Ohio Construction Defect Law

Insurance Company Seminar Presentation

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Who Brings Claims Based Upon Construction Defect?

Owners sue sellers and developers. Depending on contractual relationships, owners might also sue design professionals (such as architects and engineers) and general contractors.

If designers and general contractors are not sued directly, the developer may bring third-party claims against them.

The designers may bring third-party claims against their consultants such as structural and geotechnical engineers.

General contractors may bring third-party claims against their subcontractors and material suppliers.

Tip – If your insured subcontracted out any of the allegedly defective work, the subcontractors should be put on notice of the claim. Similarly, if materials are allegedly defective, the material supplier should be put on notice.

What is Construction Defect Claim?

A construction defect claim is a claim for damages based upon allegations of defective design, construction, or oversight.

Claims brought against trades may include:

Failure to build in a workmanlike manner
Failure to build according to plans and specifications
Failure to build according to industry standard
Failure to build according to applicable building codes
Failure to protect building materials from damage
Breach of contract
Breach of warranty
Consumer Sales Practices Act

Claims brought against general contractors / construction managers may include:

Same as for trades, plus:
Failure to hire competent subcontractors
Failure to have the different traders perform in the correct order
Failure to oversee and ensure quality work by subcontractor
Vicarious liability for subcontractors

Claims brought against design professionals may include

Failure to design according to the community standard of care
(i.e., a professional errors and omissions claim)
Failure to ensure construction in a accordance with plans and specs
(no responsibility for means and methods)
Breach of contract

Claims brought against Developers/Sellers

Same as for trades, general contractors, and design professionals, plus…
Fraud, misrepresentation
Breach of statutory obligations and warranties
Breach of contract
Vicarious liability for the conduct of the general contractor and design professionals

Tip – Trades cannot avoid liability for poor workmanship merely because the general contractor or architect should have noticed the defect. In that instance, the general contractor or architect with project administration duties may have been independently negligent, based upon failure to supervise. Where work is well-executed, but is obviously changed from the plans and specs, trades may have some defense by contending that the general contractor and architect knew or should have known, and expressly or impliedly approved or ratified the change.

Tip – Sometimes claims involve construction issues, even though the claims are not obviously construction claims. For example, a fire loss at a construction site may involve not only fire cause and origin investigation, but also may require consideration of the allocation of on-site responsibilities by contract or custom.

Tip – Unless a warranty explicitly states that it provides the exclusive remedy under the contract, and unless there no ambiguity as to intent is created by other provisions in the contract, it can be difficult to avoid liability based solely on expiration of warranty period.

Examples of Construction-Related Claims

Water damage is discovered on exterior walls and windows of condominium units. There appear to be multiple causes, include lack of kick out flashing at roof line, lack of adequate flashing at window head, and wicking of moisture through masonry veneer at grade. Was the lack of kick out flashing a design issue or construction issue? If a construction issue, who should have installed – the roofer or the veneer mason? Also, who was responsible for flashing the window head - the window installer or the exterior trim installer?

Boiler in older, steam-heated home fails to work, so that radiator pipes freeze and break. The insured HVAC contractor was last to work on the boiler. There was a question as to whether his work directly related to the failed boiler control element. If it did not, should the insured nevertheless has identified the potential for future failure and recommended additional

work? The home was on market, and was not inhabited or regularly checked. Was the owner / realtor negligent in failing to regularly check that the heat was working?

The connector that joins the water tank feed line to a toilet tank breaks while claimant owner is on vacation, resulting in significant water damage. Did plumber incorrectly install the feed line and connector? Had there been any alterations or work done by others after the time the plumber completed his work? Was the homeowner negligent for failing shut off the water to the house before leaving for vacation?

Condominiums were built on rolling terrain that required significant earthwork prior to construction. Units exhibited bowing and cracking of basement walls, and some basement water intrusion. Did the rough grade excavators and footer excavators adequately compact the soils prior construction? Did the structural engineer design the units with adequate lateral stability? Did the architect design for suitable drainage? Was the grading plan reasonable as to building elevations and drainage? Where the units sited at the specified elevations? Were the basements backfilled using the correct material, per either plan or spec or custom? Did the site civil engineer and geotechnical engineer adequately advise the developer and oversee the work?

Who Are the Players?

Owners

Developers / Sellers

Bonding Companies

- Bid bond
- Performance bond
- Warranty bond

Design Team

- Environmental
- Geotechnical
- Architect
- Civil
- Structural
- Mechanical

Build Team

General Contractor / Construction Manager

Trades

Block Mason	Gutters
Brick Mason	HVAC
Caulking	Mechanical
Electric	Painting
Excavator	Paver
Exterior trim	Plumbing
Finish carpenter	Roofer
Finish grade	Siding
Fire Suppression	Underground Utilities
Framer	Windows & Doors
Insulation	

Basics of Insurance Coverage

Insuring Agreement

What is an "Occurrence"? Is defective construction an "accident" of a type intended to be insured against, or is it a "business risk?"

What is "Property Damage?" It includes loss of use of property not physically injured.

What is "Impaired Property?" Tangible property that cannot be used or is made less useful because it incorporates "your work" or "your product," or because you failed to fulfill the terms of the contract or agreement

Exclusions

Ref., Form CG 00 01 040 13, Coverage A.

k. "Property damage" to "your product"

l. "Property damage" to "your work". May or may not include work performed by subcontractors, depending on whether the subcontractors exception to the your work exclusion is removed by endorsement

j(5). "Property damage" to that particular part of real property on which you are performing operations

j(6). "Property damage" to that particular party of any property that must be restored, repaired or replaced because your work was incorrectly performed on it. This exclusion does not apply to complete operations.

m. "Property damage" to impaired property or property not physically injured arising out of a defect in your work.

Tip – The exclusions for mold appear in a separate amendatory endorsement.

Resulting Damage

Under exclusion k., there is no coverage for damage to "your work." However, it is commonly held that there is coverage where the insured's negligence causes "resulting damage," i.e., damage to property other than the insured's work or product.

For example, a concrete contractor installs a large patio. The patio spalls, but no other property is damaged, and no other contractor's work has to be replaced. In this case, there would be no coverage, because all damage falls within the "your work" exclusion.

On the other hand, consider the case of an exterior trim contractor who fails to install flashing that is required by the drawing or by industry standards governing the trade. If the lack of flashing results in water intrusion and damage to wall sheathing installed by others, there is coverage for damage to wall sheathing, but no coverage to repair or replace the flashing itself.

The classic example is a defective light switch that starts a fire, resulting in complete destruction of a house. As to the insured light switch supplier, the reconstruction of the entire house is covered, except for the light switch, which is "your product."

Other Issues

Additional Insureds
Other Insurers on Risk
Defunct Corporation

Tip – When damage occurs over a long period of time, such as hidden water damage, identify all carriers who covered the insured during that period. Suggest that each be responsible for any settlement or judgment based upon time on risk.

Tip – When damage becomes known to an insured, subsequent insurers may argue that there is no coverage due to known risk / loss in progress.

Tip – Developers and general contractors may additional insureds under the subcontractor's policy. Typically, additional insureds are covered only for the subcontractor's negligence, not for their independent negligence. Further, coverage for them is subject to the same conditions and exclusions as coverage for the sub.

How to Investigate and Prepare the File

Get the insured's story. Be sure to ask about:

Scope of work
Source of materials supplied by the insured
Subcontractors used by the insured
Dates work started and completed
Challenges during construction
Changes during construction
When was the damage first disclosed to the insured
Were there any attempts to remedy
Key witnesses, associated with the insured or otherwise

Consider issuing a reservation of rights letter.

Put subcontractors and material suppliers on notice, if appropriate. Consider indemnity obligations, discussed below.

Put other insurers on notice. These may include insurers, who provided coverage when the work was performed, at any time when damage occurred, when damage was discovered, or when the claim was made.

Collect documents. A complete list of documents appears below, but key documents typically include:

Contracts
Invoices / applications for payment
Drawings and specs
Change orders, Requests for Information
Meeting minutes and inspection reports

Retain an expert. In order to maintain privilege, work through an attorney.

Consider the issue of covered and uncovered damages.

Consider legal defenses. Defenses based upon passage of time, such as statutes of limitation and statutes of repose, are discussed below. Others may include contractual periods for limitation of action, waivers of subrogation, contractual invalidity, wrong party, and so on.

Tip – In order to defend claims of construction defect, it is important to inspect the allegedly defective conditions ***prior*** to the commencement of remediation. Ask the claimant not begin any remediation without adequate notice to you and fair opportunity to inspect. Retain a qualified expert to inspect the work. In high dollar cases, or if litigation seems likely, have an

attorney retain counsel, in order to maintain work-product privilege. In any event, do not disclose the expert's report, if it is unfavorable.

Tip – Claimants sometime use more expensive designs and materials during the course of remediation. These are called "betterments." Liability for betterments must be evaluated on a case by case basis.

Tip – The mere fact that a corporation is dissolved does not relieve it from liability for past acts. It simply means that no corporate assets remain to be placed at risk. However, insurance remains available.

Documents Relative to a Construction Project

1. What are the Contract Documents (AIA A201-1997, 1.1.1)
    (a) Agreement between Owner and Contractor
    (b) General, Supplementary, and other conditions
    (c) Drawings
    (d) Specifications
    (e) Addenda issued before Contract execution
    (f) Other documents listed in the Agreement
    (g) Modification issued after Contract Execution
        i. Written Contract Amendment
        ii. Change Order
        iii. Construction Change Director
        iv. Written order for a minor change
2. What are the Project Documents
    (a) Request for Information
    (b) Schedule
    (c) Record Documents
    (d) Submittals
    (e) Changes in Work
    (f) Change Order
    (g) Construction Change Directive

(h) Minor changes in work - These are often issued in Architect's Supplemental Instruction ("ASI")

(i) Meeting Minutes

(j) Daily Job Report

i. Weather conditions

ii. Work activities

iii. Labor

iv. List of Subcontractors, including crew size and hours worked

v. Deliveries

vi. Job Logs

vii. Unit costs

viii. Equipment rental and usage

ix. Comments, Field Conditions

(k) Photographs and video provide a visual record of construction progress

(l) Communications

3. Documents Relative to Project Closeout

(a) Substantial Completion

i. Punch List

ii. Certificate of Substantial Completion

(b) Final Documentation

(c) Certificate of occupancy

Applicable Statute of Limitations

TYPE OF CLAIM	PERIOD	AUTHORITY
Bodily injury or injury to personal property	2 years	R.C. §2305.10
Wrongful death	2 years	R.C. §2125.02
Employer Intentional Tort	2 years	R.C. §2305.10
Damage to Real Property	4 years	R.C. §2305.09
Violation of Ohio's Consumer Sales Practices Act	2 years	R.C. §1345.10
Professional Negligence Claims Against Design Professional	4 years	R.C. §2305.09(D)
Breach of Written Contract	8 years	R.C. §2305.06

Contract Not in Writing / Oral	6 years	R.C. §2305.07
Most Breach of Warranty Claims	4 years	R.C. §2305.09

Pursuant to Ohio's Statute of Repose, no cause of action exists for real or personal property damage, bodily injury, or wrongful death that arises out of a defective and unsafe condition of an improvement to real property against a person who performs services for the improvement to real property or a person who furnished the design, planning, supervision of construction, or construction of the improvement to real property later than 10 years from the date of substantial completion. R.C. §2305.131(A)(1). However, a claimant who discovers a defective and unsafe condition of an improvement to real property during the 10-year period, but less than 2 years prior to the expiration of that period, may pursue a claim within 2 years from the date of discovery of the defective and unsafe condition. R.C.§2305.131(A)(2). The Statute of Repose, however, does not apply to claims against an owner, tenant, landlord, or other person in possession and control of an improvement to real property that is in actual possession and control at the time the defective and unsafe condition constitutes the proximate cause of bodily injury, injury to real or personal property, or wrongful death that is the subject matter of the claim. R.C.§2305.131(B). The statue of Repose does not bar claims against a person who has expressly warranted or guaranteed an improvement to real property for a period longer than the statutory 10-year period and whose warranty or guarantee has not expired at the time of the bodily injury, injury to real or personal property, or wrongful death. R.C.§2305.131(D). The Statue of Repose is purely remedial in operation and applies to any claims commenced on or after its effective date.

Indemnification

Indemnity arises from contract, either express or implied, and is the right of a person who has been compelled to pay what another should have paid to require complete reimbursement. *Wagner-Meinert, Inc. v. Eda Controls Corp. (2006), 444 F.Supp2d 800 (N.D.Ohio).* The right of indemnity may result from an express agreement or contractual provision when one party, who has been compelled to pay what the other party should have paid, reserves the right to require complete reimbursement. *Indiana Insurance Company v. Barne*s (2005), 165 Ohio App.3d 262, 267. An implied contract for indemnity exists only within the context of a relationship wherein one party is found to be vicariously liable for the acts of a tortfeasor. Id. Implied indemnity can only be enforced by a party which is without fault.

R.C.§2305.31 prohibits clauses in construction contracts that require a party to be indemnified for its own negligence for damages arising out of bodily injury to persons or damage to property. The statute applies to all contracts relating to the design, planning construction, alteration, repair, or maintenance of a building, structure, and roadway, including demolition and excavation.

Since R.C.§2305.31 was enacted, there has been a body of case law in Ohio addressing the validity of "additional insured" and "defense/indemnification" clauses typically found in construction contracts. As to additional insured provisions, the definition of who is an insured under the policy will determine whether the additional insured clause violates R.C.§2305.31. If the clause requires the promisor to purchase insurance for the promisee for the promisee's own negligence, whether sole or concurrent, it will be deemed to violate the statute. However, if the

clause requires the promisor to purchase insurance for the promisee for liability solely arising out of the promisor's negligence, the clause will be deemed valid. In other words, if the additional insured provides coverage to the promisee for the promisee's passive, secondary, and vicarious liability to the primary liability of the promisor, it will be valid. *Buckeye Union Ins. Co. v. Zavarella Brothers Constr. Co.*, 121 Ohio App.3d 147 (1997); *Liberty Mut. Ins. Group v. Travelers Property & Casualty*, 2002 WL 1933244 (Ohio App. 8 Dist.)

As to indemnity clauses in construction contracts, the focus, once against, is on whether the indemnity clause requires the promisor to defend and indemnify the promisee for claims arising from the promisee's negligence, whether sole or concurrent. In short, if the indemnity clause in any way requires the promisor to defend and indemnify the promisee for its negligence, the clause will be deemed to violate R.C.§2305.31. *Kendall v. U.S. Dismantling Co.*, 2 Ohio St.3d 61 (1985); *Kemmeter v. McDaniel Backhoe Service*, 89 Ohio St.3d 409 (2000).

As a matter of practice, in situations where there were negligence allegations against the promisee, the promisor often used this as a basis to deny the promisee's request for defense and indemnity. In these situations where the promisee later settles the claim, courts have held that the promisee waived its rights to pursue a claim against the promisor to recover its fees and expenses based on the argument that the claim did not arise from the promisee's negligence. *C.J. Mahan Constr. Co. v. Mohawk Re-Bar Svs., Inc.*, 2005 WL2562600 (Ohio App.5 Dist). However, there is case law that stands for the proposition that, in situations where the promisee's request for defense and indemnity was denied, but the promisee later proves (i.e., by summary judgment or verdict) that the promisee was not negligent, the promisor can be responsible for the promisee's fees and expenses, provided the defense/indemnification clause excludes indemnification for the sole or concurrent negligence of the promisee. *Kavach v. Warren Roofing & Illuminating Co.*, 2007 WL1508530 (Ohio App. 8 Dist).

Residential Construction

O.R.C. Chapter 1312 - . Applies only to contracts for construction and rehabilitation, not to sales of spec homes. Does not provides warranties, but does lay out dispute resolution duties.