

CONSTRUCTION CLAIMS TASK FORCE
DRAFT
Regular Meeting Minutes
August 23, 2006

The Construction Claims Task Force met on Wednesday, August 23, 2006, in Room 260, Labor and Industry Building, 350 Winter Street NE, Salem, Oregon.

Members Present: Eric Grasberger
Elsie Jones
Steve Malany
Tom Skaar

Jim Vavrek
Jon Fahr
Bill Nesmith
Laura Schauer

Members Absent: David DeHarrport

Staff Present:

Mark Long, Administrator BCD
Richard Baumann, BCD
Chris Huntington, BCD
Cory Streisinger, Director DCBS
David Dahl, OID
Bill Boyd, CCB
Gina Fox, CCB

Kristie Patton, CCB
Cece Newell, OID
Joel Ario, Administrator OID
Rick Blackwell, BCD
Michael Morter, BCD
Cathy Dixon, CCB
Ravi Mahajan, BCD

Appearing by Phone:

Joe Pitts, American Actuarial Consulting Group

Guests Present:

Steve Pinnell, Pinnell/Busch
Joe Riter, Leonard Adams Co.
Tom Dymont, CBIC
Larry Byers, CBIC
Connie Rodriguez, CBIC
Pat Dorney, CBIC
John McKee, CBIC
Kirk Eland, CBIC
Tim Spencer, BASF
Ron Allen
Curtis Rosser, HBW Ins. Service
Larry Boyd, Surplus Line Assoc OR
Kelly Atwood, Contractors Insurance
Ron Kozlowski, Towers Perrin/CBIC
Rob Walling, Pinnacle Actuaries
Steve Krieg, City of Woodburn
Dave Johnson, 2-10 Home Buyers Warranty
Brian Doherty, CBIC
Jeff Dean, ABC
William F Connor, 2-10 Home Buyers

Kelly Ross, CBIC
Alan Seymour, ODOE
Amanda Rich, CBIC
Christian Rataj, NAMIC
Larry Peabody, Superior Exteriors Inc.
Shawn Miller, PCI
Scott Barrie, OHBA
Ron Manza, Stewart & Tunno Insurance
Janet Adkins, Legislative Staff
Stephen Kafoury, ORA
Jim Brown, Red Shield
Christopher F Jones, Red Shield
Steve Murrell, State Farm
Jutta Barneg, Oregon Mutual Insurance
Gary Hargis, Empire Pacific Sovereign
Gail Clark, Residential Warranty
John Powell
Adrienne Sexton, Legislative Fiscal Office
Jeff Thomas, CBIC

Action Items

- Submit public notice for September 19, 2006 meeting.
- Prepare insurance concept papers for review and consideration

I. TASKFORCE BUSINESS**A. Call to Order:**

Chair Eric Grasberger called the meeting to order at 9:00 a.m.

B. Approval of Agenda for August 23, 2006 Meeting and Order of Business:

MOTION: Eric Grasberger moved to approve the agenda for the August 23, 2006 meeting.

VOTE: 8-0, Ayes—Grasberger, Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek.

MOTION APPROVED

C. Approval of July 26, 2006 Meeting Minutes:

MOTION: Eric Grasberger moved to approve the July 26, 2006 minutes.

VOTE: 8-0, Ayes—Grasberger, Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek.

MOTION APPROVED

D. Next Meeting Date:

MOTION: Eric Grasberger moved to approve the meeting dates of September 19, 2006, 1:30 p.m. to 5:00 p.m. and re-confirmed October 25, 2006, 9:00 a.m. to 12:30 p.m.

VOTE: 8-0, Ayes—Grasberger, Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek.

MOTION APPROVED

MOTION: Eric Grasberger moved to approve the meeting dates of November 28, 2006, 1:30 p.m. to 5:00 p.m., December 20, 2006, 9:00 a.m. to 12:30 p.m., and January 12, 2007, 9:00 a.m. to 12:30 p.m.

VOTE: 8-0, Ayes—Grasberger, Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek.

MOTION APPROVED

Elsie Jones reported that she would *not* be able to attend the December 20 meeting.

E. Project Update:

Mark Long, Building Codes Division, reported that at the conclusion of this meeting, the task force would direct staff to conduct further research and draft into concepts insurance recommendations approved by the task force. Public comment on insurance issues under consideration is on the agenda for this meeting. Included in the packet are the six Phase I items for consideration by the task force.

The September 19 meeting will wrap-up any unresolved issues from either the construction defects phase or the insurance phase. The goal of the September meeting is to approve or discard insurance concepts, including any previously tabled items from either Phase I or Phase II. Staff will present a preliminary draft report. **(Exhibit 1, Exhibit 2, and Exhibit 3)**

II. OREGON INSURANCE DIVISION

Joel Ario, Insurance Division Administrator, discussed the insurance items for consideration. **(Exhibit 4)** Task force members will need to decide whether to move forward with these items or table them. Task force members will need to decide what type of construction to be covered: new homes, residential only, etc. Mr. Ario noted that the Task Force would also need to determine the scope of the warranty coverage. Mr. Ario briefly discussed the six concepts with task force members as follows:

- 1. Warranty Program:** A warranty program could be established to allow for warranty coverage for targeted sections of the contractor market such as new residential construction. Mr. Ario noted that under most warranty programs, the contractor maintains responsibility for the warranty for the first full year or two years after occupancy. Mr. Ario stated that some contractors would not be able to join a warranty program. Mr. Ario asked the Task Force whether in those instances would the state to provide a warranty to those contractors. **(Exhibit 12)**
- 2. General Liability Coverage to Include Completed Operations:** Mr. Ario stated that the proposed warranty program might impact the task force's decision whether to require completed operations coverage. Mr. Ario asked if the insurance requirement for contractors under ORS ch. 701 should be expanded to include coverage for completed operations. Mr. Ario stated that if a full warranty program is required, then full general liability coverage that includes completed operations might not be as important.

Task force members discussed what the definition of residential includes or should include and asked that staff research whether other states include high-rise condominiums in warranty programs. Task force members asked where other states draw the line between residential and commercial construction. Task force members also asked if both the warranty program and completed operations general liability concepts are adopted, would they create overlaps that could lead to more litigation. Task force members discussed that warranty programs and general liability insurance recommendations would be a package and how important it will be that the legislature understands the recommendations are a packaged approach.

- 3. Lower Limits on Wrap Projects:** Mr. Ario talked about streamlining regulatory restrictions on wrap projects by lowering the project eligibility limit under ORS 737.602 to \$10 million to reflect current liability claim environment.

4. **Loss Control Discounts:** Mr. Ario discussed implementing loss control discounts for contractors who adopt mandatory or voluntary best practices could be encouraged by streamlining the filing process and reducing any documentation requirements. Mr. Ario discussed an existing example – discounts for drivers 55 years of age or older that participated in accident prevention courses.
5. **Agent Disclosure of Market Search Efforts:** Mr. Ario stated that agent duties could be clarified to ensure that contractors are provided reasonable opportunity to have their insurance placed in the admitted market before being offered surplus lines coverage or being told that no options are available.
6. **Specific Data Reporting:** Mr. Ario suggested that insurers could be required to report premium and loss information for contractors' general liability insurance in a standardized format to the Oregon Insurance Division.

Chair Grasberger suggested discussing and possibly adding three additional issues:

1. **Address lack of "bad faith" law in Oregon:** Chair Grasberger noted that the defense costs and transactions costs eclipse the actual payout costs of these claims. Chair Grasberger also noted that there are good arguments that some of the basis for that is that there is not enough teeth in Oregon law to get the parties to resolve claims faster so we do not have long drawn-out lawsuits every time we have a construction defect claim. Chair Grasberger stated that a "bad faith" law is something that Washington State has enacted in their consumer protection statutes.
2. **Require architects and engineers to carry professional liability insurance:** Chair Grasberger stated that architects and engineers are not required to carry any professional liability insurance or general liability insurance. Chair Grasberger said that the task force needed to address the same issues.
3. **Clarify the current law on "additional insured":** Chair Grasberger discussed recent case law in Oregon regarding liability of additional insured protections. Chair Grasberger stated that the *Walsh* decision was confusing and did not provide any clarity on the issue. Chair Grasberger said that the task force needed to clarify what additional insurance coverage is in our state and should we have it, or not allow it and what is it allowed to cover.

III. PUBLIC COMMENT

- A. Steve Pinnell, President Pinnell/Busch Inc.: (**Exhibit A**). Pinnell/Busch is a project management consulting firm for the design and construction industry. He understands two major areas of construction claims: 1) homeowner construction claims, primarily over nonperformance, disputed payment, and delay (also construction defects within one year). These disputes are currently processed by CCB. 2) Construction defects occurring between one and ten years after completion of construction and covered by contractor's general liability insurance. Mr. Pinnell stated that nearly half of all contractors do less than \$250,000 of construction per year

and only five percent of all work. Mr. Pinnell also noted that just two percent of all contractors doing over \$10 million of work per year perform nearly half of all work. His concern is that legislation implemented will not adversely affect smaller contractors and MWESB contractors. Mr. Pinnell believed that Oregon is doing something right. Oregon general liability insurance rates are substantially lower than the rates of other Western states. Mr. Pinnell stated that CCB's dispute resolution process works very well and he recommends CCB hiring another field investigator to replace the one who left and to give field investigators more responsibilities. Mr. Pinnell recommended a \$10,000 increase in bond amounts, which would cover 50 percent of the shortfall. The largest issue for the task force is contractor's general liability insurance coverage for construction defects. Alternative solutions put forward by Mr. Pinnell were: 1) reducing the frequency and severity of construction defects; and 2) reducing the cost of determining responsibility. Mr. Pinnell also suggested reducing the cost of resolution by mediating all disputes; expanding first party warranties, and examining tort reform. Mr. Pinnell stated that he would not recommend mandated third-party warranties because it would either be of limited value or have severe impacts on smaller contractors and fail to provide full coverage. Mr. Pinnell noted that after British Columbia implemented their third-party warranty program, the province went from 7,000 contractors to 4,000 in the general contractor category. Finally, Mr. Pinnell suggested that the task force seek input from design and construction industry professionals and trade associations.

- B. Kirk Eland, Rob Walling, Jeff Thomas, and Larry Byers, CBIC: (Exhibit B)
Kirk Eland reported that in 2005 2% of builders build 50-500 homes, 11% build 10-49 homes, and 87% build 1-9 homes. Mr. Eland stated that given the number of small contractors, the average annual premium is \$1,708, which is not unreasonable. Mr. Eland said that Oregon has less loss cost than other states and is a more competitive market. Mr. Eland believed that a broad brush solution is not best for Oregon. Mr. Eland suggested that the Task Force target large construction defects. Mr. Eland stated that there is no insurance crisis for most contractors. Mr. Eland noted that there have been significant rate increases for larger general contractors and building envelope contractors due to long tail construction defect coverage. Mr. Eland said that fixing construction defect issues would reduce premiums. Finally, Mr. Eland said that third-party warranty systems provide little coverage for construction defects and hurt the small contractor.

Rob Walling reported that 25% of construction defects are reported within 24 months and 70% occur within 57 months. Mr. Walling believed that the current insurance rates are reasonable. Mr. Walling noted that CBIC had an operating loss last year. Mr. Walling suggested that the 20 percent increases each year over the last few years are due to losses. Mr. Walling stated that classes of contractors working on the building envelope have larger losses and pay higher premiums.

Ron Kozlowski, Towers Perrin/CBIC, (Exhibits C) reported that there are significant differences between warranty programs and general liability insurance. Mr. Kozlowski noted that a third-party warranty is a contract between the warranty insurer, the developer (contractor), and the homebuyer where the warranty insurer acts as both the insurer and surety. Mr. Kozlowski said that a typical warranty policy

is a 1-2-10 year policy that covers faulty workmanship and materials. Mr. Kozlowski noted that most construction defect claims are not covered under third-party warranty programs. Mr. Kozlowski suggested that to reduce premiums there needs to be improved construction. Mr. Kozlowski stated that completed operations coverage of contractors' general liability insurance is a fault-based policy that provides coverage against first-party and third party claims and excludes faulty workmanship. Mr. Kozlowski believed that requiring full coverage warranty policy over ten years may be prohibitively expensive for the homebuyer and more costly than combined warranty and contractor's general liability policies.

Larry Byers reported that the CCB dispute resolution program is remarkable and has great achievements; do not tinker with the program. Mr. Byers believed that recovery funds do not address the bond shortfall. He recommends increasing the bond and limiting access to the bond to homeowners. Mr. Byers suggested that recovery funds are expensive, typically have solvency issues, and create a false sense of security to homeowners who may not use due diligence when selecting a contractor. Mr. Byers instead recommended increasing bonds and not bothering with a recovery fund. Finally, Mr. Byers said that even with a recovery fund, good contractors pay for bad contractors.

- C. Larry Boyd, Surplus Line Association of Oregon (SLAOR): (Exhibit F) Mr. Boyd believed that agent disclosure of market search efforts were not needed. Mr. Boyd communicated that SLAOR supports a warranty program and suggests provisions being made for contractors to have equal access to admitted and non-admitted markets, which would require adoption of "export list" provisions current practices in 16 other US jurisdictions. Mr. Boyd stated that the export list would allow the Insurance Division to specify that certain distressed coverage could be written in the non-admitted market, even if there is an admitted market willing to write coverage at a higher price. Mr. Boyd stated that SLAOR also endorses adoption of requiring completed operations insurance coverage by amending licensing requirements, but not insurance statutes. Mr. Boyd also noted that SLAOR endorses lower limits on wrap projects. Finally, Mr. Boyd said that SLAOR is neutral on loss control discounts, believed that agent diligent search requirements are not needed, and had no position on the issue of specific data reporting.
- D. Kelly Atwood, Contractors Insurance Services: (Exhibit D and Exhibit E) Mr. Atwood stated that warranty programs benefit the contractor when binding arbitration is required. Mr. Atwood said that these warranty claims eliminate lawsuit exposure and require all parties to abide by the arbitrator's decision. Mr. Atwood believed that this would have an impact on claim costs and in the long run would reduce insurance costs. Mr. Atwood noted that these warranties also cover structural defects after the second year. He is in favor of a warranty program. Mr. Atwood said that general liability insurance coverage that includes completed operations coverage is not waived through the purchase of a warranty program. Mr. Atwood stated that binding arbitration in the warranty applies to issues that need to be repaired or corrected. Mr. Atwood noted that if there is no coverage under the warranty, the homeowner can file a lawsuit that the contractor will need to defend. Mr. Atwood noted that his agency will not sell a policy that does not include completed operations coverage. He has no

- issue with lower limits on wrap products. Mr. Atwood believed that loss control discounts based upon mandatory or voluntary best practices would be hard to monitor. Mr. Atwood also believed that if mandated discounts for certain practices were adopted, then insurance carriers would raise rates. He is not in favor of agent disclosure of market search efforts as they are not necessary. He is in favor of specific data reporting requirements.
- E. Shawn Miller, Property Casualty Insurance of America: Mr. Miller reported that David Golden was going to comment on these items and will be sending in his comments in writing. Mr. Miller noted that PCIA had some issues with the loss control discount concept that David will report on. Mr. Miller also pointed out that some of these proposals that are being considered may have unintended consequences in the marketplace.
- F. Ron Manza, Stewart & Tunno Insurance: Ron Manza stated that he supports a warranty program, but it needs to complement contractor's general liability insurance. Mr. Manza also noted that on the issue of requiring completed operations coverage, it is worthless if there is no tail coverage. Mr. Manza believed that agents writing general liability insurance without completed operations coverage could be in trouble with their own errors and omissions coverage. Mr. Manza stated that a claims-made policy must be in force when a claim is made. On the issue of loss control requirements, Mr. Manza said that the markets compete any way they can. Mr. Manza believed that the agent disclosure concept is not necessary, because the data reporting concept is more of a company issue since most insurance companies have data, it is the way it is manipulated that is at issue. Finally, Mr. Manza stated that companies are already leaving Oregon because of increased costs.
- G. Chris Jones, Red Shield Insurance: Chris Jones remarked that alleviating construction defects is the goal of all, which would lower rates. Mr. Jones believed that while warranties are easy to look at past claims paid, having to predict the future and add costs in for things not thought of at the time is difficult. Mr. Jones stated that it is very difficult to anticipate code changes and construction defects that may arise in ten years. Mr. Jones suggested that we need better quality construction to reduce costs of lawsuits. Mr. Jones believed that it hurts small contractors when they are named in a lawsuit that has nothing to do with their trade. Mr. Jones remarked that Red Shield Insurance did not have a problem with the data call requirements. Mr. Jones stated that RSI was no longer in the marketplace for contractors; they left three years ago. Mr. Jones observed that RSI received many construction defect claims in the ninth and tenths years. Finally, Mr. Jones suggested that changes in the legal climate drives costs up.

IV. TASK FORCE DISCUSSION ON PHASE II INSURANCE ISSUES:

A. Warranty Program:

MOTION: Elsie Jones moved to *reject* the third-party based warranty proposal as stated in the August 23, 2006 memo from Insurance Division.

VOTE: 8-0, Ayes—Grasberger, Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek.

MOTION APPROVED

Task Force members discussed what a warranty program tailored to building envelope might look like or perhaps recommend a mandatory first-party warranty program for new homes like condominiums currently use. Tom Skaar reported that he has his own warranty he gives to homeowners, which excludes maintenance issues like caulking and owner caused damages. He will get a copy to Task Force members.

MOTION: Eric Grasberger moved to ask staff to research a concept paper on first-party warranties from the builder. And if they happen upon any warranties covering design whether from the builder or a separate design on residential, defined as single family homes, condominiums and townhouses.

VOTE: 7-1, Ayes—Grasberger, Fahr, Malany, Nesmith, Schauer, Skaar, and Vavrek; Nays—Jones.

MOTION APPROVED

B. General Liability Coverage to Include Completed Operations:

MOTION: Steve Malany moved to have staff draft a concept to require general liability insurance covering completed operations, and research the “occurrence versus claims made” issue.

VOTE: 8-0, Ayes—Grasberger, Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek.

MOTION APPROVED

C. Lower Limits on Wrap Projects:

MOTION: Tom Skaar moved to have staff draft a concept to lower the limit for wrap projects.

VOTE: 8-0, Ayes—Grasberger, Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek.

MOTION APPROVED

D. Loss Control Discounts:

MOTION: Tom Skaar moved to have staff draft a concept offering voluntary loss control discounts.

VOTE: 7-1, Ayes—Grasberger, Fahr, Jones, Nesmith, Schauer, Skaar, and Vavrek, Nays—Malany

MOTION APPROVED

E. Agent Disclosure of Market Search Efforts:

MOTION: Tom Skaar moved to *reject* requiring insurance agent to disclose their marketing efforts.

VOTE: 7-1, Ayes—Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek,
Nays—Grasberger

MOTION APPROVED

F. Specific Data Reporting:

MOTION: Tom Skaar moved to direct staff draft a concept requiring data reporting. Focus on what data is desired, what form should the data be submitted to the state, what will the state do with the data, and mechanisms for reviewing the appropriateness of the data.

VOTE: 6-2, Ayes—Grasberger, Fahr, Malany, Nesmith, Schauer, and Skaar,
Nays—Jones and Vavrek

MOTION APPROVED

G. Lack of bad faith law in Oregon.

MOTION: Tom Skaar moved to direct staff to move forward with this concept.

VOTE: 6-2, Ayes—Grasberger, Fahr, Malany, Nesmith, Schauer, and Skaar,
Nays—Jones and Vavrek

MOTION APPROVED

H. Require Architects and Engineers to Carry Professional Liability Insurance:

MOTION: Eric Grasberger moved to have staff look into why architects and engineers don't have insurance requirements for licensure.

VOTE: 2-6, Ayes—Grasberger, Nesmith, Nays—Fahr, Jones, Malany, Schauer,
Skaar, and Vavrek

MOTION FAILED

I. Clarify Law on Additional Named Insured:

MOTION: Eric Grasberger moved to have staff further investigate clarifying law for additional insured coverage in Oregon.

VOTE: 5-3, Ayes—Grasberger, Fahr, Malany, Nesmith, and Skaar, Nays—Jones,
Schauer, and Vavrek

MOTION APPROVED

Issues: Clean up the Walsh decision put it in the statutes; make it clear so that everybody knows what they can sell. Make it reasonable. Right now it is a mess.

J. Limited Liability Company (LLC) Issue. Steve Malany suggested that the problem with LLCs is that they form, construct a project, and then dissolve. Mr. Malany further commented that when problems arise, the LLC no longer exists and there is no coverage in place to take care of the damages.

MOTION: Steve Malany moved to have staff look at the insurance requirements of architects, engineers, and LLCs.

VOTE: 7-1, Ayes—Grasberger, Fahr, Malany, Nesmith, Schauer, Skaar, and Vavrek,
Nays—Jones

MOTION APPROVED

K. Early Mandatory Mediation Process:

MOTION: Eric Grasberger moved to direct staff to look into early mandatory mediation early in the process when a dispute arises before lawsuits are filed.

VOTE: 8-0, Ayes—Grasberger, Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek

MOTION APPROVED

Extend September Meeting Time:

MOTION: Eric Grasberger moved to change the September 19 meeting times to 12:00 p.m. to 5:00 p.m.

VOTE: 8-0, Ayes—Grasberger, Fahr, Jones, Malany, Nesmith, Schauer, Skaar, and Vavrek

MOTION APPROVED

IV. ADJOURNMENT

Chair Grasberger adjourned the meeting 2:18 p.m.

Exhibits:

- 1 – Phase I Motions and Proposal Schedule (3 page) – *Agenda item I-E*
- 2 – CCTF Agenda/Timeline (1 page) – *Agenda item I-E*
- 3 – Strategy/Schedule for completion (2 pages) – *Agenda item I-E*
- 4 – Insurance Division presentation (5 pages) – *Agenda item II*
- 5 – Status report on Phase I proposals (1 page) – *Agenda item V*
- 6 – Building Code Amendments proposal (5 pages) – *Agenda item V*
- 7 – CCB Enforcement powers proposal (7 pages) – *Agenda item V*
- 8 – Recovery fund proposal (19 pages) – *Agenda item V*
- 9 – Consumer information proposal (3 pages) – *Agenda item V*
- 10 – Residential permits (3 pages) – *Agenda item V*
- 11 – Building envelope certification (13 pages) – *Agenda item V*
- 12 – New Jersey warranty pricing (1 page) – *Agenda item II*
- A – Steve Pinnell, Pinnell/Busch, Inc. – testimony (11 pages) – *Agenda item III*
- B – Kirk Eland, Rob Walling, Ronald Kozlowski, Jeff Thomas, and Larry Byers, CBIC – Market Segmentation (20 pages) – *Agenda item III*
- C – Ronald Kozlowski, Towers Perrin/CBIC – (4 pages) – *Agenda item III*
- D – Kelly Atwood, Contractors Insurance Services – Testimony for August 23, 2006 Meeting (4 pages) – *Agenda item III*
- E – Kelly Atwood, Contractors Insurance Services – Testimony for August 23, 2006 Meeting Insurance Items for Consideration (5 pages) – *Agenda item III*
- F – Larry Boyd, Surplus Line Association of Oregon (SLAOR) – Comments on the “Insurance Items for Consideration” to the Construction Claims Task Force (5 pages) – *Agenda item III*