Mind the Gap: Insurance Coverage for Construction Defects in the Wake of the Ohio Supreme Court's Decision in *Ohio Northern*

On October 9, 2018, the Ohio Supreme Court issued an important decision in ***Ohio N. Univ. v. Charles Constr. Servc., Inc., Slip Opinion 2018-Ohio-4057.*** Departing from the majority view, the Ohio Supreme Court held that a general contractor's commercial general liability (CGL) policy does not cover claims for property damage caused by a subcontractor's faulty work. Specifically, the Court reasoned that faulty work is not accidental or "fortuitous," as contemplated within the policy's definition of an "occurrence" triggering coverage.

The *Ohio Northern* Case

The lawsuit arose out of a contract between Ohio Northern University (ONU) and Charles Construction Services (CCS) to build a hotel and conference center on ONU's campus. Following completion of construction, ONU discovered extensive water damage. In the process of remediating the water damage, ONU also uncovered significant structural defects.

ONU sued CCS and CCS tendered to its CGL carrier, Cincinnati Insurance Company (Cincinnati). Cincinnati declined coverage and sought a declaration from the court that it was not obligated to defend or indemnify CCS. Cincinnati argued that under the Ohio Supreme Court's 2012 decision in *Westfield Ins. Co. v. Custom Agri Sys*., property damage arising from defective work does not constitute an occurrence, regardless of whether the work was performed by the insured contractor or its subcontractors. CCS argued that *Custom Agri* was inapplicable because CCS did not self-perform the work at issue and because CCS had purchased products-completed operations coverage, which applied to defective construction claims arising from the work of its subcontractors.

The Ohio Supreme Court held that Cincinnati did not have a duty to defend and indemnify CCS, finding that a subcontractor's inadvertent faulty work can never meet this definition. Many legal commentators have criticized the decision as applying an outdated rationale to this evolving, national legal issue, and noting that many of the policy terms have no meaning if faulty subcontractor work can never meet the definition of "occurrence." What is clear is that the *Ohio Northern* decision puts Ohio in the minority of states across the country that do not recognize defective subcontractor work as an "occurrence" and is contrary to the overwhelming trend in the law on this issue.

Next Steps for Contractors

The practical impact of *Ohio Northern* is that claims for property damage arising from faulty work—regardless of whether the work was self-performed or completed by a subcontractor—will not be covered under an existing CGL policy. Additionally, though not characterized as retroactive, *Ohio Northern* applies to ongoing litigation and arbitration. So, even if your company is currently being defended by insurance defense counsel, contractors should not expect to receive settlement funds or indemnity protection from the carrier. In fact, we recommend that contractors engage backup counsel to get up to speed on pending disputes in the event their carriers withdraw their defense in light of this decision and disclaim coverage.

We also recommend that contractors buy the *Damage to Your Work* endorsement to their existing CGL policy. This endorsement has been used in other states and is designed to provide coverage for damages caused to your work (or other property) by the negligent or defective work of a subcontractor. In short, it restores this critical coverage, which protects your business from expensive latent defect claims that can

arise years after substantial completion. Contractors should also require their subcontractors to purchase the endorsement. Because the endorsements provided by different insurance carriers all vary, they should be discussed with your attorney or insurance broker to ensure you get the right protection.

Securing this essential endorsement is not the only step contractors can take to manage the risks associated with defective construction. We recommend that contractors meet with their professional advisors to perform a holistic evaluation of their current enterprise risk management program as soon as possible. That discussion should include an analysis of your existing risk management program, including not only insurance, but also critical subcontract provisions such bonding, change management requirements, maintenance periods, retention, conditional payment clauses, schedule and delay responsibility, post-completion walk-through obligations, and indemnity, among others. Frantz Ward LLP's Construction Practice Group is currently working with a number of its clients to develop long-term strategies and programs to address these interrelated risks, particularly in light of the *Ohio Northern* decision. We are also working closely with the principal insurance brokers that serve the construction industry in Northeast Ohio to monitor the response of insurance carriers to this decision, as well as jointly develop comprehensive risk management solutions for the contractor community.

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