Protect Your Bottom Line on Ohio Construction Projects: Ohio High Court's October 2018 Ruling Denying Coverage for Defective Construction Work Confirms Need to Re-Evaluate and Revise Traditional Risk Transfer Mechanisms

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Beware! On October 9, 2018, the Ohio Supreme Court issued a final ruling that, not surprisingly, will effectively eliminate meaningful insurance coverage for contractors, subcontractors, and owners for defective construction work. The most recent ruling reaffirms what experienced construction counsel cautioned for years; project participants cannot rely on comprehensive general liability ("CGL") insurance coverage to remediate defective or non-conforming work. According to the Ohio Supreme Court, although defective construction work causes "property damage," that damage is neither "accidental" nor "fortuitous" and, therefore, represents an "ordinary business risk" that members of the construction industry must manage without recourse to insurance proceeds. It does not matter that the cause of loss was defective work of a contractor or its downstream subcontractor. This decision is a significant, if not insurmountable, bar to insureds forcing insurers to defend defective work claims, pay for expert evaluations, or to fund settlements under standard coverage forms that have permeated the Ohio construction industry for decades. The Court held that, under the terms of these form insurance agreements, no downstream insurance coverage exists for damages arising from defective work of a subcontractor. *Ohio Northern University v. Charles Construction Company, et al.* (Ohio Supreme Court, October 9, 2018)

It is critical that industry participants understand the far-reaching and long-term effects of the *Ohio Northern University* decision and take prompt action to evaluate and mitigate risk or loss. The decision reaffirms and expands the Supreme Court's 2012 ruling in *Westfield Ins. Co. v. Custom Agri Sys., Inc.* to the detriment of Ohio's construction industry participants since it involved a contractor's policy, and it denied coverage under standard "products completed operations" ("PCOC") endorsements. For years, insurance agents and insureds' assumed PCOC endorsements and related policy provisions covered losses arising after substantial completion to the extent the cause of loss was a subcontractor or other lower tier's defective work. The October 2018 Supreme Court ruling will also impact available insurance coverage for work performed out of state if a contractor's or subcontractor's CGL policies are governed by Ohio law.

The underlying lawsuit involved nearly $6 million in alleged repair and remediation costs associated with water infiltration following Ohio Northern University's beneficial use and occupancy of a completed project. The Supreme Court ruled that the contractor's and subcontractor's standard CGL and PCOC insurance coverages, which were routinely relied upon by project participants to transfer risk of loss to insurers, actually do not cover the cost of repairing and replacing defective work. Even worse from the perspective of the insureds, the Supreme Court ruled that the insurer had no "duty to defend" the contractor or subcontractors from claims involving defective or non-conforming work resulting in damage to a construction project. This decision applies to insurance policies of construction project participants

who routinely and blindly relied upon these types of policies for decades as a primary risk-transfer mechanism for post-substantial completion property damage.

The practical effect of The Ohio Supreme Court's ruling is profound. First, insureds presently are involved in hundreds of pending lawsuits throughout Ohio and other states where an insurer provided a "reservation of rights" defense to contractors and subcontractors. Under the Ohio Supreme Court's decision, insurance companies likely will withdraw the "reservation of rights" defenses without risk, thus requiring insureds to secure other counsel to defend pending claims at their sole expense. Thus, insureds who are parties to pending litigation should promptly retain experienced construction counsel to evaluate options and strategies for pending litigation, active claims, and alternative dispute resolution proceedings, including mediation and arbitration. Second, for owners and contractors that relied too heavily on CGL and PCOC as primary risk transfer mechanisms, they now find themselves in the undesirable position of significant uncovered risk of loss and damage. This applies not only to work in progress, but also to completed projects spanning decades. Indeed, it is fair to assume that most construction project insurance programs, including large projects covered by Contractor Controlled Insurance Programs ("CCIP") and Owner Controlled Insurance Programs ("OCIP"), will lack real risk transfer protections and place significant risk of out-of-pocket loss to project participants.

Project participants should consider re-evaluating their contract risk-transfer mechanisms and related company practices. Project participants must understand the available options and related costs to effectively and cost efficiently transfer risk of loss. The October 2018 decision necessitates re-educating the industry and implementing and negotiating significantly different approaches. Fear not: There are effective options and strategies that work to control and mitigate risk of loss. As a start, existing contracts and subcontract forms must be modified to require appropriate policy endorsements for future work that modify, where applicable and available, policy definitions of damage, occurrence, and accident. Construction performance bonds, project-specific maintenance and warranty bonds, limitations of liability clauses, and shortened contractual statutes of limitations, and other forms of insurance, including rectification coverages, are a few other options that should be evaluated. Additionally, parties contracting for improvements should determine the true financial strength of participants, including subtrades and vendors, to back their performance, warranty, and long-term workmanship obligations. The recent ruling also reinforces the importance of contractually identifying the right of project participants to rely on tests and inspections as work progresses, and the role and involvement of, and reliance on, professionals who evaluate and approve work in progress. Further, parties can negotiate an option to transfer risk to owner property policies with appropriate waivers of subrogation for post substantial completion loss.

Hahn Loeser & Parks' experienced and dedicated Construction Team swiftly and efficiently evaluates risks, reviews and drafts contract and risk transfer mechanisms, and counsels companies concerning construction needs and issues. We are honored to provide a complimentary initial evaluation to construction industry participants. For more information, please visit www.hahnlaw.com, or contact Andrew Natale at 216/274-2320, Rob Remington at 216/274-2208, Aaron Evenchik at 216/274-2450, Eric Levasseur at 216/274-2346 or Andrew Agati at 216/274-2323.