

Construction Defect: Oregon Supreme Court Strips Wyoming Sawmills Down to the Studs

A recent Oregon Supreme Court case, *FountainCourt Homeowners Association v. American Family Mutual Ins. Co.*, 360 Or 341 (Or. 2016), holds that the insurers of a subcontractor sued for water damage were bound by a finding in the underlying case that the water damage was “physical injury” to property. In so holding, the court eviscerated the seminal case of *Wyoming Sawmills v. Transportation Ins. Co.*, 282 Or 401, 578 P.2d 1253 (Or. 1978), finding *Wyoming Sawmills* relevant only in situations where the damages sought are for depreciation in value of the property.

In *FountainCourt*, the subcontractor installed siding and windows that caused water intrusion. The jury in the construction defect action was instructed that the plaintiffs had to prove physical damage to their property. The jury was further instructed that they had to determine the amount of physical damage to the property, and that the measure of damages was the “reasonable cost of repairing the damaged property.” The jury was not asked to separate out the cost of repairing the work done by the subcontractor from the further damages caused by the defective windows.

The plaintiff then moved to collect the judgment from the insurers. American Family maintained that plaintiff had not met its burden of proving property damage within the policy. Citing *Wyoming Sawmills*, American Family argued that the total amount of undifferentiated damages could have included the cost of repairing the insured’s defective work as well as other damages. The court rejected that argument, finding “no significant legal distinction” between the jury instruction for “physical damage to the property” and the policy language “physical injury to tangible property.” The court also stated that “*Wyoming Sawmills* does not stand for the proposition that actual physical damage to property is not covered under an insurance policy merely because it may be associated with defective workmanship by an insured.” 360 Or 341, 361-362.

The court’s distinction is not well taken. *Wyoming Sawmills* involved the supplying of defective lumber incorporated into a number of townhomes. The court held that absent any further damage shown to the homes, the cost of repair and replacing the studs was not a covered loss. However, the cost of labor and materials to reach the warped studs was a covered loss. The court viewed the warranty costs of repairing one’s own product as an intangible loss. If the rationale of *Wyoming Sawmills* were applied to the same situation in *FountainCourt*, the cost of repairing and replacing the windows would not be a covered loss but the damages to other property caused by the windows would be covered. Instead *FountainCourt* holds that it is all covered unless the jury in the underlying action finds otherwise.

FountainCourt follows a recent wave of judicial re-thinking of whether an insured’s defective product constitutes property damage or qualifies as an occurrence. The current trend is to mesh all damages together as the accidental consequence of the defective work. Cases that follow *Wyoming Sawmills* — and there are quite a few in Washington, California, Minnesota, South Dakota, Pennsylvania, and other courts — may need to be re-examined in light of the Oregon Supreme Court’s ruling.



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