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
IT’S ALL ABOUT THE INSURANCE

PLENARY SESSION 2

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Hurricanes, earthquakes, and fires, oh my!
INTRODUCTION

• **Natural disasters are a real threat that can occur suddenly and without warning**

• **Key factors for insurance coverage:**
  • The cause of the damage
  • Scope and Amount of insurance coverage
  • Did disaster occur during construction or post-construction
  • Are you the owner of the property or working on the property?
TYPES OF INSURANCE

- Property
- General liability
- Builder’s risk
- Pollution
- Professional liability
- Automobile
- Marine
- Parametric
- Weather
- Floaters
PROPERTY INSURANCE POLICIES

Property insurance is “first party coverage” that reimburses the Named Insured, generally the property owner, for the replacement cost (or actual cash value) of its insured property if that property is damages or destroyed by a “covered cause of loss”.

PROPERTY INSURANCE POLICIES

• Property coverage can come in many different forms including commercial property coverage, homeowners’ insurance coverage (HO3), or home insurance for owners of co-ops or condominiums (HO6).

• Typically cover fire damage up to policy limits.
TYPES OF COVERAGE FORMS

- **When a tornado, fire, storm, flood, or other event damages the property and its contents, the insured needs to be able to recover quickly for its loss of property and business income losses so that it can resume business promptly. Within a property insurance policy, there are two necessary forms that can assist a named insured in a quick recovery.**

  - **Building and personal property coverage form**
  - **The causes of loss form**
    - Basic
    - Broad
    - Special
Specific policies may also contain a broadening endorsement such as flood, quake, terrorism, business income, etc., to help further assist the insured in the recovery process.
THE INSURED AMOUNT

• Replacement Cost

• Actual Cash Value

• The coinsurance penalty for underinsurance and how to avoid it
POTENTIALLY APPLICABLE EXCLUSIONS AFFECTING NATURAL DISASTER RELATED LOSSES

OVERARCHING ISSUE OF CAUSATION

The most common exclusions present in each of the above types of property policies that may plague a loss caused by a natural disaster are: earth movement, water (flood and water-related occurrences as well as water seeping through doors, windows or other openings A/K/A wind-driven rain), and fungus (mold), wet rot, dry rot, and bacteria, as well as defective design, construction, materials, or maintenance.
• The prevailing approach for analyzing causation issues in first-party property insurance coverage cases has been the efficient proximate cause ("EPC") doctrine. Jacqueline Young, Efficient Proximate Cause: Is California Headed for a Katrina-Scale Disaster in the Same Leaky Boat?, 62 Hastings L.J. 757, 793 (2011).

Coverages to add (and limitations to avoid)

• Add Building Ordinance or Law Coverage
• Watch Out for Vacancy
• Add Mechanical Breakdown Coverage
• More Exotic Types of Business Loss Coverage to Consider
  • Utility Interruption
  • Contingent Business Income
SPECIALIZED PROPERTY TYPE POLICIES

• FLOOD COVERAGE
• DIFFERENCE-IN-CONDITIONS COVERAGE (“DIC”)
POTENTIALLY APPLICABLE EXCLUSIONS AFFECTING NATURAL DISASTER RELATED LOSSES

ENSUING LOSS PROVISION

• AN ENSUING LOSS PROVISION IS ANOTHER METHOD BY WHICH AN INSURED MAY BE ABLE TO RESTORE COVERAGE WHERE THERE OTHERWISE MAY NOT HAVE BEEN ANY.

• IT IS AN EXCEPTION TO AN EXCLUSION IN A FIRST-PARTY PROPERTY POLICY THAT APPLIES IN A SPECIAL TYPE OF FACT PATTERN WHERE THE DAMAGE CAUSED BY AN EXCLUDED PERIL OPERATES AS A LINK IN THE “CHAIN OF EVENTS” THAT ENABLES A COVERED PERIL TO DAMAGE OTHER PROPERTY

EXCLUDED PERIL → EXCLUDED DAMAGE → COVERED PERIL → ENSUING DAMAGE
ENSUING LOSS PROVISION EXAMPLE

Ensuing loss clauses were developed after the San Francisco earthquake of 1906. Earth movement caused about $80 million in property damage. Gas emitted from pipes broken during the shaking sparked a fire, which spread to the rest of the city and caused another $400 million in other property damage (in 1906 dollars).

Symbolically: earth movement (excluded peril) → earthquake damage (excluded loss) → fire (covered peril) → fire damage (ensuing loss).
POTENTIALLY APPLICABLE EXCLUSIONS AFFECTING NATURAL DISASTER RELATED LOSSES

EARTH MOVEMENT EXCLUSION
Potentially Applicable Exclusions Affecting Natural Disaster Related Losses

Water (Flood and Water Related Occurrences)

Typically, losses caused by flood waters are excluded by the property policies as insurers intended for property owners to purchase flood insurance to cover the risk associated with flood waters. A typical water damage exclusion states as follows:

Water Damage [is excluded], meaning:

Flood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these, whether or not driven by wind.
POTENTIALLY APPLICABLE EXCLUSIONS AFFECTING NATURAL DISASTER RELATED LOSSES

FUNGUS/BACTERIA EXCLUSION

• Property policies often come with limited fungus/mold coverage that is insufficient to cover the totality of damages. Accordingly, insurers may attempt to assert that the fungus or mold is the “cause” of the damage to the project in turn limiting their exposure.

• Mold exclusions, depending on how they appear in the policy, and whether they are the sole cause of the loss, can mean the difference between coverage and no coverage.
POtentially Applicable Exclusions Affecting Natural Disaster Related Losses

Defective Construction Exclusion

- Often also known as the “Faulty Workmanship” exclusion.

- This exclusion mostly comes into play when a covered cause of loss such as rain combines with an uncovered cause of loss (defective construction) to cause damage to the property.
Potentially Applicable Exclusions Affecting Natural Disaster Related Losses

Fire related losses

- The great fire of London spurred the creation of the modern-day insurance company.
- A standard fire insurance policy will not provide coverage for consequential losses, such as loss of income.
GENERAL LIABILITY INSURANCE

• **The most common type of liability insurance is “Commercial General Liability Insurance,”** often abbreviated as **“CGL” insurance.**

• **CGL is unlikely to be the primary coverage for a loss caused by a natural disaster, but could be a related component of coverage.**
Potentially Applicable Exclusions Affecting Natural Disaster Related Losses - CGL

- Developers of multi-family residential or commercial projects that are still under construction should pay particular attention to portions of their CGL coverage.

- Most likely exclusions to impact the availability of coverage for a natural disaster are exclusions (J) and (L), commonly referred to as the “your work” exclusion.

- The timing of when the natural disaster occurs will likely impact which exclusions may apply to bar coverage – was the loss during construction or after completion?
Potentially Applicable Exclusions Affecting Natural Disaster Related Losses - CGL

- Business risk exclusions
  - Owned Property exclusion
  - Ongoing operations exclusions
- Your work exclusion
- Pollution exclusion
Risk Transfer as a Method for Expanding Available Coverage

• An important consideration for large builders and general contractors is the transfer of risk downstream to other potentially liable parties.

• While it may not be possible to predict the occurrence of a natural disaster, monitoring the CGL policies of its subcontractors can provide an avenue for a general contractor to prepare for the risk it may face in the event that a natural disaster occurs.

• By ensuring that the general contractor appears in the policies of its subcontractors as an additional insured, the risk associated with damages caused by a natural disaster—or even the revelation of faulty construction work that a natural disaster may provide—may be mitigated or eliminated entirely.
INLAND MARINE/BUILDERS RISK INSURANCE

Builder’s risk coverage is often purchased to provide coverage for the gaps left by the (J)(5) and (J)(6) exclusions and is a targeted form of insurance designed to cover direct property losses to property under construction or an existing building undergoing substantial additions, alterations or repairs.
Inland Marine/Builders Risk Insurance

- Even the broadest form of builder’s risk coverage does not achieve complete risk avoidance.
- Builder’s risk policies frequently include multiple deductibles.
- Most builder’s risk policies are provided on an “all risk” basis.
POTENTIALLY APPLICABLE EXCLUSIONS

CAUSES OF LOSS

• COLLAPSE
• CONSEQUENTIAL LOSS, DAMAGE, OR EXPENSES OF ANY KIND
• CONTAMINANTS OR POLLUTANTS
• COST OF MAKING GOOD ANY FAULTY OR DEFECTIVE WORKMANSHIP, SUPPLIES OR MATERIALS OR FAULT, DEFECT, ERROR, DEFICIENCY OR OMISSION IN DESIGN, PLAN OR SPECIFICATION
• DAMAGE BY RAIN, SNOW, SLEET OR ICE TO PERSONAL PROPERTY IN THE OPEN
• DELAY, LOSS OF USE, LOSS OF MARKET, FINES, PENALTIES, & OTHER CONSEQUENTIAL LOSSES
• EARTHQUAKE, VOLCANIC ACTIVITY, AND OTHER EARTH MOVEMENT
• EROSION
• FLOOD, MUDSLIDE, SEWER BACKUP, AND SEEPAGE OF WATER
• FREEZING
• FUNGUS/MOLD/BACTERIA
• INFESTATION, DISEASE, OR DAMAGE CAUSED BY INSECTS, VERMIN, RODENTS OR ANIMALS
• INSURRECTION, REBELLION, REVOLUTION, CIVIL WAR, OR COMMOTION
• SUBSIDENCE, SHRINKING, SETTLING, CRACKING & EXPANSION
• WEAR & TEAR, GRADUAL DETERIORATION, INHERENT VICE, LATENT DEFECT, CORROSION, RUST, DAMPNESS OR DRYNESS OF THE ATMOSPHERE
• WEIGHT OF ICE & SNOW
POTENTIALLY APPLICABLE EXCLUSIONS

Types of Property

- Accounts, bills, currency, money & securities
- Contractor’s tools, machinery, plant and equipment
- Existing property/structures
- Land
- Landscaping
- Maps, plans, blueprints, drawings
- Property away from the project site
- Property in transit
- Prototype, developmental, used machinery or equipment
- Radio or television antennas, including lead-in wiring, masts and towers
- Signs
- Transmission and distribution lines upon energization at the completion of testing
- Vehicles or equipment licensed for highway use, rolling stock, aircraft or watercraft
- Water, animals, standing timber and growing crops
- Waterborne property
PROTECTIVE SAFEGUARD ENDORSEMENTS

Protective safeguards are conditions precedent to coverage, added to builder’s risk policies to assure the insurance company of certain protection being provided and ostensibly to reduce the rate. Violation of a protective safeguard provision voids coverage!

EXAMPLES:

• Emergency response protocols
• Fencing surrounding the project—must be at least a 6-foot cyclone fence which must be locked during non-working hours
• Project lighting during night hours
• Surveillance by an insured, licensed and bonded watchperson at all times during non-construction hours
• Water for fire suppression stored on-site, or a working fire hydrant must be within 1,000 feet of the structure under construction
Delay in completion/"soft costs"

Indirect damages may arise from covered damage to the project that causes of delay in the completion of the project, including loss of the anticipated revenue stream and a variety of additional costs. These costs may be insured by delayed completion and/or soft cost coverage. Delayed completion/soft costs endorsements commonly include coverage for:

- Rents and Rental Value
- Additional Advertising and Promotional Expenses
- Additional Insurance Expense
- Additional Interest Expense
- Additional Leasing/Commission Expenses

...
POLLUTION COVERAGE

• **For any commercial entity that has a potential or actual risk of creating a pollution loss, pollution liability insurance is necessary.**

• **Such coverage is necessary due to the “absolute” or “total” pollution exclusion present in most CGL policies as discussed above.**
OTHER POTENTIAL SOURCES OF INSURANCE RECOVERY

- Auto Insurance
- Marine Insurance
- Parametric/Weather Exposures
CONCLUSION

• **Owners, contractors and their lawyers need to understand basic insurance concepts, what is covered and not covered, and what endorsements should be requested and obtained.**

• **Most importantly, we need to remember that owners and contractors under construction contracts are taking risks when they rely on the other party’s insurance—or an obligation by the other party to procure this coverage.**
CONCLUSION

• Each time a contract is amended, the insurance and indemnification provisions should also be reviewed to see if they are still accurate and if the insurance obligations are current.

• The safest course—and one all lawyers should recommend to their clients—is that each party carry its own insurance for its own property and at least back-up liability insurance that will provide coverage if the other party fails to comply with its contractual insurance obligations.