

Report and Recommendations

Background

The 73rd Oregon Legislature created the Construction Claims Task Force to address increasing construction claims and rising contractor general liability insurance premiums. The task force was charged with studying and evaluating the causes and extent of construction defects in Oregon, the need for consumer protection, and the availability and affordability of general liability insurance for contractors. The task force was directed to deliver a report of its findings — including recommendations for legislation — to the 74th Oregon Legislature.

The Construction Claims Task Force offered the first opportunity to study and address all issues relating to building codes, construction contractors, insurance, and energy in a single forum. The task force consisted of nine members. The director of the Department of Consumer and Business Services (DCBS) appointed five members, the administrator of the Construction Contractors Board (CCB) appointed three members, and the director of the Oregon Department of Energy appointed one member.

The legislation that created the task force directed CCB and DCBS to provide staff support. Together these agencies provided administrative support, coordinated task force activities, performed research, and provided expertise on construction and insurance regulation.

This report discusses the work of the task force and describes the task force's final recommendations. The discussion papers following the report provide the basis for each recommendation, including research, analysis, and supporting commentary.

Methodology

The task force divided its work into three phases. During phase I, the task force studied issues related to construction defects. 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.

The task force convened for the first time on Sept. 21, 2005 and held 16 meetings through January 2007. To identify and scrutinize the recommendations that ultimately became part of the legislative report, the task force followed a pattern of information gathering, analysis, public comment, and decision making.

In gathering information the task force relied on construction and insurance industry experts as well as the experiences of the general public. More than 30 invited experts in the fields of construction and insurance provided recommendations. The task force also received recommendations and input from the public during five public comment sessions. The task force received more than 80 specific suggestions from which it selected the 11 final recommendations.

Transparency and the Public Interest

Public comment and participation contributed greatly to the task force. The task force heard public comment during five of its 16 meetings. In addition, the task force created a Web site to provide the opportunity for individuals to track the work of the task force and to contribute to it by submitting information. The task force posted agendas, meeting minutes, exhibits, staff analysis, discussion papers, and public submissions on the Web site and provided e-mail notification of Web site updates to individuals who registered. The Web site received more than 400 submissions, and more than 350 people signed up for automatic notification of updates. The task force Web site is located at: <http://egov.oregon.gov/DCBS/CCTF/>.

Phase I: Study and Discussion of Construction-Related Issues

During phase I, which consisted of six meetings between November 2005 and May 2006, the task force studied and evaluated construction practices in order to identify potential recommendations to reduce construction defects. The task force's staff organized panels of experts representing eight key segments of the construction industry. These panels offered insight into the causes of construction defects and submitted recommendations for consideration by the task force. The task force heard from construction experts 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 panels, the task force heard from homeowners and construction professionals during three public comment periods specific to phase I issues. These sessions allowed the public to share experiences and offer recommendations.

As a result of invited testimony, public comment, and staff research, the staff compiled approximately 70 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 phase I recommendations.

Phase II: Study and Discussion of Insurance-Related Issues

Phase II of the task force work plan consisted of four meetings between June and September 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 and Insurance Companies (July)
- Public Comment (August)
- Wrap-up and final insurance study report (September)

Another aspect of phase II was an independent insurance study conducted by an actuarial consultant. This study was mandated by the legislation that created the task force, House Bill 2078 (2005). The consultant was directed to study options regarding actuarially sound insurance reforms. The consultant also compiled contractor premium and claim data to provide background and insight on the Oregon contractor insurance market. The study is excerpted in Appendix A. The full insurance study report is available on the Web at: <http://egov.oregon.gov/DCBS/CCTF/>. [Click on Insurance Study Report.](#)

Based on the recommendations of industry experts and the report of the actuarial consultant, the task force considered six proposals from which it selected the five phase II recommendations.

Phase III: Finalizing Recommendations for Legislative Report

Phase III consisted of four meetings over three months during which the task force refined and finalized recommendations. The task force assembled the 11 recommendations as a comprehensive system designed to reduce the number of construction defects, enhance contractor accountability, improve consumer confidence, and ensure the increased availability of contractor insurance.

While the task force recognized that each recommendation, if implemented, would result in progress, the task force agreed that the problem required a comprehensive approach. Therefore, each one of the 11 recommendations is presented as a component of a comprehensive system designed to improve the construction environment in Oregon.

Task Force Recommendations: Phase I

Recommendation #1: Building Code Requirements

Preventative measures for dealing with moisture intrusion could curb construction defects. The task force recommends changes to the state building code that will help prevent moisture from entering a building, and changes that will remove moisture from a building.

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 makes the following recommendations:

1. To ensure enclosure of dry buildings and dry materials, require moisture-sensitive framing components carry a moisture content of less than 19 percent at the time of covering, verified by the contractor to obtain a certificate of occupancy.
2. Enhance mechanical ventilation systems in bathrooms, laundry rooms, and similar facilities by requiring ventilation systems that provide a minimum number of air changes per hour or a minimum flow rate.
3. In bathrooms, require humidity sensors or other acceptable methods of automation to activate ventilation systems and to limit maximum noise levels of fans to ensure ventilation is used.
4. In kitchens, prohibit the use of recirculating range hoods or provide for other approved forms of active ventilation and limit maximum noise levels of fans to ensure ventilation is used.
5. Require appropriate, horizontal flashing over all plant-on trims, penetrations into a building envelope, and transitions between similar and dissimilar materials comprising a building envelope.

Recommendation #2:

Construction Contractors Board (CCB) Enforcement and Licensing Changes

Stronger enforcement tools and more knowledge of a license applicant's history may help improve the overall quality of contractors. The task force recommends granting CCB — which is the primary licensing agency for construction contractors — additional enforcement authority to address the problem of defective construction.

Through testimony from invited speakers and examination of comparative models, the task force recommends the following items to help CCB meet its regulatory mandate:

1. Expand CCB's enforcement authority by adding an expedited emergency suspension process to deal with problem contractor licensees, including suspensions on the basis of carrying unpaid construction debt.
2. Licensees or responsible managing individuals subject to sanction by CCB may be prohibited from serving as owners, officers, directors, and managers including, but not limited to, responsible managing individuals of another construction firm to the extent permissible by federal or state law.

3. At the time of application or renewal, require officers, directors, owners, responsible managing individuals, or entities to disclose, from the past five years, financial matters that may indicate past financial malfeasance – unsatisfied court judgments, insolvencies, fraud, misrepresentation, conversion of funds, and other acts that may unfavorably affect future construction contracts. Allow CCB to actively investigate an applicant’s past financial dealings extending back five years as needed.
4. At the time of application or renewal, require officers, directors, owners, or responsible managing individuals to disclose their personal criminal activity from the past five years involving dishonesty, fraud, deceit, a felony of “moral turpitude,” embezzlement or misappropriation of funds entrusted to them. Allow CCB to conduct active criminal checks extending back five years as needed, including using state and federal databases. Allow CCB to acquire criminal records extending back five years as needed 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. Grant CCB criminal citation authority.

Recommendation #3: Limited Consumer Assistance Fund

In the event that a residential structure contains a defect and an owner is unable to recover some measure of relief from the contractor’s assets, the task force recommends that a fund should be at the disposal of CCB to provide limited relief for homeowners.

Recommendations by the task force on the subject of a limited consumer assistance fund include the following:

1. Establish a consumer assistance fund from monies collected through CCB civil penalties. Consumer assistance would be available for residential construction defects only and be paid out once a year.
2. Require only those contractors whose work is directly connected to residential construction to participate in the consumer assistance fund.
3. Confer administrative authority for the consumer assistance fund upon CCB.
4. Maintain a minimum balance of \$250,000.
5. Assess contractors only in order to maintain the minimum fund balance, and assessments are limited to \$40 per contractor doing residential work.
6. Retain investment income made from consumer assistance fund money for additional resources.
7. Restrict the use of the consumer assistance fund to pay construction defect claims.
8. Set aside a flexible percentage of consumer assistance fund money for administrative expenditures.
9. Allow CCB to pursue subrogation claims to replenish the consumer assistance fund.

10. Allow CCB to condition, suspend, or revoke a license to secure repayment to the consumer assistance fund.
11. Cap payouts from the consumer assistance fund at \$20,000 per claimant.
12. Cap aggregate annual liabilities incurred by a contractor against the consumer assistance fund at \$100,000.
13. Limit damage reimbursement to damages for a proven injury or loss (actual damages).
14. Create mechanisms for prorated and proportional share distributions to claimants from the consumer assistance fund.
15. Provide limited ability to CCB to modify orders to protect the integrity of the consumer assistance fund.
16. Increase the bond amounts required from each contractor by \$5,000.

Recommendation #4: Consumer Information

The task force recommends giving consumers information on how to proceed early in the construction process and directing consumers to appropriate resources, which may help prevent or alleviate claims.

CCB currently requires that contractors provide their clients with some information, but the task force recommends that contractors should provide additional information focused on protecting the consumer. The task force makes the following recommendations related to consumer information:

1. Require by statute signature lines on consumer information, lien notice, and dispute resolution forms for a residential consumer and contractor to sign to verify distribution.
2. Invalidate a claim of a valid residential construction lien for a lack of a written contract.
3. Provide one business day after signing a residential construction contract for new or remodeling work to allow a consumer to fully review consumer protection information and the contract.
4. Extend the length of time to file a claim with CCB from one year to two years in cases where a contractor does not provide required forms to the consumer.
5. Amend administrative rules to disallow distribution of previous versions of the consumer notification form on construction liens (i.e., Information Notice to Owners) — which do not include additional information — to residential consumers.

Recommendation # 5: Residential Permits

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

Building permits serve as a means of alerting the local building department of construction work occurring in the jurisdiction. The task force thus recommends the following to provide more clarity on what information a permit must contain and who is responsible for the work:

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 the certified envelope specialists working on the permitted construction project.
2. When an owner acts as the general contractor and acquires a permit, for work including the building envelope, require the local building department to distribute revised Information Notice to Owners About Construction Responsibilities. The revised form should include at a minimum (1) the owner's duty to comply with building codes and (2) the owner's responsibility to make corrections after inspection.
3. Require a certificate of occupancy for all residential structures.
4. Implement a standard inspection checklist, which details an inspecting jurisdiction's minimum scope of responsibilities, to communicate to consumers what is and what is not inspected by a municipality.

Recommendation #6: Building Envelope Training and Competency

In order to raise the quality of construction, the task force recommends implementing competency training and certification for people directing work as well as those working on a construction site. This recommendation includes the creation of a two-tiered certification for individuals working on the exterior enclosure of a structure – called the “building envelope.”

Data gathered by the research consultant as well as a survey of comparative regulatory models in other states and Canada led the task force to believe that some level of training and verification should occur for people working on the building envelope structure. The task force specifically recommends:

1. Maintain the CCB licensing system currently in place and modify as needed the appropriate CCB enforcement laws to allow CCB to enforce new certification system.
2. Each entity or person that works on the elements of a building envelope (e.g., roof, walls, windows, deck connections, doors, etc.) must employ or otherwise use the services of a “first-tier” certified envelope specialist, whose role includes some substantial observation of envelope construction.
3. The certified envelope specialist must verify by checklist that construction work involving the envelope meets code requirements and/or approved designs as well as installation methods, means, and techniques.
4. Each individual worker who installs elements of a building envelope must also have a “second-tier” envelope certification, which is geared to the particular scope of work.
5. Require both tiers of certified persons carry appropriate evidence of certification while working (i.e., certification card).

6. A “first-tier” certified envelope specialist must complete and submit a verification form to the local building department in order to obtain a certificate of occupancy. Allow general contractors and subcontractors to work out which “first-tier” certified envelope specialist will submit the verification form.
7. CCB will establish for both tiers of certified persons a system for certification and continuing education on substantive construction requirements, including the content and number of continuing education hours.
8. Require all contractors to obtain continuing education, which may include education on building code changes.

Task Force Recommendations: Phase II

Recommendation #1: First-Party Warranty

The task force found that a construction warranty can provide clarification for the consumer regarding the specific components of a structure that a contractor must guarantee. The task force recommends the establishment of a two-year first-party warranty and a 10-year structural defect warranty.

The task force specifically recommends:

1. Every builder of a new residential structure must provide a written first-party warranty for two years. The agreement warrants the following:
 - a. The residential structure will be free of any defect for one year.
 - b. The plumbing, electrical, heating, cooling, and ventilating delivery and distribution systems and the building envelope will be free from any defect for two years.
2. A separate structural defect warranty should be provided for 10 years and may be provided on a first-party basis or backed by a third-party warranty provider. The agreement warrants the following:
 - a. The residential structure will be free of any structural defect for a period of 10 years.
3. The following will apply to both the two-year and the 10-year warranties:
 - a. Warranty will apply to new residential structures.
 - b. Warranty starts on first occupancy or title transfer, whichever occurs first.
 - c. Warranty will be recorded in the deed records.
 - d. No disclaimers, limitations, or waivers of warranty would be permitted.
 - e. Warranty disputes may be settled through the CCB dispute resolution process if dispute arises within the period allowed for CCB dispute resolution, otherwise, a claim could be brought subject to ORS 701.560.
 - f. Remedies shall include attorney’s fees for the prevailing party.

Recommendation #2: General Liability Coverage

The task force recommends that general liability insurance obtained by contractors be required to include completed operations liability. This would extend coverage for liability that arises after the job is complete.

The task force specifically recommends the following:

1. Change the statute to require completed operations liability coverage.
2. Require contractors to have proper documentation of insurance coverage, including completed operations.
3. Violations will be enforceable by CCB as currently established in OAR 812-003-0200 (2).
4. Provide a transition period for contractors to obtain proper coverage at time of the contractor's next policy renewal.

Recommendation #3: Contractor Group Liability

The task force found that contractors engaged in certain types of construction projects such as condominiums, multifamily units, and tract homes encountered difficulty obtaining insurance coverage. To better ensure that contractors have access to general liability coverage, the task force recommends streamlining the rate filing requirements for contractor group liability policies.

This would entail amending ORS 737.600(3) to remove certain restrictions that may be limiting the ability of admitted carriers to write in this market. Specifically, this recommendation would:

1. Streamline the rate filing requirements for contractor group general liability coverage by exempting contractor liability from the fictitious group statute of the Insurance Code.

Recommendation #4: Voluntary Loss Control Discounts

Current law requires that insurers provide statistical or cost accounting support for insurance rate discounts. The task force recommends encouraging insurers to implement voluntary loss control discounts in their rating plans for contractors who adopt task force recommendations and other best practices. Since statistical data for contractor best practices may not be available for several years, the task force recommends that the preliminary statistical report requirement for contractor general liability rate filings be suspended for best practice discounts.

1. Issue an insurance bulletin that encourages insurers to offer voluntary loss control discounts for construction-related best practices.

Recommendation #5: Data Reporting Requirements

The task force recommends developing a list of insurance data items for construction claims that insurers will report to the Oregon Insurance Division. This data will be used to review and monitor the effectiveness of task force recommendations.

The task force specifically recommends the following:

1. Allow the Department of Consumer and Business Services to determine required data elements in conjunction with an advisory committee.
2. The data may be collected going forward or on a limited historical basis.
3. The costs of insurer programming and the cost of state agencies to collect and monitor the data, relative to the expected benefit, should be considered when requesting data.
4. Use data to monitor the effectiveness of CCTF recommendations on construction defect liability claims as well as the effect on the availability and affordability of contractor liability insurance.

Additional Issues to Consider

In developing the final list of recommendations, the task force encountered a number of additional issues that may impact construction defects in Oregon. Although the task force does not make any specific recommendations on these issues, it believes that the following issues may merit further analysis:

Design Issues

- *No insurance requirements for design professionals*
During its discussion of insurance issues, the task force noted that architects, engineers, and other design professionals are not required by law to maintain liability insurance coverage for the work they perform.
- *Design professional training*
Since the task force recommends that contractors and their employees obtain training and certification on code and envelope construction, similar training requirements for design professionals may merit further analysis.
- *Lack of envelope design details*
During the task force's work, an issue was raised as to the lack of required envelope design detailing on building plans and a lack of design specifications required by the building code.

Construction Issues

- *No sanction for repeated reinspections*

During the public testimony, a concern was raised that jurisdictions have limited ability to sanction contractors whose work required repeated reinspections in order to meet the requirements of the building code. The task force observed that information on contractors whose work requires repeated reinspections might be useful to consumers when they select a contractor.

Claims Issues

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

During 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 and insurance companies involved in a construction dispute to mediate resolution of the dispute before filing a lawsuit or enforcing arbitration rights.

- *Ability of a business entity to dissolve and leave contractor liable*

During its work, the task force noted that a business entity is allowed to dissolve after its purpose has been achieved (a construction project), potentially leaving the contractor, subcontractor, owner, design professional, or others liable for the full project.

- *High transactional costs in insurance litigation*

During meeting discussions, the task force noted that construction contractors' liability insurance claims have higher defense costs than other general liability classes. There are many theories as to why these litigation costs are higher and what can be done to reduce them. Costs could be reduced by encouraging timely settlement of claims. This could be accomplished by providing a private right of action for insurer bad faith, which exists in other states. Measures designed to discourage litigation could also reduce litigation costs, including mediation, tort reform, and reduction of frivolous lawsuits.

- *Indemnification of additional insured parties in construction contracts*

During discussion, the task force noted unresolved disputes relating to the meaning of certain statutory provisions, as well as judicial decisions and insurance policy language related to indemnification of additional insured parties. The statutes governing indemnification of additional insured parties may be unclear.