts give it the common meaning: an event that is **“unexpected, as well as unintended”**
- Concept of **“Fortuity”**

Ohio Northern Univ. v. Charles Construction



Owner: Ohio Northern



Contractor:
Charles Construction



Insurer:
Cincinnati Insurance



Subcontractors

Ohio Northern Univ. v. Charles Construction



Ohio Northern Univ. v. Charles Construction

- **Direct & resulting water** damage discovered after construction complete
- Parties agreed that the **defective work was performed by a sub**, not Charles Construction
- Ohio Northern sued Charles Construction; Charles Construction filed third-party complaints against several subs

Ohio Northern Univ. v. Charles Construction

{¶ 21} In “Section V—Definitions,” the CGL policy defines “occurrence” and “property damage” as follows:

16. “Occurrence” means:

a. An accident, including continuous or repeated exposure to substantially the same general harmful conditions.

* * *

20. “Property damage” means:

a. Physical injury to or destruction of tangible property including all resulting loss of use. All such loss of use shall be deemed to occur at the time of the physical injury or destruction that caused it; or

Ohio Northern Univ. v. Charles Construction

{¶ 22} By its terms, the CGL policy emphasizes that only “an occurrence” can trigger coverage for property damage. It states that CIC agrees to “pay those sums that the insured becomes legally obligated to pay as damages because of * * * ‘property damage’ to which this insurance applies.” But the damage must be due to an “occurrence,” which is defined as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” There is no question that the damage to the inn was “property damage” that was discovered after work was completed. But without an “occurrence” as defined in the CGL policy, there is no coverage for any property damage.

Ohio Northern Univ. v. Charles Construction

- Policy also contained a Products-Completed Operations Hazard **(PCOH)** clause
 - Provides coverage for liability (1) arising out of business operations, (2) which occurs on premises not owned or rented by insured, and (3) the business operations were completed or abandoned at the time liability arose

Ohio Northern Univ. v. Charles Construction

- PCOH clause operates as an **exception** to exclusion:

(6) That particular part of any property that must be restored, repaired or replaced because “your work” was incorrectly performed on it.

* * *

Paragraph (6) of this exclusion does not apply to “property damage” included in the “products-completed operations hazard.”

Ohio Northern Univ. v. Charles Construction

- Cincinnati: no duty to defend or indemnify Charles Construction because “claims for **defective workmanship** are not claims for ‘property damage’ caused by an ‘**occurrence**’”
- Extension of ***Westfield Ins. Co. v. Custom Agri Sys., Inc.*** – involved contractor’s own work

Ohio Northern Univ. v. Charles Construction

- Quoting from *Custom Agri*:

[A] CGL policy is not intended to insure business risks that are the normal, frequent, or predictable consequences of doing business and which businesses can control and manage. * * * A CGL policy does not insure the insured's work itself; rather, it insures consequential damages that stem from that work. * * * As a result, a CGL policy may provide coverage for claims arising out of tort, breaches of contract, and statutory liabilities as long as the requisite accidental occurrence and property damage are present.

Ohio Northern Univ. v. Charles Construction

subcontractors.

{¶ 3} To resolve this matter, we need only apply the holding of *Custom Agri.* Property damage caused by a subcontractor's faulty work is not an "occurrence" under a CGL policy because it cannot be deemed fortuitous. Hence, the insurer is not required to defend the CGL policy holder against suit by the property owner or indemnify the insured against any damage caused by the insured's subcontractor. We therefore reverse the judgment of the court of appeals.

- CGL policies not intended to insure against normal, frequent, or predictable consequences of doing business **which can be controlled or managed**

Ohio Northern Univ. v. Charles Construction

DEFECTIVE WORKMANSHIP IS A NORMAL
CONSEQUENCE OF DOING BUSINESS



THEREFORE DEFECTIVE WORKMANSHIP IS
NOT FORTUITOUS



THEREFORE DEFECTIVE WORKMANSHIP IS
NOT AN "ACCIDENT"



THEREFORE DEFECTIVE WORKMANSHIP IS
NOT AN "OCCURRENCE"



THEREFORE THERE IS NO COVERAGE

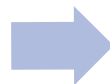


Ohio Northern Univ. v. Charles Construction

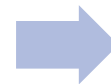
- **What about the PCOH Clause?**

{¶ 28} The language within the Coverage A portion of the CGL policy is critical to the policy's overall effect. It states that CIC agrees to pay for property damage under certain circumstances. But the damage must be due to an "occurrence," which the policy defines as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Again, there is no question that the water-related damage to the inn was "property damage" and was discovered after work had been completed. But unless there was an "occurrence," the PCOH and subcontractor language has no effect, despite the fact that Charles Construction had paid additional money for it.

Insuring
Agreement



Policy
Exclusions



Exceptions to
Exclusions

Ohio Northern Univ. v. Charles Construction

{¶ 29} If the subcontractors' faulty work were fortuitous, the PCOH and subcontractor-specific terms would require coverage. But as we explained in *Custom Agri*, CGL policies are not intended to protect owners from ordinary "business risks" that are normal, frequent or predictable consequences of doing business that the insured can manage. *Custom Agri* at ¶ 10. Here, we cannot say that the subcontractors' faulty work was fortuitous.

Ohio Northern Univ. v. Charles Construction

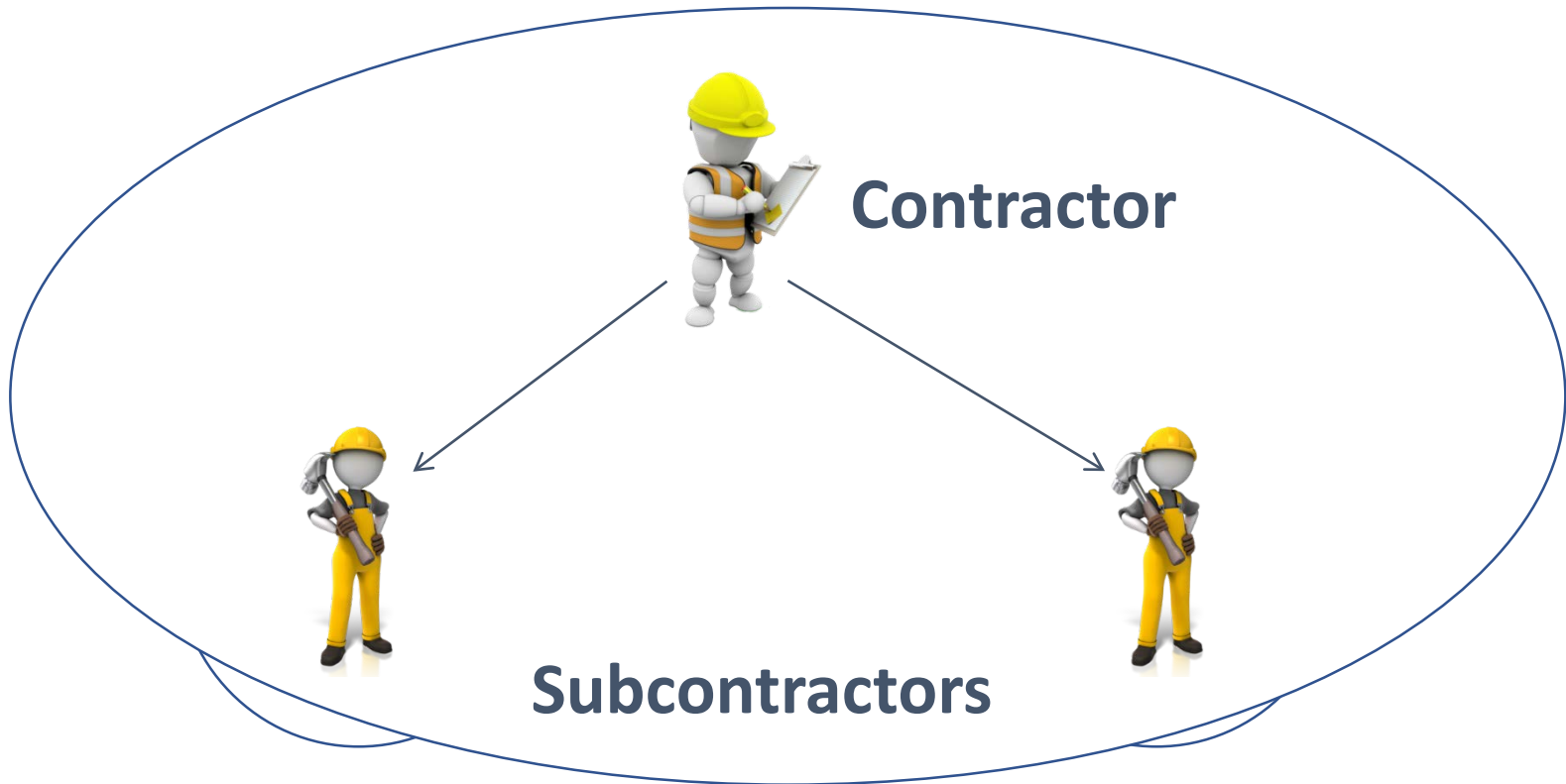
CONCLUSION

{¶ 35} We hold that property damage caused by a subcontractor's faulty work is not fortuitous and does not meet the definition of an "occurrence" under a CGL policy. CIC was not required to defend Charles Construction against ONU's lawsuit or indemnify Charles Construction against any damages. We reverse the judgment of the court of appeals and reinstate the judgment of the trial court.

Are Consequential Damages Still Covered After *Charles Construction*?

- Recall *Custom Agri*: insurance covers “consequential risks that **stem from** the insured’s work”
- *Charles Construction* **did not** overrule *Custom Agri* on this point, but some of its language was inexact
- Cincinnati **admitted** “consequential damages, *when they exist*, may be covered”

Consequential Damages: Focus on **Scope of Work**



Impacts of *Charles Construction*

Lender



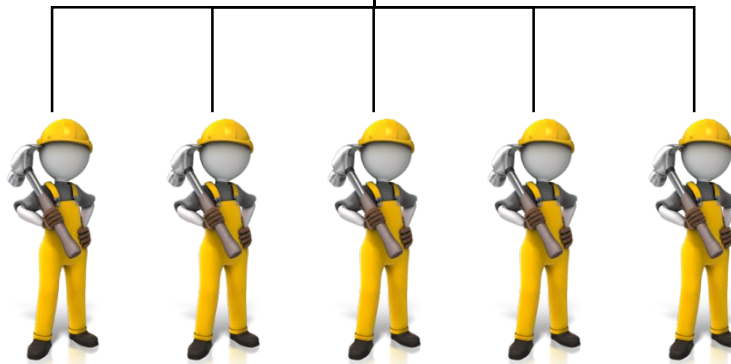
Owner



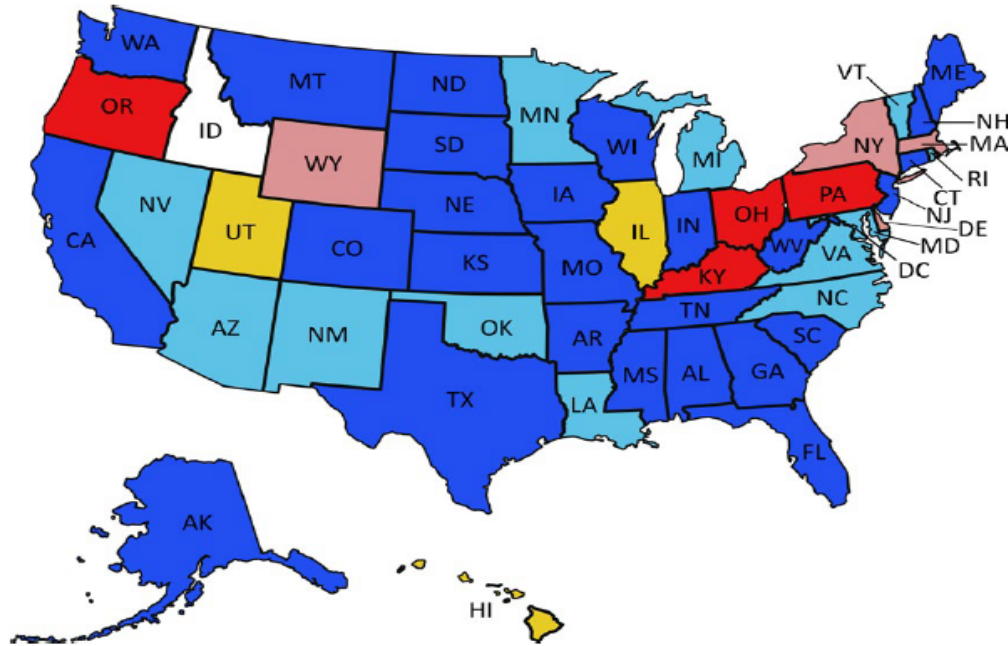
Prime
Contractor



Subcontractors



How are other states addressing this issue?



Defective Construction as an "Occurrence"

- Dark Blue: Highest Court has found defective construction to be an occurrence (or by state statute).
- Light Blue: Tending towards coverage; only lower state court or federal court authority exists.
- Red: Highest Court has found defective construction not to be an occurrence.
- Pink: Tending against coverage; only lower state court or federal court authority exists.
- Yellow: Unclear, cases/legislation conflict.
- White: No decision.

<http://www.sdvlaw.com/docs/news.25.pdf>

Avoiding the Rule of *Charles Construction*

- Negotiate with insurer for **expanded definition of “occurrence”** in the policy
 - **CAUTION**: make sure you’re getting what you’re paying for!

Proposed Endorsements

- Each insurer has filed endorsements with the State of Ohio to address the “Occurrence” issue.
- The insurance companies have chosen to tackle it in different sections of the CGL policy:
 - Amend Insuring Agreement
 - Amend Definition of “Occurrence”
 - Amend Coverage Part
- Some address “work performed on your behalf by subcontractors” and some also add “your work”



Insuring
Agreement

Exclusions

Exceptions
to Exclusions

SAMPLE ENDORSEMENT – AMENDED INSURING AGREEMENT

COMMERCIAL GENERAL LIABILITY COVERAGE PART

THE FOLLOWING IS ADDED TO PARAGRAPH 1. **INSURING AGREEMENT** OF SECTION I – COVERAGE A – BODILY INJURY AND PROPERTY DAMAGE LIABILITY:

DAMAGES BECAUSE OF "PROPERTY DAMAGE" INCLUDE DAMAGES THE INSURED BECOMES LEGALLY OBLIGATED TO PAY BECAUSE OF "**PROPERTY DAMAGE**" TO "**YOUR WORK**" OR CAUSED BY "**YOUR WORK**" AND SHALL BE DEEMED TO BE CAUSED BY AN "**OCCURRENCE**" REGARDLESS OF WHETHER THE "PROPERTY DAMAGE" ARISES FROM BREACH OF CONTRACT.

HOWEVER WITH REGARD TO "PROPERTY DAMAGE" TO "YOUR WORK" INCLUDED WITHIN THE "**PRODUCTS-COMPLETED OPERATIONS HAZARD**", SUCH "PROPERTY DAMAGE" SHALL ONLY BE DEEMED TO BE CAUSED BY AN "OCCURRENCE" IF:

- (1) THE "PROPERTY DAMAGE" IS CAUSED BY **WORK PERFORMED ON YOUR BEHALF BY A SUBCONTRACTOR(S)**; OR
- (2) THE DAMAGED WORK WAS PERFORMED ON **YOUR BEHALF BY A SUBCONTRACTOR(S)**.

ALL OTHER TERMS AND CONDITIONS OF THIS POLICY REMAIN UNCHANGED

SAMPLE ENDORSEMENT – AMENDED OCCURRENCE DEFINITION

The following is added to **SECTION V – DEFINITIONS**, Paragraph **13**. "Occurrence":

"Property damage" to "your work" arising out of it or any part of it and included within the "products-completed operations hazard" will be deemed to be caused by an "occurrence" if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

ALL OTHER TERMS AND CONDITIONS OF THE POLICY REMAIN UNCHANGED.

PROBLEMATIC VERBIAGE

AMENDING THE “SUBCONTRACTOR EXCEPTION” TO DAMAGE TO YOUR WORK EXCLUSION (EXCL. L) ONLY

“...BUT ONLY IF THE PROPERTY DAMAGE IS UNINTENDED AND UNEXPECTED FROM THE STANDPOINT OF THE INSURED”.

“HOWEVER, SUCH “PROPERTY DAMAGE” OR “BODILY INJURY” THAT IS EXPECTED OR INTENDED BY ANY INSURED, OR ANYONE PERFORMING WORK ON BEHALF OF THE INSURED, WILL NOT BE CONSIDERED TO BE CAUSED BY AN OCCURRENCE”.

PROBLEMATIC VERBIAGE

“OCCURRENCE INCLUDES ACTS OR OMISSIONS THAT CAUSE “PROPERTY DAMAGE” WITHIN THE “PRODUCTS COMPLETED OPERATIONS HAZARD”.

“BUT ONLY IF “THE “PROPERTY DAMAGE” IS ENTIRELY THE RESULT OF WORK PERFORMED ...BY A SUBCONTRACTOR.”

PROBLEMATIC VERBIAGE

**WILL THE COURTS CONCUR WITH ENDORSEMENT
INTENT?**



**WILL THE COURTS CONSIDER FAULTY WORKMANSHIP
“NOT FORTUITOUS” IF OCCURRENCE IS REDEFINED?**

Proposed Endorsements

- **Proposed HLP Endorsement**
 - **Defective work by a sub constitutes an “occurrence”**
 - **Includes “rip and tear” coverage**
 - **Minimizes concept of “fortuity”**
 - **Minimizes common business-risk exclusions**

PROPOSED ENDORSEMENT LANGUAGE FOR INSURING AGREEMENT

10/30/2018 Rev. 1

Hahn Loeser & Parks Construction Team

© all rights reserved

1. Insurer agrees that defective, faulty, or otherwise non-conforming work, materials, or services of a subcontractor or vendor of the Insured, or other work, materials or services furnished by others on behalf of the Insured, shall constitute an “Occurrence” after such work, materials, or services are put to their intended use;
2. Insurer agrees that the Policy covers, and the Insurer shall pay, all costs to investigate, test, inspect, remove, replace and/or rework (i) such defective, faulty, or otherwise non-conforming work, materials or services of the subcontractor or vendor, (ii) damaged, compromised, defective, faulty, or otherwise non-conforming work, materials or services furnished by others on behalf of the Insured; and/or (iii) any other work, materials, or services of the Insured that is damaged or affected by such work of the subcontractor or vendor; and the property, work, materials and services of others that are affected or damaged as a result or by virtue of defective, faulty, or otherwise non-conforming work, materials, or services of a subcontractor or vendor of the Insured or other work, materials or services furnished on behalf of the Insured;
3. Insurer agrees that Policy requirements of fortuitousness, sudden and accidental, and/or unexpected or unintended shall not be applied to avoid, negate, or minimize coverage for such Occurrence under this Endorsement including any resulting loss or damage arising from or relative to defective, faulty,

Contractors Errors & Omissions Coverages Designed for Sub-Contractors

Contractors Errors & Omissions includes a range of coverages designed for the specific risks of sub-contractors.

Policy highlights for eligible and qualified insureds include the following:

Contractors Errors & Omissions

Errors & Omissions:

Coverage for claims alleging *faulty workmanship, design errors or omissions*, and the use of *defective materials* and *products*

Use of Building Information Modeling (BIM) Systems

Covers negligent acts, errors or omissions by the insured or a person acting on its behalf in the performance of design services

Contractors Errors & Omissions

Errors & Omissions:

For Commercial Contractors – Not Residential

Premiums are based on Class & Revenue

Best Practices

- Be **cautious** when evaluating endorsements the insurer says will get around *Charles Construction* and *Custom Agri*
- Be wary of “**expected or intended**” language

Best Practices

- Subcontractor Selection:
 - **Quality subcontractors**
 - With bonding capacity – gone through underwriting
- Demanding **performance bonds**
 - Caution: time limits on bond claims
- **Other insurance coverages:** E&O – design; rip-and-tear; contractor's re-work; rectification
- Understanding uninsured risks – **eyes wide open**

Take-Aways

- Understand the Ohio Supreme Court's position on construction defects
- Understand the importance of **QA/QC**
- Make sure you have **proper coverage** – talk to your agent

Take-Aways

- Prequalify subcontractors **annually**
- Review your subcontract agreement with legal counsel **annually**
- The Industry should take **action**

QUESTIONS?

Aaron S. Evenchik

aevenchik@hahnlaw.com

Matthew K. Grashoff

mgrashoff@hahnlaw.com

Dale A. Kaprosy

dkaprosy@oswaldcompanies.com

