

## ORDINANCE OR LAW INSURANCE COVERAGE

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### ABOUT THE AUTHOR

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Generally, Ordinance or Law insurance coverage provides limited protection for costs associated with repairing, rebuilding, or constructing a structure when physical damage to the structure by a covered cause of loss triggers an ordinance or law.

According to Adjuster's International Disaster Recovery Consulting, compliance with ordinances and laws after a loss can add 50% or more to the cost of the claim. (Paul O. Dudey CPCU and Donald S. Malecki, *Adjusting Today* Issue #3009, "Ordinance or Law Coverage – Code for Recovery!").

Insureds should take a proactive approach to their insurance program and the coverage provided by the program. Learning about important exclusions and limitations after a catastrophe strikes will cause the Insured to experience frustration and anxiety. Insureds should always read their policies, and in some states, may be required by law to do so.

### ORDINANCE OR LAW EXCLUSION

Most property insurance policies will have an Ordinance or Law exclusion. The exclusion applies to both physical damage and time element coverage.

This exclusion will preclude coverage when an enforcement of any ordinance or law (1) regulates the construction, use, repair or removal of any property, including debris removal; or (2) requires the tearing down of such property, including the cost of removing its debris; or (3) results in increased costs of complying with any ordinance or law.

### COVERAGE BEGINS WITH THE INSURING AGREEMENT

An Insuring Agreement will usually stipulate what causal connection must exist between the covered cause of loss, damage and ordinance or law in order for coverage to apply.

An Ordinance or Law insuring agreement might include:

- Coverage if the insured building or structure sustains direct physical damage by a covered cause of loss and as a result, the Insured is required to comply with an ordinance or law in force at the time of the loss.
- Coverage when the direct physical loss to an insured building or structure is caused by both a covered cause of loss and an uncovered cause of loss *and* the resulting damage requires the Insured to comply with an ordinance or law in force at the time of the loss.

Ordinance or Law forms traditionally trigger coverage based on ordinances or laws at the time of the loss. But what if an ordinance or law is changed after a loss occurs but before the repair or reconstruction begins? Providing coverage for post-loss ordinances and laws is less common in the marketplace, but it is available.

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## THE CAUSAL CONNECTION – ONE SIZE DOES NOT FIT ALL!

How an Insurer links the cause of loss to the ordinance or law that was triggered depends on the wording the Insurer drafted in its coverage form. Courts will interpret coverage based on the words in the form.

City of Elmira v. Selective Ins. Co. of N.Y. (Supreme Court, Appellate Division, Third Department, New York, April 2011).

- On March 10, 2006, the City of Elmira (N.Y.) suffered windstorm damage to the southern wall of its historic three-story brick building known as the Armory Building, causing the wall to collapse.
- Engineers determined the collapse of the wall was caused by hidden deterioration of mortar, which weakened the wall and left it unable to withstand gusting winds.
- It was determined such deterioration was not exclusive to the southern wall, and as a result, the building was found to be unsafe. The Code Enforcement Officer found the Armory to be in violation of the New York State Property Maintenance Code. The building was evacuated, and the City was told to either repair or demolish the structure.
- The City had Ordinance or Law Coverage with Selective.
  - The coverage did not require that the covered cause of loss (wind) be the reason why the ordinance or law was invoked.
  - Instead, the policy's causal link requirement was that a covered cause of loss occur and the City incur costs to demolish and clear the site of the undamaged parts of the property as a result of the endorsement of an ordinance or law.
- The court ruled that "if [Selective Insurance Company] wanted to limit its coverage to only those situations where the enforcement of an ordinance or law is caused by a covered cause of loss, it could have easily done so through language of the contract. It did not."

This case, and others, make it clear – words matter.

## ORDINANCE OR LAW COVERAGE

Ordinance or Law coverage consists of several parts. Unless an Insurer automatically includes coverage, each part must be negotiated for and purchased.

**Coverage A – Undamaged Portion of the Building.** When an Ordinance or Law requires an Insured to tear down the undamaged portion of a building, this coverage provides protection for the value of the undamaged portion of the building.

**Coverage B – Demolition.** When an Ordinance or Law requires an Insured to tear down the undamaged portion of a building, this coverage pays for the cost to demolish and haul away debris from the undamaged portion of the building.

**Coverage C – Increased Costs of Construction.** When an Ordinance or Law requires modifications in how a building must be repaired or reconstructed, this coverage provides protection for the increased costs of construction associated with repairing or rebuilding the structure to the code existing at the time of the loss. Coverage usually applies to both the damaged and undamaged portions of the building.

Coverage will not apply until the property is repaired or replaced. In addition, there is often a time limit (e.g. 2 years) to have the repairs or reconstruction finished. Insurers may offer to extend the period required for repairs or reconstruction, but the Insured must request this extension of time in writing.

Orleans Parish School Board v. Lexington Insurance Company, ET AL. (Court of Appeals 4th Circuit, Louisiana, June 2013).

- When Hurricane Katrina struck the New Orleans area on August 29, 2005, the Orleans Parish School Board ("OPSB") was managing 126 public schools in the area. The storm significantly damaged the properties.
- The damage to the properties triggered the Ordinance or Law provision in OPSB's property program, and specifically, the Increased Costs of Construction coverage.
- The policy provision for Increased Costs of Construction included a requirement that code upgrades would need to be performed by August 29, 2007 (2 years after the initial damage) in order for OPSB to be indemnified for the increased costs of construction. Failure to satisfy this condition precedent would result in payment not being made to OPSB for the upgrade costs.
- The provision included wording which stated that the two-year requirement could be increased if Lexington agreed to do so in writing.
- It was determined that OPSB never made a request to increase the period of time to have the upgrades performed on its properties.
- Instead, OPSB argued:
  - Lexington had agreed to extend other dates during the claim adjustment process.

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- Lexington's own adjusters did not complete their inspections and estimates until May 2006, and then re-priced their estimates in 2007, yet Lexington wanted the repairs and upgrades completed by 8/29/07.
- OPSB had only received a portion of its insurance funds, which complicated its ability to make timely repairs.
- The court ruled there was no reason for the delay by OPSB to request in writing to Lexington that the two-year period be extended. Lexington was not obligated to remind OPSB of the two-year requirement in the policy.

**D. Increased Period of Restoration** (*sometimes referred to as Coverage D*). When an Ordinance or Law requires the undamaged portion of the building to be demolished and/or results in increased costs of construction, the Business Interruption Period of Restoration increases because the length of time required for the Insured's business to reopen increases.

Ordinance or Law coverage does not usually provide any coverage when the ordinance or law is triggered due to contamination by pollutants, decontamination costs or the loss in value or costs due to an ordinance or law the Insured was required to comply with before the loss. However, decontamination coverage is available.

## LOSS PAYMENT

While each Ordinance or Law endorsement may differ, the following is a common approach to determine the amount of loss paid under Ordinance or Law coverage:

### Coverage A

- Lesser of amount spent at the same location for the same height, floor area, style, quality or limit of insurance. If the Insured does not have replacement cost coverage, then actual cash value for the undamaged portion of the building will apply.

### Coverage B

- Lesser of the amount spent or the limit of insurance.

### Coverage C

- The amount paid depends on where the building is constructed. The valuation method of replacement cost is usually required to have Coverage C and the repairs and/or replacement must be completed before Coverage C costs are reimbursed.
  - If the building is repaired or reconstructed at the same location, then the lesser of:
    - The Increased Cost of Construction that would have been paid at the existing location; OR
    - Limit of Insurance
  - If the Ordinance or Law requires relocation of the building, then the lesser of:
    - The Increased Cost of Construction at the new location; OR
    - Limit of Insurance

Payment for costs to comply with ordinances or laws often means complying with the minimum standards required. These loss payments may be subject to a Proportionate Payment provision.

## ALLOCATION OF PAYMENT PROVISION - MULTIPLE CAUSES OF LOSS

An Allocation of Payment Provision is not found in all Ordinance or Law coverage forms, and wording will not be standard between forms.

It is not uncommon for physical damage of a building to be caused by both a covered cause of loss and a cause of loss excluded by the policy. When this happens, and there is Ordinance or Law coverage with an Allocation of Payment Provision, the policy will pay a portion of the Ordinance or Law coverage based on the amount of loss applicable to the Covered Cause of Loss and the amount of loss applicable to the excluded cause of loss.

This Allocation of Payment Provision may apply to Coverages A, B and C.

Example: A hurricane strikes the gulf region of the United States.

- The Insured's building valued at \$1,500,000 sustains physical loss to their building in the amount of \$800,000. There were varying degrees of loss over 65% of their building.
  - It was determined that wind (covered cause of loss) caused 45% of the damage and flood (excluded cause of loss) caused 55% of the damage.

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- The Insured sustains an Increased Cost of Construction loss in the amount of \$175,000.
- The direct damage to the property was the result of both a covered cause of loss (wind) and an excluded cause of loss (flood).
- The Insured has an Increased Cost of Construction Limit of \$250,000.
- An ordinance or law requires the Insured to repair all of its property to the current codes if the property damage is to more than 55% of the square footage of the building.

Assuming there are no exclusions or limitations to the contrary, what allocation of the Increased Cost of Construction loss will be paid?

- \$250,000 limit x 45% (covered cause of loss allocation) = \$112,500.

Even though the Insured had a limit of \$250,000 (enough to pay the \$175,000 Increased Cost of Construction loss), only the portion the covered cause of loss bears to the total loss is insured (45%).

## DETERMINATION OF A LIMIT OF INSURANCE

### Coverage A

- The undamaged portion of the building, should be equal to the value of the building.

### Coverage B

- Demolition and debris removal, requires the Insured to evaluate potential costs associated with demolishing the undamaged portion of the building and hauling the debris away.

The following questions can help determine what those costs could be:

- How will the debris have to be hauled away? By truck? Barge? Ferry?
- How far must the debris be transported?
- What are the projected costs to dispose of the debris?
- What is the projected length of time to accomplish demolition and debris removal?
- What additional costs might be incurred? (e.g. increased wages, equipment rental, cost for disposal at the landfill(s), etc.)
- Are there any local codes that will dictate who must haul away debris? Private company? Army Corps of Engineers?
- Is the building located in a densely populated area? Rural area?
- Are permits required?
- Are additional or special personnel required during demolition? (e.g. police officers)
- Will the demolition require explosives?
- Will debris need to be retrieved from water? (e.g. coastline, lake, bay)
- What additional cost and time for removal and/or remediation of pollutants and contaminants might be required? *Note: Unless coverage for this cost is negotiated into the policy, this cost is often excluded. Covered or not covered, it is still a cost to be analyzed.*

### Coverage C

- Increased costs of construction, is often said to be the most difficult to calculate.

Unfortunately, some Insureds believe that “replacement cost” will pay for increased costs of construction at time of loss. A replacement cost provision in conjunction with other provisions of the policy must be reviewed to determine if this is true. It likely is not the case.

In order to have an adequate limit for Coverage C, an Insured must do the work. How have ordinances, laws and codes changed since the building was last updated? What would be the cost to get the building up to code? This process requires knowledge of the ordinances and codes that affect an Insured’s building.

## CONCLUSION

Ordinance or Law coverage is readily available in the market. The limits and nuances of coverage available will vary by Insurer and the risk profile of the property requiring the coverage. The coverage wording should be parsed and studied carefully to determine if the coverage offered meets the needs of the Insured. Always remember, these provisions may contain condition precedents that the Insured must oblige in order for coverage to apply. Coverage wording is not standardized between insurers. Therefore, it would be dangerous to assume such a premise.