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-----November 28, 2006-----

**Construction Claims Task Force**

*Executive summary*

**State of Oregon**

**Department of Consumer and Business Services**

**Construction Claims Task Force members:**

- **Eric Grasberger (Chair)**, representing the public
  - **Laura Schauer (Vice-chair)**, representing commercial structure contractors
  - **Tom Skaar**, representing single-family dwelling contractors
  - **Steven Malany**, representing commercial multi-family dwelling contractors
  - **Bill Nesmith**, representing the Oregon Department of Energy
  - **David DeHarpport**, representing the state Residential Structures Board
  - **John Fahr**, representing residential construction designers
  - **Elsie Jones**, representing insurance agents
  - **Jim Vavrek**, representing insurers that offer contractor liability coverage
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## Executive Summary

The 73<sup>rd</sup> Oregon Legislature created the Construction Claims Task Force to address increasing construction claims and rising contractor liability insurance premiums. The Task Force was charged with studying the relationship between construction claims and industry practices, construction defects, consumer protection and state-mandated requirements for contractors. The task force was directed to deliver a report of their findings, including recommendations for legislation, to the 74<sup>th</sup> Oregon Legislature.

This executive summary provides an overview of the work of the task force and the task force's recommendations to the legislature. The full report contains supporting commentary and data for each task force recommendation. A detailed list of the recommendations can also be found in the full Task Force report. Based on study and evaluation carried out over a period of approximately 18 months the Task Force makes the following recommendations:

\*\*Placeholder only. No final recommendations have been made. Items below are still under consideration.

### **Phase I Recommendations: Construction-related issues**

1. Change CCB enforcement authority and duties.
2. Change building code requirements relating to moisture content, mechanical ventilation and flashing.
3. Establish a recovery fund for consumers.
4. Enhance consumer information and information availability.
5. Change regulations regarding permit issuance.
6. Increase certification, competency and training standards for contractors working on building envelope.

### **Phase II Recommendations: Insurance-related issues**

1. Encourage voluntary loss control discounts
2. Streamline rate filing requirements for wrap projects
3. Establish a warranty requirement
4. Amend contractor general liability requirements to include completed operations
5. Require insurers to maintain and report specific date elements

### **Background**

The 2005 Oregon legislature created the Construction Claims Task Force (CCTF) in response to an increase in the number of construction claims and sharply rising costs for contractor liability insurance. The Construction Claims Task Force offers the first opportunity for all issues relating to building codes, construction contractors, insurance, and energy to be studied and addressed at once.

House Bill 2078 authorized the creation of the CCTF to study and evaluate the causes of, and the extent of construction defects in Oregon, the need for increased consumer protection and the availability and affordability of liability insurance for contractors. Based on the study and evaluation of these issues, the Task Force was directed to produce a report to the 74<sup>th</sup> Oregon Legislature, including recommendations that would reduce construction claims, and ensure that appropriate consumer protection measures are in place.

The Task Force consists of nine members. The Department of Consumer and Business services appointed five members, the administrator of the Construction Contractors Board appointed three members and the director of the State Department of Energy appointed one member.

The legislation that created the Task Force also designated the Construction Contractors Board and the Department of Consumer and Business Services as staff support for the Task Force. Together these agencies provided administrative support, coordinated task force activities, performed research and provided expertise on construction and insurance regulation in Oregon.

### **Methodology**

The task force convened for the first time on September 21, 2005 and held a total of 14 meetings through January 2007. To identify and scrutinize the recommendations that ultimately became part of the legislative report the Task Force followed a pattern that included information gathering and analysis, as well invited testimony and public comment sessions. The Task Force received input and recommendations from more than 30 experts in the fields of construction and insurance and received more than 70 different recommendations.

Public comment and participation was a major part of the Task Force's work. During the course of the Task Force's work members heard public comment from 41 individuals. The Task Force Web site also provided the opportunity for individuals to track the work of the Task Force and to contribute by submitting material for consideration by the Task Force, which was posted on the Web site. The CCTF Web site received more than 330 submissions and more than 300 persons signed up for automatic notification of Web site updates.

The Task Force divided its work into three phases. During Phase I, the Task Force studied issues related to construction. Phase II of the Task Force's work focused on issues related to construction insurance. Phase III focused on analysis of recommendations and development of the final report to the legislature.

### **Transparency and the Public Interest**

The Task Force operated in full public view and made every effort to involve the public in the information gathering as well as the deliberative aspects of the process. The Task Force provided several opportunities for the public to contribute through oral testimony. In addition, Task Force staff created an easy system that allowed all interested parties to submit information for consideration by the Task Force. All submitted materials and anything considered by the task force was also made available to the public through a continually updated Web site.

**Public Participation.** The task force encouraged and welcomed the input of the public. In addition to accepting the submissions of the public on the task force Web site, the task force heard from the public on a number of occasions. In total the task force heard approximately 10 (this number may change as the Task Force completes its work) hours of public comment. The task force asked for public comment at the outset in order to understand the issues faced by those who have confronted construction defect issues. The task force also solicited the comments of the public on the specific recommendations offered by the invited experts.

**Web site.** Task Force materials including agendas, meeting minutes, white papers and public submissions were posted on the Web site. Submitted items were posted bi-monthly.

### **Phase I: Study and discussion of construction-related issues**

Phase I of the Task Force work plan consisted of six meetings occurring between November 2005 and May 2006. During Phase I the task force studied and evaluated construction practices in order to identify potential recommendations to reduce construction defects. Staff organized panels of experts representing eight key segments of the construction industry. These panels offered insights into the causes of construction defects and submitted recommendations for consideration by the task force. The task force heard from roughly 30 construction experts sitting on the following panels:

- Building Science Panel (November)
- Design Panel (December)
- Building Code Panel (January)
- Developer Panel (January)
- Owner Panel (January)
- Contractor Panel (February)
- Crafts and Trades Panel (February)
- Building Material Supplier Panel (February)

In addition to the invited panelists, the task force heard from a number of homeowners as well as construction professionals during three public comment periods. The first two public comment sessions allowed the public to share experiences and offer recommendations to the Task Force. For the final public comment period in Phase I the task force asked for and received specific public comments focused on the concepts under consideration. The Task Force held public comment sessions on:

- September 2004
- February, 2005
- May 2005

As a result of invited testimony, public comment and staff research, staff compiled approximately 65 recommendations for improving construction practices and reducing defects. Through discussion and analysis the Task Force identified the most promising recommendations, which have been consolidated into the six (subject to change, depending on Task Force review) proposals offered for review by the legislature.

These proposals are discussed in detail with supporting data in the full report. A detailed summary of the proposals can be found near the end of this executive summary.

### **Phase II: Study and discussion of insurance-related issues**

Phase II of the Task Force work plan consisted of three meetings occurring between July and August 2006. The task force heard from industry experts regarding the potential causes of rising insurance rates for contractors and possible recommendations for increasing availability and affordability. The task force also allotted time for public comment during Phase II. The Task Force gathered input from invited experts and the public at the following meetings:

- Insurance Regulators (June)

- Insurance Agents (July)
- Insurance Companies (July)
- Public comment: August meeting

One of the key aspects of Phase II was an independent insurance study conducted by an actuarial consultant. This study mandated by House Bill 2078. The consultant was directed to compile data of insurance defect claims in Oregon and study options regarding actuarially sound insurance reforms.

The consultant presented the findings of the study at the July Task Force meeting and was present at other meetings to respond to Task Force inquiries.

Based on the recommendations of industry experts and the report of the actuarial consultant, a list of items for consideration by the task force was compiled. The Task Force discussed and evaluated the proposals and selected a set of recommendations for consideration by the legislature. These proposals are discussed in detail with supporting data in the full report.

### **Phase III: Recommendations of the Task Force**

The task force agrees that its recommendations will help reduce the number of construction defects, enhance contractor accountability, improve consumer confidence, and ensure the availability of contractor insurance.

While the Task Force understood that each of the following recommendations, if implemented, would be a positive step, members agreed to take a comprehensive approach. Therefore, each recommendation constitutes a component of a whole system designed to improve the construction environment in Oregon. The Task Force believes that recommendations implemented in a piecemeal manner, will not be as effective at alleviating the problems Oregon is confronting as full implementation the Task Force recommendations.

The task force makes the following recommendations:

#### *Phase I Proposal Package:*

##### **CCB Licensing & Enforcement Changes Proposal**

- Expand CCB's enforcement authority by adding an expedited emergency suspension process outside the Administrative Procedures Act to deal with problem contractor licenses.
- Licensees or responsible managing individuals subject to sanction by the CCB must not serve as owners, officers, directors, or managers of another construction firm.
- Require officers, directors, owners and entities to disclose, from the last five years, financial matters that evidence past financial malfeasance – unsatisfied court judgments, insolvencies, fraud, misrepresentation, conversion of funds, and other acts that may unfavorably affect future construction contracts. Allow the CCB to actively investigate an applicant's past financial dealings extending back five years.
- Require officers, directors, and owners to disclose criminal activity bearing on the ability to contract from the last five years. Allow the CCB to conduct active criminal checks, including using state and federal biometric databases. Allow the CCB to acquire criminal records in the course of investigating applicants.

- Expand prohibited acts by contractors that can be prosecuted by the government as crimes, and expand the range of penalty options to include restitution, enhanced fines and limited incarceration based on the monetary value of the contract, the nature of the offense and whether a person is a repeat offender.
- Confer on CCB authority to issue criminal citations.

### **Building Code Amendment Proposal**

- Prohibit components within a cavity from exceeding 19% at the time of covering.
- For mechanical ventilation systems in bathrooms, laundry rooms and similar facilities, require a minimum flow rate of 80 cubic feet per minute (cfm).
- In bathrooms, require humidity sensors or other acceptable methods of automation to activate ventilation systems.
- Restrict the noise level of active bathroom ventilation to less than 2.5 sone levels (approximately 40 decibels).
- Locate bathroom fans as close as is practicable to the shower or tub area.
- In kitchens, prohibit the use of recirculating range hoods or provide for other approved forms of active ventilation.
- Noise produced by active kitchen ventilation should not exceed 4.0 sone levels (approximately 48 decibels).
- Require appropriate, horizontal flashing over all plant-on trims, such as 'z' metal flashing configurations. [May need rework as performance standard]

### **Recovery Fund Proposal**

- Establish a recovery fund for residential construction only.
- Require only those contractors whose work is directly connected to residential construction to participate in the recovery fund.
- Allow current CCB dispute resolution services to directly pay out of the recovery fund at the conclusion of dispute resolution proceedings, or payouts based on civil litigation.
- Confer administrative authority for the recovery fund in the Construction Contractors Board.
- Assess residential-only contractors a reasonable fee (\$20 to \$50), offset with civil penalty funds and other funding sources.
- Retain investment income made off recovery fund money for additional resources.
- Restrict the use of the recovery fund to pay construction defect claims.
- Set aside a flexible percentage of recovery fund money for administrative expenditures.
- Allow the Construction Contractors Board to pursue subrogation claims to replenish the recovery fund.
- Allow the Construction Contractors Board to condition, suspend or revoke a license to secure payment from the recovery fund.
- Cap payouts to \$20,000 per claimant.
- Cap aggregate liabilities against a contractor to \$100,000.
- Limit damage reimbursement to actual damages.
- Create mechanisms for prorated and proportional share payments from recovery fund.

- Provide limited ability to Construction Contractors Board to modify orders to protect the integrity of the recovery fund.

### **Consumer Information Proposal**

- Amend administrative rules to disallow distribution of previous versions of the Information Notice to Owners.
- Require by statute signature lines on consumer information, lien notice and dispute resolution forms for consumer and contractor to sign to verify distribution.
- Lack of written contract invalidates a claim of a valid construction lien.
- Provide one business day after signing a construction contract for a consumer to fully review consumer protection information and the contract.
- In cases where a contractor does not provide required forms for the consumer, extend length of time to file a claim with the CCB from one year to two years.

### **Residential Permits Proposal**

- Alter permit application process to require the applicant to specify the owner of the project, the contractor performing the work for the owner, and identify the CCB-issued license number and the identity of any certified envelope specialists working on the permitted construction project.
- When an owner acquires a permit, require local building department to distribute revised Information Notice to Owners About Construction Responsibilities. Revised form should include at a minimum (1) the owner's duty to comply with building codes, (2) the responsibility of the owner to supervise construction work, if the owner is acting as their own general contractor, and (3) the owner's responsibility to make corrections after inspection.
- Require a certificate of occupancy for all structures built to the residential component of the state building code.

### **Building Envelope Certification Proposal**

- Maintain the CCB licensing system currently in place.
- Create a certification that is required for any contractor licensed in Oregon directly working on a residential or commercial building envelope.
- Prohibit uncertified contractors from working on building envelopes.
- For contracting firms, require contractors that work on building envelopes employ at least one individual acting in a supervisory capacity who has obtained the certification.
- Require a contracting firm's certified envelope specialist provide the prescribed degree of training to subordinate employees on the appropriate materials, code requirements, and design requirements utilized at the particular structure.
- Require the certified envelope specialist to verify by checklist that construction work involving the envelope meets code requirements and approved designs.
- Require a certified envelope specialist to complete and submit additional verification to the local building department in order to obtain a certificate of occupancy.
- Require certified individuals take a set number of continuing education hours on substantive construction requirements.

- Modify as needed the appropriate CCB enforcement laws to ensure contractors are properly certified and meeting any responsibilities under the certification.
- Require all contractors obtain continuing education, which may include education on building code changes.

### *Phase II Proposal Package*

#### **Voluntary Loss Control Discounts Proposal**

- Encourage use of loss control discounts on construction contractor business.
- Clarify by issuance of an Insurance Division Bulletin that discounts offered for contractors adopting best practices recommended by the Construction Claims Task Force will not be required to include statistical support for the discounts in their filings.
- Bulletin to be issued using examples of best practices adopted by the Task Force in their final report to the Legislature in 2007.

#### **Wrap Project Limit Proposal**

Streamline rate filing requirements for policies on single project owner or contractor controlled coverage applying to all contractors working on a job in two areas:

- Eliminate project minimum limit for projects including workers' compensation to allow open consideration by insurers for projects of any size. Filing and prior approval would continue to be required in order to allow for proper handling of claims for injured workers.
- Waive requirements for fictitious groups for group general liability policies for contractors to encourage open market for smaller projects that do not include workers' compensation.

\* Approval of the additional three Phase II proposals is pending Task Force review. First party warranty proposal has been adjusted as suggested by the Task Force at the October 25, 2006 meeting. The additional two items have not yet been reviewed.

#### **Warranty Proposal Part 1 – First Party Warranty**

- Establish a first party warranty requirement for new residential structures.
- One year warranty provided by the builder to warrant that the structure will be free from any defect due to workmanship, materials or noncompliance with building code.
- Two year warranty provided by the builder to warrant that the building envelope will be free from any defect due to materials, workmanship or noncompliance with building code.
- Warranty to be recorded in deed at the time of sale.
- Transfer of warranty without charge to subsequent owners during the warranty period.
- No disclaimer or waiver of warranty permitted.

#### **Warranty Proposal Part 2 – Structural Warranty**

- Ten year warranty for any structural defect that results in failure of a load bearing part of the home or causes structural damage that materially affects the use of the home for residential occupancy.
- Builder may warrant structural defect or purchase warranty coverage that meets the requirements of the warranty provisions.
- Specific definition of structural defect would apply. The current proposed language is:
  - \* *Structural defect* means any defect in the load-bearing portions of a new residential structure that adversely affects its' load-bearing function to the extent that the home becomes or is in serious danger of becoming unsafe, unsanitary, or otherwise uninhabitable.
  - \* As in the First Party Warranty Part 1 the following requirements would be included:

- ❑ Warranty to be recorded in deed at the time of sale.
- ❑ Transfer of warranty without charge to subsequent owners during the warranty period.
- ❑ No disclaimer or waiver of warranty permitted.

#### **General Liability Coverage Proposal**

- Amend requirements for contractor licensing to provide that the coverage necessary for contractors general liability include completed operations liability.
- Enforcement would continue under existing law with the Construction Contractors Board.
- Phase-in period would be allowed to implement the requirement as existing licensure renews after the effective date.

#### **Data Reporting Requirements Proposal**

- Require insurers writing contractors liability in Oregon to maintain and report specific data elements on contractor business to allow for assessment of market conditions on an ongoing basis.
- Proposed areas of consideration for regularly maintained data include:
  - \* Written premium by classification
  - \* Policy count by classification
  - \* Paid Losses
  - \* Loss reserves
  - \* Reported claim count

#### **Issues to consider**

In developing the final list of recommendations to the legislature the Task Force considered many recommendations and encountered a number of additional issues that may reduce construction defects in Oregon. The Task Force wanted to identify that further work and analysis on these issues should occur. These issues include: **\*\*Placeholders Only\*\*** No final decision made\*\*

- Early Mandatory Mediation for construction disputes
- Insurance requirements for architects, engineers and limited liability companies
- Clarifying the additional named insured coverage issue.
- Private right of action/bad faith in insurance litigation.