

**CONSTRUCTION CLAIMS TASK FORCE
INSURANCE -ITEMS FOR CONSIDERATION
8-23-06**

At the request of the task force chairman, the Oregon Department of Consumer and Business Services has provided these proposals for consideration by the Task Force. These proposals are based on input received from presentations and discussions by industry professionals, Task Force members, and -American Actuarial Consulting Group. The Department is presenting these for discussion purposes only, and most of them would require further analysis before either the Department or the Task Force could make a final decision on their feasibility and potential impact on the availability and affordability of insurance and potential impact on consumer protections.

1. WARRANTY PROGRAM

Proposal: A warranty program could be established that would allow for warranty coverage for targeted sections of the contractor market.

Discussion: The warranty program could provide a mechanism to address issues impacting targeted contractors such as new residential construction.

Most programs would have the builder maintain responsibility for the warranty for the first full year or two after occupancy of the dwelling. The program could be modeled after elements of the British Columbia model known as the 2/5/10 Program or the New Jersey model, both of which require a third party insurer to stand behind the warranty.

The warranty provider could cover a specific schedule of items and conditions. The liability of a builder or warranty provider is normally limited to the purchase price of the home or the fair market value of the home on its completion date. The scope of the warranty program might be aligned with the definition of residential structure in the state building code – that is, detached single family homes, duplexes, townhouses, rowhouses and residential structures three stories or less in height.

[\[Ed Davis: A reasonable solution would be to define what would be an acceptable “warranty” but not require that the warranty be provided by any one specific “program.” Terms should include not only what defects are to be covered, but provide reasonable notice to the builder, opportunity to repair alleged defects, and a binding arbitration process for resolution of disputes.\]](#)

2. GENERAL LIABILITY COVERAGE TO INCLUDE COMPLETED OPERATIONS

Proposal: Depending on whether the Task Force proposes the warranty option, the insurance requirement for contractors under ORS 701.105 could be expanded to include coverage for completed operations.

Discussion: The Department of Justice was asked to interpret the statutory language under ORS 701.105 and determine whether the intent of the law would allow the required insurance to

exclude completed operations coverage. Legal analysis concluded that “the law does not appear to impose” the requirement that completed operations be provided.

On several occasions during the course of the work by the Construction Claims Task Force this has been an issue of discussion. Submitted written testimony suggests that coverage should include completed operations that would extend for the entire period of the statute of repose.

[Ed Davis: Insurance carriers aren't likely to offer completed operations coverage other than on a year-to-year basis. "Discontinued operations" coverage is now supposedly available for companies that terminate their ongoing operations, but it requires ongoing payment of a reducing premium level, and most buyers choose not to purchase the coverage. Current premium levels are set on the premise that coverage applies to damage that "occurs" during the current policy term. This proposal would re-define completed operations coverage to apply not when the "occurrence" takes place, but for all "occurrences" that happen within the statutory period after the work has been completed. If the construction work takes place over multiple policy periods, perhaps even with different insurers, which policy's completed operations coverage would be expected to apply? You can expect significant premium increases and less availability of completed operations coverage if this proposal should be implemented.]

The rationale for this proposal would be less compelling if the warranty is adopted since warranty and general liability coverage do overlap in some areas of property damage liability. However, completed operations general liability would also extend to certain areas such as bodily injury issues, which may not be covered under a warranty option.

The Task Force may want to limit the scope of the proposals for warranty and completed operations to the affected areas of the market.

3. LOWER LIMITS ON WRAP PROJECTS

Proposal: Regulatory restrictions on wrap projects could be streamlined by lowering the project eligibility limit under ORS 737.602 to \$10 million to reflect the current liability claim environment.

[Ed Davis: The larger "wrap" projects almost always include both general liability and workers compensation coverages. Smaller "wraps" have been used primarily for residential condo projects, not because of safety or cost issues, but simply because a high percentage of the contractors and subcontractors now have exclusions on their general liability policies for such work. Using a "wrap" policy is the only way the owner/developer/general contractor can find coverage and get enough subcontractors to bid on the project. The project eligibility limit should not be reduced, but the statute should be modified to allow exceptions for smaller projects when it can be shown that the coverage to be provided by the "wrap" isn't otherwise reasonably available. Minimum coverage limits should also be required, based on project size, and completed operations coverage should be mandated for the full 10-year statutory period.]

Discussion: Currently, ORS 737.602 allows “wrap” coverage for construction projects when the aggregate value exceeds \$90 million. This statute also requires the project sponsor to show that

the grouping will substantially improve accident prevention and claims handling. This statute further describes rating, auditing and deposit requirements. The qualifying project limit was determined in 1990 when construction defect claims, which often involve multiple claimants and multiple insurer expense costs, were a small portion of the general liability claim costs.

The proposed limit was selected to allow medium sized projects to benefit from the loss prevention and claim handling incentives provided under wrap projects. Testimony to the Task Force has indicated that “safety groups” are being used for projects in the \$10 million range. Allowing those projects to qualify as “wrap” -projects would offer additional flexibility to include workers’ compensation.

[\[Ed Davis: The only reason for a “wrap” on these smaller condo projects is for general liability coverage, and only because of the proliferation of exclusions for that work. There’s no problem with contractors obtaining workers compensation coverage for condo work, and there’s no justification for including it in any exceptions to the current statute.\]](#)

The rating plan filed under ORS 737.602 could also be streamlined by removing the requirement for prior approval and allowing a file and use format to reduce regulatory barriers. Deposits could be eliminated or reduced. The requirement that the grouping demonstrate accident prevention and claims handling improvement could also be eliminated, since this has been demonstrated by prior filings.

Construction defect claims currently are at least 40-60% of the contractors total liability claim costs. Since legal expenses can comprise as much as half of the total construction defect loss and adjusting expense, any project or insurance mechanism that coordinates legal defense costs for construction defect claims is likely to streamline claim processing for the construction project and project contractors.

4. LOSS CONTROL DISCOUNTS

Proposal: 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.

Discussion: Discussions and proposals stemming from Phase I of the Task Force’s work may potentially reduce construction defect claims – and consequentially, contractor losses. Since construction defect claims can have up to a ten-year reporting period, the effect of these proposals may not be reflected in contractor loss experience for several years.

[\[Ed Davis: While streamlining the filing and documentation process may encourage some discounts, you shouldn’t expect any significant short-term impact from this proposal. Most of the affected contractors are smaller builders whose loss record and building practices have already been reviewed and considered in the pricing of their policies.\]](#)

There is currently a model to mandate discounts in Auto Insurance. ORS 742.490 mandated discounts for drivers 55 years of age or older that participated in accident prevention courses approved by the Department of Transportation.

[Ed Davis: Mandating discounts for specific loss control practices is likely only to move the current credit factor from one pricing component to another, and may very well reduce the level of credits available for other pricing and underwriting factors. If it requires significant deviation from what companies are allowed to do in other markets, it may also result in some carriers choosing not to offer such coverage in Oregon.]

5. AGENT DISCLOSURE OF MARKET SEARCH EFFORTS

Proposal: 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.

Discussion: Agents working with any licensed contractor or contractor seeking new licensing could be required to present full disclosure of their marketing efforts when asked to write coverage or quote for insurance required by ORS 701.105. Information presented to the contractor might include: names of insurance carriers, names of brokers and the contact person at the brokers office, specific reasons for denial to quote coverage, specific rating and underwriting information presented in the quotation request and final outcome. Disclosure issues would necessarily be sensitive to privacy requirements.

Under current law ORS 735.410 requires a “diligent search” of the market before a risk can be placed with a surplus lines. The definition of “diligent search” could be amended to include the duty of an agent to advise the potential contractor client that there may be other alternatives to the coverage offered by his/her agency through outside sources and to identify those whenever possible.

6. SPECIFIC DATA REPORTING

Proposal: Insurers could be required to report premium and loss information for contractors’ general liability insurance in a standardized format to the Oregon Insurance Division.

Discussion: There is no consistent publicly available information on construction contractors’ general liability premium and claim levels. As a result, some insurers were unable to report the requested information for use by the task force. In order to obtain data in a standard format and be able to compile a solid picture of the condition of the marketplace, including the extent to which Oregon premiums are dependent on regional or national specific data reporting could be required.

This would allow the Division to monitor progress in response to the work of the Construction Claim Task Force and to have an earlier indication of market difficulty if it should occur.

Requested information could include written premiums, number of policies written, number of reported claims, paid losses and case reserves as of year end starting with 2007. The data could also be divided into premises operations and construction defect completed operations and non-construction defect completed operations claims. Timely reporting of this basic information may help insure that there is relevant information on contractor business.

Any reporting requirement should consider increased cost as well as the expected benefit the data may provide.

[Ed Davis: Again, please recognize that any requirement which would cause significant increased cost to insurers to do business in Oregon is likely to result in increased premiums, fewer available markets, or both.]

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The Insurance Division introduced proposed legislation in 2005 to ease the statutory barriers to formation of Joint Underwriting Associations (JUA) and Market Assistance Plans (MAP). MAP and JUA are regulatory remedies for the problem of access to and affordability of commercial insurance during a “hard” market. Under current law, DCBS may implement a MAP or JUA but the process is complex, making it difficult to respond quickly to market changes. The proposed bill would have removed administrative barriers required to form a MAP, removing the restriction that a MAP must be formed and found ineffective before a JUA may be formed, and ease regulatory barriers to creation of a JUA.

The reconsideration of that 2005 legislation, Senate Bill 116, may be another area that the Task Force may want to consider.