DEALING WITH NATURAL DISASTERS
Here Comes The Flood (Of Legal Issues)

2019 Annual Meeting | ABA Forum on Construction Law
APRIL 24-27, 2019
The Diplomat Beach Resort | Hollywood, Florida
Insurance Issues Involving Natural Disasters
Introduction of Speakers

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Philip C. Silverberg
Cleveland: River Fires
Cleveland: Midge Swarms
The following presentation is for educational purposes only and is not intended for any other use. It does not represent the view of any firm, insurer, or reinsurer.
Builder’s Risk Insurance

• First-party coverage for property in the course of construction or renovation
  – Physical loss or damage
  – “Delay in Startup”

• Coverage amount is based on the value of the Project

• There are often multiple insured’s with different insurable interests
Period of Coverage

• Commencement -> Termination
• Variations in termination, e.g.:
  - Set date
  - Final completion
  - Accepted by owner
  - Project occupied
Property Insured

• Permanent works
• Temporary works such as scaffolding, shoring, fences, construction forms, etc.
• Often will NOT include:
  – Land/land value; Existing buildings or structures;
  – Contractor’s tools, machinery, and equipment not destined to become part of the Project...
Lend Lease (U.S.) Const v. Zurich

- 74-floor residential building and hotel project
- Tower crane damaged during Superstorm Sandy
Lend Lease (U.S.) Const v. Zurich

- “Covered Property”
  - included property under construction and temporary works
  - Excluded contractor's tools, machinery, and equipment
- Court held:
  - Regardless of whether crane was a “temporary work,” would nonetheless be excluded machinery and equipment exclusion barred coverage
  - Contract documents described crane as “heavy equipment,” and crane removed at completion of project
Physical Loss or Damage

• Generally insures against all risks of direct physical loss or damage to Covered Property

• Usually requires some distinct, demonstrable physical alteration to the property

• May include an impairment of function or value, e.g., contamination
No Coverage: Exclusions

- Damages from Catastrophe Perils
  - Earthquake, Windstorm, Flood, Storm Surge, etc.
  - Named Windstorm, but sublimit or high deductible
  - Wildfire = Fire

- Others
  - Design Defect & Faulty Workmanship
  - Wear & Tear; Inherent Vice
  - Corrosion, Rust, Gradual Deterioration
Exclusion: Consequential Loss

Consequential losses are typically excluded:

- loss of market or delay
- delay in completion
- liquidated damages or performance penalties
- penalties for non-completion
- non-compliance with contract conditions
Delay in Startup

May be separate Delay in Startup / Completion coverage:

- Gross Earnings/Profits
- Rental Income
- Soft Costs (e.g., interest expense, loan fees, operational expense, premiums, marketing/advertising, legal fees)
Delay in Startup

Property damage (hard costs) versus delay-driven costs

- Only covers physical loss, damage and specified impacts resulting therefrom
- Does not cover increased costs of labor, materials, general conditions to complete not-yet constructed portions of the project
Property Damage versus Delay

- *One Place Condominium, LLC.* v *Travelers*, (N.D. Ill. 2015)
- *Indianapolis Airport Auth. v Travelers*, (7th Cir. 2017)
Even where no “Delay in Startup”, multiple coverage extensions may pick up some delay-related costs:

1. **EXPEDITING EXPENSE**

   - Costs incurred to facilitate repairs (e.g., overtime, express freight)
   - May extend coverage for costs necessary to return the work on the **damaged portion** of the project to the same schedule as immediately prior to damage
   - Tied to costs related to property damage - does not provide coverage for increased costs on the project as a whole
Builder’s Risk Coverage Extensions

2. CONTRACTOR’S EXTRA EXPENSE

• Coverage for excess costs during the period of repair to mitigate delays and continue the project schedule as a whole, including for the undamaged work

• Only for period of time to restore or repair the damaged property

• Once repairs are completed, coverage ends; no coverage for additional costs to make-up for delays
Exclusion: Faulty Workmanship-Design Defect

- Generally is no coverage for loss or damage resulting from faulty or defective design or workmanship.
- Protects against fortuitous loss; responsibility for damages on the party that performed the faulty work rather than on the property insurer.
Faulty Workmanship-Design Defect

Exclusions typically contain an **Exception** for damage that **ensues or results** from the faulty workmanship, *e.g.*,:

*This Policy does not insure:*

Against the cost of correcting or making good defective, faulty or deficient designs, plans, specifications, materials or workmanship; however, *this exclusion shall not apply to direct physical loss, damage or destruction resulting from such defective design or specifications, faulty material, or faulty workmanship ... OR ... this exclusion shall not apply to physical loss or damage that ensues from such faulty or defective workmanship or material.*
Traditional U.S. Defect Exclusions

• “Ensuing loss” – restores coverage for subsequent and collateral losses caused by a covered cause of loss
  
  ➢ Acme Galvanizing - No peril separate from the initial excluded peril (welding failure and kettle rupture); the spillage of molten zinc was part of the loss directly caused by the excluded peril, not a new hazard
  
  ➢ Narob Dev. Corp. - Wall collapsed as a result of faulty workmanship; costs to repair the collapsed wall were not covered; there had to be “collateral or subsequent damage or loss as a result of the collapse of the . . . wall.”
Another Approach – LEG Exclusions

• "LEG": London Engineering Group
• In the 1990s, developed three defects exclusions, which recently found their way into property and construction policies covering U.S. risks.

  1) LEG 1/96 – A Model “Outright” Defects Exclusion; No ensuing loss
  2) LEG 2/96 – A Model “Consequences” Defects Wording
  3) LEG 3/06 – A Model “Improvement” Defects Wording
Coverage Considerations

• What are the appropriate coverages?
  Builders Risk / Property Damage  Contractor’s Equipment
  Delay in Start Up

• Who is insured?

• Who buys the coverage / pays the premiums?

• What is the coverage period?

• What **endorsements/extensions are** needed?

• Deductibles and/or self-insured retention

• Who pays the deductible?
After Disaster Strikes – What Do We Do?

• Immediate notice to broker, insurer
• GET THE POLICY! Understand reqts, coverages
• Rally the team (mgmt, broker, counsel, etc.)
• Establish communication protocol
• Preserve evidence and gather documentation
• Consider request for interim / advance payment