



PRELIMINARY DRAFT FOR DISCUSSION PURPOSES ONLY

-----December 8, 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

Executive Summary

The 73rd 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 74th 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 data 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 74th 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 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 encountered 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 approximately 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 comprehensive 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 held an additional public comment session at the November meeting, allowing the public to provide input on the package of 11 proposals that were the result of the work completed during Phase I and Phase II.

The recommendations of the Task Force are as follows:

Phase I Recommendations:

Recommendation #1: Clarifying Building Code Requirements

Policy Statement

The Task Force recognizes that preventative measures for dealing with moisture intrusion are needed to curb construction defects. Changes to the state building code are needed for preventing moisture from entering a building, as well as removing moisture from a building.

Discussion

The state building code sets minimum standards for residential and commercial structures in Oregon. These minimum standards focus on protecting the occupants of buildings and the general public from fire and life safety hazards. Other aspects of construction, such as reducing water intrusion, are regulated through general code provisions. Testimony and other gathered information suggested making changes to the state building code in key areas: the allowable moisture content of a building cavity, applications of flashing and additional mechanical ventilation provisions.

The Task Force arrived at the recommendations in this section through testimony, background research and examining comparative approaches to building code regulation in other states and Canada. The Task Force recommends:

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

Recommendation #2: Construction Contractors Board Enforcement and Licensing Changes

Policy Statement

The Task Force recognizes that more knowledge of an applicant's history before a license is granted may help improve the overall quality of contractors entering the profession. The Task Force also recognizes that the CCB may need more enforcement tools to address the problem of defective construction.

Discussion

As the primary licensing agency for construction contractors, the CCB has regulatory authority over approximately forty-two thousand contractors. Through testimony from invited speakers and examination of comparative models, the Task Force recommends the following items to help the CCB meet its regulatory mandate:

1. Expand CCB's enforcement authority by adding an expedited emergency suspension process outside the Administrative Procedures Act to deal with problem contractor licenses.

2. Licensees or responsible managing individuals subject to sanction by the CCB must not serve as owners, officers, directors, or managers of another construction firm.
3. 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 as needed.
4. 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 databases. Allow the CCB to acquire criminal records in the course of investigating applicants as needed.
5. 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.
6. Confer on CCB criminal citation authority.

Recommendation #3: Recovery Fund

Policy Statement

In the event that a structure contains a defect and a homeowner is unable to recover some measure of relief from the contractor's assets, the Task Force believes that a limited fund should be at the disposal of the Construction Contractors' Board to provide some relief for homeowners

Discussion

The Construction Contractors Board provides dispute resolution services to homeowners and contractors in breach of contract disputes. If the CCB orders a contractor to pay money to a homeowner and the contractor fails to pay, the contractor's bond may be available to pay the unpaid portion of the order. However, the bond may not be sufficient to cover the amount of the claim. The Task Force recommends the use of existing enforcement money collected by the CCB to be made available to homeowners. Other recommendations by the Task Force on the subject of an assistance-type recovery fund include:

1. Establish a recovery fund for residential construction only.
2. Require only those contractors whose work is directly connected to residential construction to participate in the recovery fund.
3. 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.
4. Confer administrative authority for the recovery fund in the Construction Contractors Board.
5. Assess residential-only contractors a reasonable fee (\$20 to \$50), offset with civil penalty funds and other funding sources.
6. Retain investment income made off recovery fund money for additional resources.
7. Restrict the use of the recovery fund to pay construction defect claims.
8. Set aside a flexible percentage of recovery fund money for administrative expenditures.

9. Allow the Construction Contractors Board to pursue subrogation claims to replenish the recovery fund.
10. Allow the Construction Contractors Board to condition, suspend or revoke a license to secure payment from the recovery fund.
11. Cap payouts to \$20,000 per claimant.
12. Cap aggregate liabilities against a contractor to \$100,000.
13. Limit damage reimbursement to actual damages.
14. Create mechanisms for prorated and proportional share payments from recovery fund.
15. Provide limited ability to Construction Contractors Board to modify orders to protect the integrity of the recovery fund.

Recommendation #4: Consumer Information

Policy Statement

The Task Force believes that some claims may be alleviated by giving consumers information on how to proceed going into a construction contract early in the construction process, as well as directing consumers to appropriate resources.

Discussion

The Construction Contractors Board currently requires that contractors provide their clients with at least three items of information as part of a licensee's ongoing requirements. However, the Task Force believes that additional consumer information, focusing on protecting the consumer and distributed by the contractor is necessary. The Task Force specifically recommends:

1. Amend administrative rules to disallow distribution of previous versions of the Information Notice to Owners.
2. Require by statute signature lines on consumer information, lien notice and dispute resolution forms for consumer and contractor to sign to verify distribution.
3. Lack of written contract invalidates a claim of a valid construction lien.
4. Provide one business day after signing a construction contract for a consumer to fully review consumer protection information and the contract.
5. 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.

Recommendation #5: Residential Permits

Policy Statement

The Task Force recommends improving the permitting process by clarifying who is the responsible party for work being done under the permit and that appropriate licensing and certification information is provided to a local building department.

Discussion

Building permits serve as a means of alerting the local building department of construction work occurring in the jurisdiction. Oregon law regulating the issuance of building permits only

requires that a person obtain a permit. The Task Force believes that Oregon law needs more clarity on what information a permit must contain, and which party is ultimately responsible on the permit. In addition, the Task Force believes that a certificate of occupancy for a residential structure would serve as a vehicle to implement the recommendations resulting from testimony and debate. The Task Force thus recommends the following:

1. 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.
2. 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.
3. Require a certificate of occupancy for all structures built to the residential component of the state building code.
4. Implement a standard inspection checklist that details an inspecting jurisdiction's scope of responsibilities.

Recommendation #6: Building Envelope Certification

Policy Statement

In order to raise the quality of construction, the Task Force recognizes the need to instill competency training for the persons directing construction on a jobsite.

Discussion

Many panelists in the Phase I discussions advocated for some form of certification beyond the current Oregon requirements. Data gathered by the research consultant, as well as a survey of comparative regulatory models in other states and Canada lead the Task Force to believe that some level of training and verification should occur for those persons working on the outside envelope of a structure. The Task Force specifically recommends:

1. Maintain the CCB licensing system currently in place.
2. Create a certification that is required for any contractor licensed in Oregon directly working on a residential or commercial building envelope.
3. Prohibit uncertified contractors from working on building envelopes.
4. For contracting firms, require contractors that work on building envelopes employ at least one individual acting in a supervisory capacity on a jobsite who has obtained the certification.
5. 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.
6. Require the certified envelope specialist to keep a training log of all training provided.
7. Require the certified envelope specialist to verify by checklist that construction work involving the envelope meets code requirements, approved designs, and that workers have been trained appropriately.

8. Require the contractor to produce a verification form before receiving a certificate of occupancy. Allow general contractors and subcontractors to work out who is the certified envelope specialist that submits the verification form.
9. Require certified individuals take a set number of continuing education hours on substantive construction requirements.
10. Modify as needed the appropriate CCB enforcement laws to ensure contractors are properly certified and meeting any responsibilities under the certification.
11. Require all contractors obtain continuing education, which may include education on building code changes.

Phase II Recommendations:

Recommendation #2: General Liability Coverage

Policy Statement

Oregon law requires general liability insurance in order to obtain a contractors license in Oregon. The current law only requires that the insurance apply while the work is in progress. The Task Force has determined that better consumer protection would exist if coverage obtained by contractors was required to include completed operations liability. Completed operations liability would extend to bodily injury or property damage that occur due to the contractors negligence and occur after the job is complete.

Recommendation #4 Voluntary Loss Control Discounts Proposal

Policy Statement

Since construction defect liability claims often emerge and settle several years after project completion, there can be a significant time lag between the adoption of best practices or other efforts expected to reduce claims and the loss data showing the effect of the efforts. The purpose of this bulletin is to encourage insurers to implement voluntary loss control discounts in their rating plans for contractors who adopt the recommendations of the Task Force rather than have insurers wait for the claim experience to reflect the loss reduction measures.

Recommendation #5 Data Reporting Requirements Proposal

Policy Statement

In order to review and monitor the effectiveness of the Task Force recommendations, the Insurance Division will develop a set of data items to be reported by insurers on an as needed basis.

Additional 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 impact construction defects in Oregon. The Task Force wanted to identify that further work and analysis on these issues may be appropriate. These issues include:

- **Failure to mediate dispute prior to filing lawsuit or enforcing arbitration rights**

During the course of its work the task force noted the time and expense involved in resolving construction defect disputes in the courts or through arbitration. Currently, nothing in Oregon law requires parties to a construction dispute to attempt resolution of the dispute prior to filing a lawsuit or enforcing arbitration rights. The Task Force believes that mandatory mediation prior to filing a lawsuit or enforcing arbitration rights merits further analysis.

- **No insurance requirements for architects and engineers**

During the course of its discussion of insurance issues the task force noted that architects and engineers are not required by law to maintain liability insurance coverage for the work they perform. The task force believes that additional analysis of the insurance requirements for architects and engineers may be appropriate.

- **Ability of a limited liability company to dissolve and leave contractor liable**

During the course of its work the task force noted that a limited liability company is allowed to dissolve after its purpose has been achieved (a construction project), potentially leaving the contractor liable for the full project. The task force believes the ability of a L.L.C. to dissolve leaving others liable may merit further analysis.

- **High transactional costs in insurance litigation**

During the course of meeting discussions, the task force identified an issue related to the fact that construction contractors' liability insurance claims have higher defense costs than other general liability classes. There are many differing theories as to why these litigation costs are higher and what can be done about them ranging from proposals that would discourage litigation to those that would encourage timely settlement of claims. The task force believes that the causes of high transactional costs in insurance litigation may merit further analysis.

- **Indemnification of additional insured parties in construction contracts**

During the course of discussion the task force identified an issue related to the indemnification of additional insured parties in construction contracts. Questions were raised regarding the meaning of certain statutory provisions, as well as judicial decisions and insurance policy language related to indemnification of additional insured parties. The task force believes that the indemnification of additional insured parties may merit further analysis.

- **No sanction for repeated re-inspections**

During the course of public testimony a concern was raised that jurisdictions have no ability to provide a sanction for contractors whose work required repeated re-inspections in order to get the work to code. In addition the task force observed that such information may be useful to consumers when they select a contractor. While the issue

was raised too late in the process for the task force to fully vet the issue, the task force believes that additional analysis on the issue may be appropriate.

- **Lack of envelope design details**

During the course of its work an issue was raised as to the lack of required envelope design detailing on structural plans. The task force believes that additional information provided on building plans may merit further analysis.

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