Your Coverage Advisor

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Ohio Supreme Court Narrows Coverage for Construction Defect Claims

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On October 9, 2018, the Ohio Supreme Court issued its long-awaited decision in *Ohio Northern Univ. v. Charles Constr. Servs.*, 2018-Ohio-4057, holding that a general contractor was not entitled to insurance coverage for its subcontractor's faulty work. Since then, some commentators have described the Court's holding as eliminating all insurance coverage for claims involving defective construction. Such a broad reading is not warranted. Still, Ohio's insureds would be wise to consider purchasing an endorsement that is readily available in today's insurance market.

Coverage for Construction Defect Claims Nationally

For years, courts around the country have grappled with coverage for claims involving defective or faulty construction. These cases generally turn on whether the court determines that defective construction is an "occurrence." An "occurrence" is defined as an accident, including continued or repeated exposure to harmful conditions. In practice, faulty work is almost always an accident as that word is commonly understood—contractor-insureds rarely, if ever, intend or expect to cause injury to persons or property, including their own work. Thus, the industry has long understood that insurance policies will generally provide at least *some* coverage for damage arising from defective work, subject to policy exclusions that bar coverage for the actual *repair*

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or replacement of an insured's faulty work. Insurers, however, argue that defective work is a non-accidental "business risk" that is not an "occurrence" covered by the policy. Since 2012, almost all courts that have considered the issue have held that defective construction is an "occurrence" and, thus, it is covered by the policy, at least to the extent that work *other than* the insured's work is damaged. *See Black & Veatch Corp. v. Aspen Ins. (Uk) Ltd,* 882 F.3d 952, 966 (10th Cir.2018) (citation omitted).

Ohio's Position: *Westfield Ins. Co. v. Custom Agri Sys., Inc.*

In 2012, the Ohio Supreme Court decided *Westfield Ins. Co. v. Custom Agri Sys., Inc.*, 2012-Ohio-4712, holding that claims for the cost to repair an insured's defective work are not covered because they "are not claims for 'property damage' caused by an 'occurrence' under a commercial general liability [CGL] policy." In its decision, however, the Court cited and approved of prior Ohio case law which held that consequential damages *arising from* a policyholder's defective work generally *are* covered by CGL policies. Since *Custom Agri,* insurance practitioners and courts in Ohio have generally agreed that:

- **Repair and replacement of a policyholder's defective work is not "property damage caused by an occurrence" and is not covered by standard CGL policies; and**
- **Consequential damages to property other than the policyholder's work *is* "property damage caused by an occurrence" and may be covered by a standard CGL policy depending upon the applicability of the policy's exclusions and conditions.**

Notably, however, the *Custom Agri* Court did not address whether a typical CGL policy would provide coverage for the repair or replacement of defective work performed by the policyholder's *subcontractors.* The Court addressed this issue in *Ohio Northern.*

Coverage for Subcontractor Work: *Ohio Northern*

In 2008, Ohio Northern contracted with Charles Construction Services (CCS) to construct a hotel and conference center. After CCS and its subcontractors completed the work, *Ohio Northern* discovered significant issues with the work and brought suit against CCS. CCS tendered the claim to its insurer, Cincinnati Insurance Company, which argued that it had no coverage obligations under *Custom Agri.* In response, CCS argued that *Custom Agri* was inapplicable because subcontractors performed almost all of the work at issue, *not* CCS.

The trial court granted summary judgment to Cincinnati, but the Third District Court of Appeals reversed. In finding in favor of CCS, the appellate court analyzed certain policy exclusions that expressly preserved coverage for damaged work or damages arising from faulty work if: (1) a subcontractor performed the work; and, (2) the damage occurred after project completion. Cincinnati then appealed to the Ohio Supreme Court, which accepted the following proposition of law for review:

> [*Custom Agri*] remains applicable to claims of defective construction or workmanship by a subcontractor included within the "products-completed operations hazard" of [a] commercial general liability policy.

Thus, the question before the Court was whether *Custom Agri* applies to claims involving a subcontractor's faulty work. In its decision, the Court concluded that *Custom Agri* does apply to such claims.

The Court acknowledged that its decision went against the weight of authority from its sister-courts nationally, but nonetheless applied *Custom Agri* to hold that "property damage caused by a subcontractor's faulty work is not fortuitous and does not meet

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the definition of 'occurrence' under a CGL policy." The Court failed to address several arguments, including: (1) that this interpretation rendered meaningless the carve-back for subcontractor work in the Your Work exclusion; (2) that the drafting history of the exclusions confirmed that the insurers themselves intended to provide coverage for subcontractor defective work; and, (3) that the meaning of "occurrence" used in *Custom Agri* contradicted the long-standing meaning given to the word in every other context. Instead, the Court suggested that the Ohio General Assembly could address the issue by requiring that all policies issued in Ohio define "occurrence" to include defective workmanship. Of course, this suggestion brings little comfort to the contractor-insureds that paid substantial sums for "completed operations" endorsements that were intended to provide coverage for these claims in the first place.

What's Next for Ohio's Construction Insureds?

Many commentators have written that the decision in *Ohio Northern* eliminates *all* coverage for construction defect claims. Taken to its logical conclusion, the absurdity of this argument is evident. Suppose an insured incorrectly affixes materials to the façade of a building, resulting in falling masonry that strikes and kills an innocent bystander. Or, suppose an insured incorrectly installs wiring during construction, resulting in a fire that destroys both the project and surrounding homes. Would any insurer even argue that there is no coverage for such claims?

The Court's opinion in *Ohio Northern* cannot be read so broadly. The Court answered a narrow question: does *Custom Agri* apply to subcontractor work? The answer, according to the Court, is yes. But, *Custom Agri* held that, while there is no coverage for the *repair or replacement* of a policyholder's defective work, there is coverage for consequential damages arising from that defective work. While at times the Court's language in *Ohio Northern* is imprecise, the Court makes clear over and again that it is simply applying its precedent, *Custom Agri*. Notably, the *Custom Agri* Court relied upon multiple cases previously decided by Ohio courts holding that consequential damages arising from defective construction are covered occurrences. Had the *Ohio Northern* Court intended to overrule this prior precedent, cited in *Custom Agri*, it easily could have stated its intention to do so. The Court's silence on these cases means they are still applicable to Ohio policyholders. Thus, consequential damages arising from defective construction should still be covered under CGL policies.

In fact, even Cincinnati recently confirmed that the Court's opinion cannot be read so broadly as to eliminate coverage for consequential damages. In its response to a motion to reconsider filed by Ohio Northern, Cincinnati stated that the opinion "correctly recognizes that consequential damages, *when they exist,* may be covered." For example, Cincinnati acknowledged that a subcontractor's CGL coverage would apply at least "where a subcontractor damages part of a construction project that is not within its subcontract." According to Cincinnati, the Court found no coverage for the consequential damages at issue in *Ohio Northern* because CCS was a general contractor and all of the damage to the project was CCS's "work."

An Ounce of Prevention…

While coverage firms like Brouse McDowell can and should continue to advocate for coverage for consequential damages, Ohio's contractors should nonetheless consider purchasing additional coverage, particularly if they are acting as a general contractor. Numerous insurers now offer endorsements that reinstate the coverage that the *Ohio Northern* decision arguably

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eliminated. For example, some insurers amend their insuring agreement to specifically cover property damage to an insured's work if it is performed by a subcontractor and falls within the products-completed operations hazard. Other insurers "deem" that property damage to the insured's work is caused by an occurrence if it is unexpected and unintended. Yet other insurers amend the definition of "occurrence" to include "subcontracted property work damage."

There may be material differences in how these various forms operate and the extent of coverage they provide, which is a subject that is beyond the scope of this article. Policyholders in Ohio should contact their brokers to discuss the options available to them and, if appropriate, should contact coverage counsel to discuss how the various, differing forms would operate. For their part, owners and developers should amend their construction contracts to compel contractors to purchase such endorsements.

Insureds and sophisticated brokers will understandably question *why* they and their clients must pay higher premiums to purchase endorsements to protect themselves from claims that the insurers intended would be covered by the existing CGL form. Nonetheless, here, an ounce of prevention is worth a pound of cure, and construction industry participants should contact their brokers and counsel today. ■

Stronghold Proposes Solvent Scheme

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All policyholders with historical commercial general liability coverage, including umbrella or excess coverage should take note: Stronghold Insurance Company, a solvent London Market company, recently announced that it is proposing a solvent scheme of arrangement. Stronghold issued coverage in the London market from 1962 through 1985, when it entered into a solvent run-off.

In the Scheme, which is a method under which Stronghold can formally resolve past, present, and future claims, any policyholders with claims (including potential future liability) will have a final opportunity to reach a settlement with Stronghold. Stronghold has just begun the process – the next steps will include a Court hearing to sanction the Scheme plan, holding a Creditor vote on the plan (expected to be in December), setting an Effective Date for the Scheme, and setting a Scheme submission date (expected to be in July 2019).

The best way to prepare is to evaluate your situation now. This includes understanding whether you have impacted coverage; valuing the coverage, your potential liabilities, and the resulting Stronghold claim; and, determining whether to participate in the Scheme vote and submission process.

We can assist you with each of these steps. Please contact us to talk further about how you can best respond to this development and ensure that you receive compensation for your coverage. ■

Brouse McDowell Adds Seven Insurance Coverage Lawyers

Over the past 30 years, Brouse McDowell has consistently obtained favorable results for policyholders, making pro-policyholder insurance coverage law in the process. Our attorneys have been on the front lines in seminal insurance coverage cases in Ohio and beyond, with a robust local, regional, and national insurance recovery practice. Recently combining with the firm of Thacker Robinson Zinz, Brouse McDowell now has more than twenty-five attorneys practicing in the area of insurance recovery, including seven attorneys certified by the Ohio State Bar Association as specialists in insurance coverage. This combination also expands the firm's geographic presence to Toledo and Naples, Florida.

There are few spaces within the insurance community that are untouched by the combined force of Brouse McDowell's insurance recovery attorneys. Well-known authors and speakers on insurance coverage topics both locally and nationally, our attorneys participate in and lead insurance groups in local, state, and national bar associations. We also maintain close working relationships with other industry insiders such as brokers, claims management specialists, and forensic accountants.

The advantage that the new Brouse McDowell insurance recovery group provides to our policyholder clients is priceless. By expanding the number of tools and resources within our insurance recovery group, we can respond to a broad array of insurance-related issues more efficiently than ever. The firm looks forward to continuing to use the breadth and depth of our experience to help our clients protect one of their most important assets and maximize their insurance recoveries. ■

Update: Ohio Affirms Preeminence Of State Insurance Law

By Sallie Conley Lux
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The controversy over the recently adopted Restatement of Law, Liability Insurance (RLLI) continues. On July 30, 2018, Ohio Governor John Kasich signed a law which unequivocally affirms that, in Ohio, state insurance statutes and state common law continues to be preeminent in insurance disputes governed by Ohio law.

Senate Bill 239 was primarily sponsored by Senator Matt Dolan and passed unanimously. The law becomes effective October 29, 2018. While the bill contained a number of non-insurance related provisions, it specifically addressed the RLLI. The bill as approved and signed adopts Ohio Rev. Code section 3901.82 which states: "The 'Restatement of the Law, Liability Insurance' that was approved at the 2018 annual meeting of the American law institute (sic) does not constitute the public policy of this state and is an inappropriate subject of notice."

Reportedly, the ALI has confirmed that Ohio is the first state ever to address legislatively a Restatement of Law in its entirety.

The Restatements of Law are adopted by the American Law Institute, "the leading independent organization in the United States producing scholarly work to clarify, modernize, and improve the law." The Restatements are extremely persuasive and influential in both state and federal courts throughout the country, routinely cited in briefs advocating various legal concepts and principles, and cited and relied upon in an untold number of judicial decisions announcing controlling legal principles in various states.

Some jurists and practitioners caution that some of the influential Restatements in certain circumstances have moved beyond clear statements of what the law is to statements of what the law should be, in the view of the ALI:

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> I write separately to note that modern Restatements . . . are of questionable value, and must be used with caution. The object of the original Restatements was "to present an orderly statement of the general common law." Restatement of Conflict of Laws, Introduction, p. viii (1934). Over time, Restatements' authors have abandoned the mission of describing the law, and have chosen instead to set forth their aspirations for what the law ought to be…Restatement sections such as that should be given no weight whatsoever as to the current state of the law, and no more weight regarding what the law ought to be than the recommendations of any respected lawyer or scholar.

Kansas v. Nebraska, 135 S. Ct. 1042, 1054 (Scalia, J., concurring and dissenting).

The recent adoption of the RLLI in May, 2018 was the culmination of many drafts over a number of years. As it evolved, the project was the object of intense interest and scrutiny by insurance scholars and practitioners representing both insurers and policyholders. Throughout its evolution, many aspects of the project were highly debated, and many proposed Sections of proposed statements of law were contested in comments submitted by interested parties.

Because of the comprehensive nature of the RLLI, which addresses a wide range of insurance topics, there remain many differences of opinion on whether particular statements of law reflect clear and accurate restatements of the law or statements of what the law should be. And, not unsurprisingly, advocates of a certain perspective may view certain sections of RLLI to be accurate reflections of the law, while other sections are not.

Insurance law is a matter of state law. It is governed by state statutes and common law, and may vary from state to state. As cases are litigated, and the resultant common law in each state is established and evolves, majority and minority views among the states concerning various insurance principles inevitably develop.

Presumably, Ohio legislators were concerned both (1) that the RLLI as adopted reflects, at least in part, aspirational statements of what the law *should be,* as proposed by the ALI, rather than statements of established black letter law; and (2) that specific provisions and sections of the RLLI do not accurately reflect Ohio law on particular topics.

Accordingly, the legislature took the unprecedented step of adopting Ohio Rev. Code section 3901.82, which protects the integrity of established Ohio law in insurance disputes. While the RLLI may be referenced and cited as persuasive authority in advocating for a certain position or change in the law, this recent legislation makes it crystal clear that, despite the recently adopted RLLI, the established and developing insurance common law of Ohio and Ohio insurance statutes continue to govern the Courts in Ohio and control Ohio insurance disputes. ■

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Attorney Highlights

Brandi L. Doniere and **Andrew W. Miller** were both named to The Toledo Business Journal's list of Who's Who in the Toledo Area Law for Insurance. (2 of only 5 attorneys named for the insurance practice area!)

Stacy RC Berliner, Jodi Spencer Johnson, Paul A. Rose, and **Joseph P. Thacker** were selected for inclusion in the Best Lawyers in America © for Insurance Law.

Christopher J. Carney, **Clair E. Dickinson**, and **Joseph P. Thacker** were selected for inclusion in the Best Lawyers in America © for Commercial Litigation.

Meagan L. Moore was selected for inclusion in the Best Lawyers in America © for Environmental Law.

Joseph P. Thacker was selected for inclusion in the Best Lawyers in America © for Bet-the-Company Litigation.

Alexandra V. Dattilo was installed as an elected director of the Federal Bar Association, Northern District of Ohio Chapter.

Congratulations to **Christopher T. Teodosio** on the new addition to his family! Baby Ava Teodosio was born on September 9, 2018.

Jodi Spencer Johnson attended the American Bar Association Section of Litigation Fall Leadership Meeting, September 27-29, 2018.

Stacy RC Berliner, **Lucas M. Blower**, and **Andrew W. Miller** presented at the Ohio State Bar Association's Insurance Law Program on October 16, 2018.

Amanda M. Leffler received Leadership Akron's 2018 Family Difference Maker Award on November 6, 2018.

Stacy RC Berliner and **Nicholas J. Kopcho** will speak at the National Business Institute's Insurance Coverage Litigation Boot Camp on December 6, 2018.

Thanks to All Who Attended!

Sixth Annual Insurance Coverage Conference
October 11, 2018



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