The Challenge of Ordinance or Law

Written by
Phyllis Van Wyhe, CPCU, CIC, CSP

The Van Wyhe Group

P.O. Box 4130
Waukesha, Wisconsin 53187

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THE CHALLENGE

There is an exclusion that has been included in our property policies for over one hundred years.

- It was the first exclusion listed in the first standard policy created in the industry in 1886.

- In the 1943 New York fire policy, the policy that formed the foundation for our all the property policies in modern times, it was not only found as an exclusion, but also included in the insuring agreement.

- Today you will find this exclusion when you read a Homeowners policy, a Dwelling Property, a Businessowners, the Commercial Property Policy and even a Flood Policy.

- In commercial lines, this exclusion is found in all of the cause of loss forms and applies to both direct and indirect losses.

An exclusion that has been around for decades is now causing problems for insurance agents across the country.

With the disasters in the 1990's, the insurance industry learned this exclusion impacts a loss far more often than previously anticipated, primarily for two reasons. First of all, governmental bodies, at all levels, have significantly increased the number and variety of codes and laws on the books. In addition, enforcement of these codes is becoming more uniform today, with fewer variances extended. In modern society, this Ordinance or Law Exclusion, which lay dormant for decades, has emerged as an issue that must be addressed by property owners and insurance professionals

In the 1990's, Insurance Services Office (ISO) adjusted and revised all of the standard property forms, with significant changes in the area of ordinance or law:

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- The exclusionary wording in the standard contracts has been expanded.
- Limited coverage is now automatically included with many forms, usually found in the section of the policy entitled Additional Coverages.
- Old endorsements have been revised and new ones have been created.

In response to the lessons learned from recent disasters, the insurance industry is adjusting old products and introducing new coverages to insure the portion of the ordinance and law exposure it considers to be insurable.

Today, the work of offering this coverage to the consuming public, including educating them in the need and how to set limits, falls on the agent. At a time when every building has an ordinance or law exposure, this is a significant challenge. Unfortunately, there is little industry education to prepare agents for the task.

THIS WORK

A fundamental responsibility of the professional agent is to help the insured identify exposures to loss and then show how they can be properly covered. The purpose of this work is to equip the agent to address the challenge of doing this with the exposures created by ordinances and laws. In addition, this work points out potential danger areas for an agent dealing with the ordinance or law exposure. All agents should approach these areas with care and document their discussions and actions uniformly because of Errors and Omissions concerns.

This book is divided into three, distinct sections:

Section I: A Changing Society

The starting point is to understand the additional exposures created by a society striving for safety, energy efficiency, maintenance of property values, and improved quality of life. Modern society has passed an increasing number of laws and ordinances to accomplish this. Every property owner today has an increased exposure to loss because of these ordinances and laws. A professional agent must be prepared to point out and discuss the wide variety of exposures created.

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Section II: The Ordinance or Law Exclusion

In addition to identifying exposures, an agent must understand the various exposures excluded by the Ordinance or Law Exclusion. In section two of this work we discuss how this exclusion works:

- The history of the exclusion, including the impact of concurrent causation language
- The three possible areas of uncovered loss
- The two issues that must be addressed

Emphasis in this section is on the problems that are created by the policy exclusion.

Section III: Providing Coverage

Not only does a professional agent bear the responsibility of identifying exposures to loss, but also demonstrating how these exposures can best be handled. In the third section of this work we address coverage issues:

- The endorsements that are available and how they should be used
- How limits should be set
- The exposures that remain uninsurable and other, related issues, such as pollution

Because every agent needs to be able to accurately answer the questions clients ask, this work concludes with a discussion of the agent's responsibility to the client.

The issue of ordinance or law has emerged as one of the prominent property issues of the new millennium, creating a significant challenge for the agent who must not only master the issues involved, but also discover how best to explain them to the prospect and the client.

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SECTION I: THE IMPACT OF A CHANGING SOCIETY

After Hurricane Andrew, dwellings located in flood plains had to be elevated before they could be certified for occupancy.

After the California earthquakes, the owners of buildings located in seismic zones 3 and 4 were required to securely anchor their water heaters and reinforce and anchor masonry and concrete chimneys.

After the Oakland fires, replacement structures were required to be of masonry construction, with tile roofs and, in many cases, containing a sprinkler system.

Most cities, towns, and municipalities have rules that determine where and what a person can build, and how repairs must be made after a physical loss. In addition to these local ordinances, there are state and federal statutes that regulate repair and rebuilding. All of these restrictions fall into four, distinct areas:

- **Building Codes**
  The twentieth century has seen a proliferation of building codes regulating every aspect of repair and construction of a building. The original purpose of building codes was fire prevention. Today, that has expanded to other safety-related issues as society designs buildings to better withstand weather-related disasters, such as hurricanes and earthquakes.

  The energy crisis of the 1970's added the dimension of conservation. In response to society's concern about dependence on foreign oil, the government began to regulate such things as the insulation used in buildings as well as the type and size of windows and sky lights.
- **Zoning & Land-Use Ordinances**
  Quality of life, uniformity of neighborhoods, and maintenance of property values have been the impetus for zoning and land-use laws and ordinances implemented at the federal, state and local level. These restrictions are

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becoming prevalent in older metropolitan neighborhoods and with water-front property. In many cases, the existing buildings are non-conforming and one either could not rebuild on the premises, or would have to build a different type of structure.

- **Anti-Pollution & Clean Air Statutes**
  The federal Environmental Protection Agency, state Departments of Natural Resources, and private environmental advocacy groups all consider clean air and fresh ground water to be top priorities. As a result, the government regulates sewage systems, factory emissions, and air replacement systems in buildings.

- **The American with Disabilities Act**
  This federal statute, designed to open our society to the disabled, requires our commercial buildings be made accessible. The specifications for this law are set by the Justice Department and enforced by local building inspectors at the time of construction or repair. Today, the federal government is pressuring states for more uniform enforcement of the requirements established by this act.

THE BOTTOM LINE

Gone are the days when a property-owner was free to build what ever he or she desired on a piece of land. Today, that property owner faces the regulation of the government even when repairing a partially damaged building. Often times, the actual requirements will not be known until after the loss has occurred.

This adds significant uncertainty in developing an appropriate insurance program and establishing the limits that will be necessary at the time of loss. A professional agent, dedicated to assisting clients in identifying possible exposures, should know more about the four possible ordinance and law exposure areas and be able to discuss them with clients. In the rest of this section we will look at each, in turn.

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THE DEVELOPMENT OF BUILDING CODES

Building codes have existed for centuries. The Code of Hammurabi contains the first recorded example.

> *"If a builder builds a house for anyone and does not complete it firmly, and the house that he has built collapses and kills the owners, then the builder shall be put to death."* Code of Hammurabi, about 2250 B.C.

In our country today, there are a great many building codes on the books, fortunately, none as severe as the first recorded one. Each state, city and municipality has the authority to regulate the way buildings are constructed and repaired. These laws impact new construction as well as the repair of both residential and commercial buildings at the time of loss.

What is a building code? Black's law dictionary contains a comprehensive definition:

> ***"Building Codes****: Laws, ordinances, or government regulations concerning fitness for habitation setting forth standards and requirements for the construction, maintenance, operation, occupancy, use or appearance of buildings, premises, and dwelling units. While many building codes are local in nature or scope, many states have uniform codes to which all local municipalities must adhere."*

Building codes have been around for centuries, but, modern building codes had their beginning in the wake of major disasters that occurred over a century ago, disasters such as the great Chicago fire.

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THE GREAT CHICAGO FIRE

In October, 1871 an inferno raged through the city of Chicago for over 30 hours. When it subsided:

- Nearly 300 people were dead.
- Forty three percent of the city's buildings had been destroyed (including most of the supposedly fireproof business district).
- One out of every four Chicago residents was left homeless.

While there were other factors involved, the primary cause of the extensive damage in the Chicago fire was a lack of safety standards in the construction of buildings. Haphazard construction, often unsafe, was common prior to the fire because building repair and construction were not regulated.

In 1875, four years after the fire, Chicago enacted an elaborate building code requiring a permit be issued prior to beginning construction of a building. It also created a Department of Buildings, which was empowered to enforce the code.

THE DEVELOPMENT OF MODERN BUILDING CODES

The risk of fire spreading from one building to another was the impetus for the development of the first building codes in this country. While fire continues to be a concern, modern building codes address two primary issues:

- **Safety Issues**
  This category includes fire safety as well as the safety of electrical, mechanical, plumbing and other construction systems. An example is the requirement that a building be sprinkled.
- **Environmental Issues**
  This category is composed of non-safety issues, such as energy conservation. A requirement that a building be properly insulated would be an example.

In modern society, both safety and environmental issues lead to additional building codes.

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THE INTRODUCTION OF MODEL BUILDING CODES

After the Chicago fire, the insurance industry recognized a need to do more than simply pay for the devastation caused by a fire. In the late 1800's, the industry accepted an active role in fire prevention and became active in the development of building codes that would prevent a recurrence of such an urban disaster.

In 1886 the industry funded the National Board of Fire Underwriters. This organization, now known as the American Insurance Association, emphasized safe building construction, control of fire hazards, and improvements in both water supplies and fire departments.

In 1905, this organization published the first model building code. The purpose of model codes was to address concerns in three areas:

- The inadequacy of the existing codes
- The lack of enforcement of codes
- The negative financial impact upon insurers

Today, there are three model codes used in the United States. Approximately 95% of America's 44,000 cities and towns use one of the three existing codes. The remaining 5% of cities and towns have over 5000 different building codes.

One reason model codes have received such widespread acceptance is that they have been promoted by the federal government. Federal grant programs encourage the adoption of model codes by providing funds to cities and towns to modernize their codes.

In addition, most states have adopted a statewide code based on one of the three model building codes. As a result, there is a considerable amount of standardization in building codes. If you compare the codes from two cities in the same state, you will see many more similarities than differences.

In 1975 the Board of Coordination of the Model Codes was established and it has been working to produce a building code to be applied nationwide. The adoption of a nationwide code is imminent and may occur early in the next decade. This will lead to even greater standardization.

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Although there is a move to standardize the actual codes on the books, there still remains wide variance in the enforcement of codes and ordinances. The building codes in neighboring municipalities may be identical, but have significantly different impact simply because of variances in enforcement. Recently, the federal government has been pressuring states for more uniform compliance of the ADA. As a result, state governments have put pressure on municipalities. The federal insistence on uniform enforcement should eventually lead to a more uniform enforcement of all building codes and ordinances.

IMPACT OF HURRICANE ANDREW

Insurers developed the first model building code in 1905, but in recent years, ceased their involvement in establishing building codes. According to a *Business Week* article *"enforcement has been spotty since insurers gave up control of the rules in 1980, relying instead on independent consultants to update specifications and on local governments to enforce them."*

Often it takes a disaster to bring deficient design, construction, or inspection into the public eye. The devastation caused by Hurricane Andrew in August 1992 was the catalyst which caused consumers, insurance regulators, state legislatures, insurance professionals, and the courts to focus their attention on building codes.

According to an ISO spokesperson, *"Up until Andrew, the assumption was that building codes were adequate and that the people enforcing them were up to the job. Then Andrew blew away those assumptions."* Industry experts estimate that at least 25% of the $16 billion in insured losses, sustained because of Hurricane Andrew, was attributable to construction that failed to meet local building codes.

Two problems became apparent in the wake of Andrew. It was discovered that the existing building codes were woefully inadequate, considering the severe wind exposures in the area. In addition, the codes that were on the books were not being enforced. The extent of damage caused by Andrew would have been greatly reduced had the codes been adequate and all buildings been constructed in compliance with the existing codes.

In the wake of Andrew, the Insurance Institute for Property Loss Reduction (IIPLR) began to support the adoption of statewide building codes in an effort to promote public safety. In addition, this non-profit organization, funded by property/casualty insurers

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joined with ISO to develop a grading schedule for community building departments, calling it the Building Code Effectiveness Grading System.

THE BUILDING CODE EFFECTIVENESS GRADING SYSTEM (BCEGS)

With ISO and IIPLR working together, the insurance industry is establishing a new system of evaluating the effectiveness of building codes. The system is being modeled after the protection class rating of fire departments and the Flood Community Rating System. The factors being reviewed include the following:

- The training, supervision, workloads, and lengths of service of building inspectors
- The extent to which inspections are conducted on site
- The qualifications and licensing of builders in the area
- The existing mandatory retrofitting provisions
- The adequacy of current building codes, in light of potential disasters in the area

From the information developed, actuaries will have the ability to grade individual cities. Each municipality will receive a numeric grade, on a scale of 10 to 1. This grade will be used in developing appropriate property rates, similar to the way fire protection classifications currently impact fire rating.

It is estimated it will take up to ten years to rate all the municipalities in the country. The end result will be increased rates for properties in communities where building codes fail to measure up to those in other areas in the country which face similar hazards. It will be a strong incentive for all communities to pass adequate codes and to aggressively enforce them. In addition to more adequate rating for the exposures, the system will also encourage better quality construction and thus minimize the severity of losses arising from future catastrophes.

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There is widespread support for this program from code officials, government representatives, community officials, and the insurance industry. But, also, there has been significant resistance, primarily from the building industry, on the grounds that building materials and wind-resistant construction would add 20 to 25% to the cost of a structure. (Insurance industry studies estimate a more conservative 1.5 to 4% increase.) There has also been some opposition from homeowners and consumer groups who feel an individual property owner should not be penalized for a community deficiency.

THE IMPACT OF BUILDING CODES

Current building codes address a wide variety of issues. They regulate the type of construction, specify standards for electrical and plumbing systems, and encourage fire safety. They impact both new construction and the repair of property after a loss by requiring more expensive materials, installations, or reconstruction methods.

The development of building codes is positive. Today, the city of Chicago is a safer place in which to live and do business, to a great extent because of the enactment and enforcement of the current codes. But, building codes also create uncertainty for the property owner. It is difficult to plan, budget and set property limits when one does not know what the code requirements will be at the time of reconstruction?

Unfortunately, transferring this unknown risk to an insurance company is not always an easy proposition. As we will see, with some risks only a portion of the exposure is insurable.

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Partial list of issues addressed by Building Codes

Wiring, heating, plumbing

Sprinkler system

Insulation and R value of doors and windows

Rise and tread of stairs

Size of bedroom windows

Type of roof

Width of hallway & stairs

Egress from basement and bedroom windows

Hard-wired smoke detectors

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HISTORIC BUILDINGS

Federal, state, and local regulations now protect many buildings that have historical, cultural, or ethnic significance. These regulations have preserved many buildings that would otherwise have been lost to the wrecking ball and have also re-created the beauty and architectural diversity of past years. The intent is to protect our valuable historical and architectural heritage.

Many people enjoy owning an historic property. However, owning a house, or commercial building, in an historic district can present special challenges. It can also add to the expense of maintaining, repairing, and replacing a structure.

The owner of a building that has been formally designated as a historic building, or is located in a historic district, may have to comply with ordinances that require the use of specific materials when repairing or rebuilding. The owner may also need to get any plans for renovation, remodeling, or repair approved by either the municipality or a local historical commission.

Properly insuring historic buildings can create a significant challenge for the insurance professional. The loss settlement clause of the standard insurance policy may not cover all the requirements stipulated by these ordinances and laws.

THE INSURANCE

There is a Homeowners program, marketed through the National Trust for Historic Preservation, called the "Historic House Insurance Program." It covers the full replacement cost of rebuilding the house itself, with coverages designed to meet the unique needs of an historic building, including coverage for ordinance or law. The National Trust for Historic Preservation can be reached at 1-800-899-6004.

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ZONING & LAND USE ORDINANCES

Zoning regulations are designed to separate land uses. They prevent the building of a slaughterhouse in a residential area, for example. This separation of land uses is done to achieve the highest and best use of property, without interference from adjacent uses. Zoning and land use ordinances are enacted to improve the quality of life in the community, to protect individual property owners, and to maintain property values.

MODERN ZONING REGULATIONS

Today, zoning regulations cover a variety of building issues:

- They regulate **allowable uses** of land, which include residential, commercial, industrial, and home-office considerations.
- They control the **height, width and depth** of a structure.
- They stipulate the **density**, for example, the number of units allowed on the site. A lot may be zoned single-family as opposed to multi-family.
- They determine the **setbacks**, mandating the number of feet the building must be from the property lines, the road or street, and even the high water mark of an adjacent body of water.

PRE-EXISTING, NON-CONFORMING USE

Because zoning and land use ordinances are constantly being changed, property owners, with a building in an older neighborhood, often find their building is not consistent with current zoning restrictions. For example, the lot with an existing single-family home may now be zoned commercial, or multifamily. This is known as pre-existing, nonconforming use.

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Most of these building and zoning laws include a “grandfather” clause. This permits existing structures or occupancies to continue in use, without requiring them to conform to the new ordinances, as long as the owner does not make any significant changes in any of the four basics areas covered by the zoning regulations. However, if the property is substantially damaged, the property owner will be required to comply with the new code in order to repair or rebuild.

If a pre-existing, non-conforming structure is damaged, the owner must repair or rebuild in compliance with current restrictions or obtain a variance from the municipality. A variance permits an exception to the rule for this specific situation. Variances are usually decided by a zoning board and are granted based upon special considerations. Obtaining a variance can involve significant time, effort, and expense; and, in some cases, variances are simply not available.

Some current laws also require that if the building is damaged beyond a specified percentage of its value (50, 60, or 75 percent is typical), the remaining portion of the building must be demolished. If the property owner wants to rebuild, the new building must meet the requirements of the current building codes.

For example, many states now have a state statute regulating the set back requirements from a body of water. The law may state that new construction be 75 feet from the high water mark. Existing structures are “grandfathered,” but if a building is more than 50% damaged, it cannot be rebuilt, but must, instead, be torn down. Any building subsequently put on that site must comply with the 75 foot set back requirement. This becomes a major concern when the building is 50% damaged.

The question immediately arises, is the threshold 50% of the replacement cost of the structure? 50% of the insurance amount on the structure? 50% of the market value? The answer can only be found in the particular statute prescribing the requirements. In some cases the threshold is based on repair or replacement cost, in other cases it is based on the market value of the structure. In some instances the valuation serving as a standard is the tax appraisal value. There is great variation.

Zoning regulations are a modern phenomenon. They were not in use until the early-to-mid-1900’s. In current times, we have seen a significant number of new regulations added, and existing regulations modified. These regulations lead to increased uncertainty for the property owner in trying to properly plan insurance to cover a potential loss.

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Partial list of issues addressed by
Zoning & Land Use Ordinances

The set back requirements in relation to the lot line, road, or alley

The number of parking spots the building parking lot must contain

The distance a building must be from a body of water

The minimum amount of green space required

Water retention areas required when building in low lands

Minimum building size or type of construction

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POLLUTION & CLEAN AIR STATUTES

In recent times, our society has made a commitment to pass on a clean and safe world to future generations. To accomplish this, governmental bodies, at all levels, have passed statutes and regulations designed to preserve the environment and control pollution. These regulations fall into several categories; there are three that can significantly impact repair and replacement of a building after a loss.

- **Air Pollution Control**
  Federal and state clear-air statutes often require that elaborate and expensive pollution-control devices be installed in buildings at the time of rebuilding or repair. As a result of these regulations, the ordinance or law exposure can even impact a business personal property loss for a commercial client.

- **Indoor Air Pollution**
  According to the World Health Organization, 40% of all buildings pose a serious health hazard, due to indoor air pollution. The EPA is calling indoor air pollution the #1 pollution problem in America today. Out of this come some statutes mandating air replacement systems in buildings and others regulating heating and air conditioning systems. In some areas of the country, fireplaces are now prohibited in new construction and, in other areas; a fireplace must be equipped with a catalytic converter.

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- **Contamination of Ground Water**
  Contamination of our ground water is an increasing concern as entire subdivisions spring up in what was previously a corn field, or a swamp. Many states now require improved septic systems or the replacement of a septic system with a holding tank. And, in some municipalities, local ordinances require that an oil heating system be replaced with a system fueled by bottled gas.

At a time of increased emphasis on the environmental legacy of future generations, we can expect to see increased regulation of pollution, indoor air quality, and ground water contamination. Many of these statutes will impact the way a property owner will repair or rebuild after a physical loss.

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THE AMERICAN WITH DISABILITIES ACT

The American with Disabilities Act (ADA) has been declared by ardent proponents to be the Emancipation Proclamation of the disabled. This federal statute was shepherded through congress by Bob Dole and signed into law by President George Bush, with an implementation date of 1992. Its purpose is to provide for the full integration of the disabled into our society. Experts predict it will have a far-reaching impact on all aspects of modern life.

THE DISABLED IN MODERN SOCIETY

Traditionally, the disabled have been left out of American society, unable to take part in many of the opportunities and benefits that go with citizenship in a free land. That began to change with the Rehabilitation Act of 1973.

The Rehabilitation Act provides for equal and integrated educational and social services for the disabled. It provides that if federal funds are accepted for a state or local program, the services provided must be made available to the disabled, on an equal and integrated basis. This law impacts health care, social services, recreation, housing, education and public transportation. It has opened up a large segment of our society to people with disabilities.

Several studies on the impact of this legislation have pointed out that during the 1970's and 1980's educational and vocational training opportunities for individuals with disabilities greatly improved. Unfortunately, the employment rate for these same people did not keep pace.

The 1980 census, and a Louis Harris poll, conducted in 1985, showed that the common thread of disability in America was unemployment. Our society had been successful in educating the disabled, but not in providing meaningful employment for them.

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The American with Disabilities Act was passed to correct this. Enforcement of the ADA is designed to accomplish two primary goals:

- Open up employment opportunities as businesses are prohibited from discriminating against the disabled in hiring, promotion, and other aspects of the employment relationship.

- Allow the disabled access to the workplace as building owners are required to remove physical barriers.

These two factors combined will mean the disabled will have the opportunity to realize the elusive goal of full participation in American society.

TITLE I: EMPLOYMENT

The ADA has five separate sections, call "titles." Two of these titles are particularly important to business owners and have implications for their insurance program. Title I of the ADA provides the following:

> *"No covered entity shall discriminate against a qualified individual with a disability because of the disability of such individual in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions and privileges of employment."*

This portion of the law is designed to provide equal treatment for the disabled in all aspects of employment, as long as the disabled person is qualified for the job. It applies to both the job applicant and to the current employee who becomes disabled. Any business employing 15 or more people is regulated by this portion of the act. This title is administered by the Equal Employment Opportunities Commission (EEOC).

The insurance industry is responding to this exposure by offering a new policy which covers employment discrimination as a peril. This is the Employment Practices Liability policy.

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TITLE III: SERVICES AND ACCOMMODATIONS

Title III of the ADA deals with the accommodations issue. It has been called a national building code for physical accessibility. It provides the following:

> *"No individual shall be discriminated against on the basis of disability in the full and equal enjoyment of the goods, services, facilities, privileges, advantages, or accommodations of any place of public accommodation by any person who owns, leases, or operates a place of public accommodation."*

This title of the law has five fundamental requirements. The one referring to new or renovated physical accommodations is of particular interest to the insurance professional. It provides that all new construction and any substantial alterations to facilities must be accessible to the disabled. The standard applies to all public-use areas, including parking areas, routes to and from the facility, entrances, rest rooms, water fountains.

When the owner of the facility is substantially altering, renovating or repairing part of an existing building, all areas open to the public must be made accessible. For example, if the owner is remodeling or repairing the dining room of a restaurant, all the public areas must be brought into compliance with the requirements of the statute. If the building is destroyed and the owner wants to replace it, all public areas must be made accessible. This, of course, can result in a considerable increase in the cost of the replacement building. It can also increase the time required for reconstruction.

The requirements of Title III of the ADA apply to all public accommodations except federal government buildings, some private clubs, religious organizations, and small bed and breakfast buildings. This portion of the law is administered by the Justice department, which publishes a manual specifying the exact physical requirements, in great detail. These specifications can be changed at any time. A building that complies with the ADA today will not comply at the time of loss if the Justice Department has changed the specifications in the interim.

This portion of the law is designed to allow the disabled access to all commercial buildings. The additional exposure of the increased cost to bring the building into compliance at the time of loss is an ordinance or law exposure.

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THE IMPACT OF THE ADA

The enactment of the American with Disabilities Act will have far-reaching impact on our entire society:

- It will mean increased employment opportunities for the disabled and significant penalties for those guilty of discrimination.

- It will mean the disabled will be able to access all public buildings, such as court houses and libraries. This will result in increased taxes, as both state and local government buildings are brought up to code.

- It will mean the disabled will be able to access restaurants, theaters, and office buildings. This will lead to an increased cost of construction as a building is repaired or replaced.

The American with Disabilities Act is a revolutionary statute that will impact all individuals in our society and businesses, large and small.

UNCERTAINTY CREATED BY THE ADA

Congress passed the ADA with one purpose in mind: *To open our society to the disabled.* It is a noble purpose; who could find fault in it? Unfortunately, it has created a great deal of uncertainty for the small business owner and magnifies the discomfort level of the commercial property owner.

- What will be required?

- How much will it cost?

- Will my insurance pay the expense?

It is important that all insurance professionals recognize and appreciate the impact this law can have on the cost to rebuild a commercial structure after a property loss. Then that professional can help the client plan accordingly.

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SOCIETAL CHANGES

One important way a financial advisor can bring additional value to a client is by identifying societal changes and their potential impact.

- The investment advisor follows changes in society's spending patterns and recommends the purchase of stock in companies poised to take advantage of these changes.

- The attorney identifies developing areas of litigation and recommends that clients avoid certain activities or exposures.

- The CPA warns of potential tax law changes and recommends a posture to prepare for the possibility.

The professional insurance agent can also provide a valuable service by identifying societal trends that may impact a client's insurance program. Today there exists a societal trend that every agent should be discussing with their clientele:

> *We, as a society, have enacted a great many new statutes and laws regulating the way a property owner must repair or rebuild a structure after a physical loss.*

This has created increased uncertainty and made it more difficult to predict the financial impact of a significant property loss. Professional agents, who become good at explaining these exposures and their impact on an insurance program, will win the respect and trust of clients. That professional may also find the client treats the insurance product and their service less as a commodity to be purchased by the pound.

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SECTION II: THE ORDINANCE OR LAW EXCLUSION

When one is aware of the prevalence of ordinances and laws that impact rebuilding in modern society, one soon realizes that every property owner faces a potential exposure. The first step in properly dealing with this issue is to recognize these changes in modern society and how they impact rebuilding and repair.

The second step is to understand the property policy exclusion that prevents recovery for the additional expenses incurred at the time of loss. In this section we will review both the history of the ordinance or law exclusion and the current wording found on standard property policies.

AN AGENT'S PERSPECTIVE

In dealing with the Ordinance or Law Exclusion, the professional property and casualty agent has two primary responsibilities:

- **Identify Possible Areas of Uncovered Loss**
  Whenever the ordinance or law exclusion is found on a property policy, there are three additional, possible, uncovered areas of loss. The agent must be prepared to point out these areas; this section contains the necessary information. Also included in this section, is a discussion of the constructive total loss issue and the valued policy laws that can complicate a substantial loss.

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- **Demonstrate How the Exposures Can Be Covered**
  The agent must also be prepared to provide direction and advice to clients. In dealing with the ordinance or law exposure, there are always two issues to address. In this section we will identify these two issues and the steps to take to cover the exposures.

Today, all property policies contain an ordinance or law exclusion an agent must be prepared to explain. Fortunately, there is little difference between the exclusion on the Homeowners policy and the one on the commercial property policy. These similarities allow the agent to learn the basics of ordinance or law once and then apply this knowledge in both the personal lines and the commercial lines areas. The exclusions found in the various standard property forms are almost identical.

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THE ORDINANCE OR LAW EXCLUSION

The problem is a simple exclusion on all property policies that states:

> *"we do not insure for loss caused directly or indirectly by . . . (the) enforcement of any ordinance or law."*

While the temptation to blame Mrs. O'Leary's cow may be very strong, the Chicago fire did not single-handedly lead to the addition of an Ordinance or Law Exclusion in our property policies. It did, however, point out the need for such a provision and step up the movement to add it to the property contract.

THE IMPACT OF THE CHICAGO FIRE ON PROPERTY INSURANCE

By 1870, Chicago had become a disaster, waiting to happen. In that year Lloyd's of London stopped writing property insurance policies in Chicago because construction was proceeding without planning and there were fires with increasing frequency. Lloyd's was not surprised by the disaster that occurred the following year; but, much of the industry was devastated.

The 1871 Chicago fire was costly for insurance companies:

- The fire destroyed 43% of all the buildings in Chicago, about one third of the city's property valuation.
- The industry sustained a total of $168 million in losses (in 1871 dollars).
- Fifty seven of the 250 insurance companies doing business in Chicago became insolvent because of their inability to pay claims.

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In 1875, in the wake of the fire, the city of Chicago instituted an elaborate building code. At the same time, it established a Department of Buildings to enforce the new code. Other major cities soon followed suit.

In the presence of these new codes, insurance companies became concerned about the additional expense of reconstructing a building according to the new specifications. The industry responded by adding a new provision to their property policies, introducing the first Ordinance or Law Exclusion. A decade later, when the industry developed the first standard property policy, the New York Standard Fire policy, it included this new exclusion.

THE EVOLUTION OF THE ENDORSEMENT

The New York Standard Fire Policy was first introduced in 1886 and remained the foundation of all property policies for almost a century. It was the first widely-used American insurance policy to have an exclusion regarding ordinance or law. That policy stated that the insurance company:

> *"shall not be liable . . . beyond the actual cash value destroyed by fire, for loss occasioned by ordinance or law regulating the construction or repair of buildings, or by interruption of business, manufacturing process, or otherwise."*

This standard fire policy was revised in 1918 and again in 1943. In the later version, the ordinance or law provision was found both as an exclusion and as part of the insuring agreement.

The first Homeowners policy was introduced in 1950. It was designed as a package policy and the property portion used the New York Standard Fire Policy of 1943 as its foundation. As a result, this new package included an exclusion for the enforcement of any ordinance or law.

POLICY "SIMPLIFICATION" AND CONCURRENT CAUSATION

In the late 1970's and early 1980's, the insurance industry went through a metamorphosis, developing "simplified" policies with "easy-to-read" formats. The New York Standard Fire Policy was no longer the foundation of those policies; but, the Ordinance or Law Exclusion was retained. The wording of the exclusion was simply updated.

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One of the significant changes made to property policies, at the time of simplification, was the addition of concurrent causation language to property policies. This language is found in the introduction to the property exclusions. In the Commercial Property Policy we find the following wording:

> *"We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded* ***regardless of any other cause or event that contributes concurrently or in any sequence*** *to the loss."*

The Ordinance or Law Exclusion is one of the concurrent causation exclusions. Because of this introductory language, this exclusion is meant to be absolute. With each concurrent causation exclusion, proximate cause does not apply and ensuring loss is not covered, unless an exception is listed in the actual exclusion. With the Ordinance or Law Exclusion, there are no exceptions listed in the policy; it is an absolute exclusion.

In the simplified commercial property forms, the Ordinance or Law Exclusion is found in each of the Cause of Loss forms. As such, it comes into play for both the direct and indirect portions of a property loss. Not only are we excluding the additional expense required in order to repair or rebuild the structure, but the policy also will not pay for the loss of business income or extra expense incurred during the additional time the business is shut down.

IMPACT IN OUR TIMES

Beginning with Hurricane Hugo in 1989, our country entered an era of magnified natural disasters. In the 1990's, the insurance industry faced staggering losses it had never anticipated. In settling claims for these disasters, the Ordinance or Law Exclusion came into play with alarming frequency.

Many people, insured for 100% of the replacement cost of their building, discovered, at the time of loss, they would not be allowed to rebuild what they had. If they were to rebuild, it must comply with current codes, significantly increasing the cost. Many property owners came up short.

In the 1990's, in both Florida and California, many property owners faced significant out-of-pocket expenses during reconstruction. When they were required to bring the building

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up to code, many adjusters offered "trade outs" to these homeowners who carried no ordinance or law coverage.

Although the policy provided for "like construction," the insured could repair on a functional replacement cost basis; a hardwood floor, for example, could be replaced by floor board and carpeting. The savings could be used to bring the building up to the current code. With the disasters of the 1990's, the insurance industry realized the impact of the Ordinance or Law Exclusion.

THE ISO POLICY REVISIONS OF THE 1990'S

In the 1990's, ISO made significant revisions to all the standard property policies. In the area of ordinance or law, they made clarifications to the wording of the exclusion, added additional coverages, and revised endorsements. The Ordinance or Law Exclusions found on the Homeowners, the Dwelling Property, the Businessowners policy and the commercial Cause of Loss forms were revised. In each case the length of the exclusion was increased significantly, which ISO explained was a "clarification," without any intended change in coverage.

In the commercial Cause of Loss forms, the revised exclusion reads as follows:

> *"a. Ordinance or Law*
>
> *The enforcement of any ordinance or law:*
>
> *(1) Regulating the construction, use or repair of any property; or,*
>
> *(2) Requiring the tearing down of any property, including the cost of removing its debris.*
>
> *This exclusion, Ordinance or Law, applies whether the loss results from:*
>
> *(1) An ordinance or law that is enforced even if the property has not been damaged; or*
>
> *(2) The increased costs incurred to comply with an ordinance or law in the course of construction, repair, renovation, remodeling or demolition of property, or removal of its debris, following a physical loss to that property.*

You will note, the revised exclusion does contain a pollution exclusion, but this is not a change in coverage. Our property policies have long contained a pollution exclusion that would also apply to the ordinance or law exposure also. By bringing the wording into the

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Ordinance or Law Exclusion, ISO is clarifying the fact that there is no intent to cover the pollution aspects of the claim.

THE BOTTOM LINE

The Ordinance or Law Exclusion is found today in all standard property policies: Homeowners, Dwelling Property, Businessowners, Commercial Property Policy, Boiler & Machinery, Flood, etc. It is also found in most specialty policies.

The exclusion is activated with increased frequency today because of the proliferation of statutes and regulations on the books. Every insurance professional must know how this exclusion can impact a loss, particularly what portion of the required repairs will be excluded.

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WHAT IS EXCLUDED?

> *"We do not insure for loss caused directly or indirectly by any of the following: a. Ordinance or Law, meaning enforcement of any ordinance or law regulating the construction, repair, or demolition of a building or other structure, unless specifically provided under this policy."*

This is the Ordinance or Law Exclusion found in the 1991 edition of the ISO Homeowners policy. A variation of it has been included in the Homeowners since the policy was first introduced. Similar wording is found on all other property policies.

This wording will exclude coverage for bringing the wiring up to code, for the cost of repairing the front steps to meet current standards, and the additional expense of rebuilding the structure according to new set-back requirements. To appreciate the scope of the exclusion, let's look at an example.

THE LOSS

Sam and Hilda recently purchased a vintage home in an older part of the city. It is an enormous house, two stories plus an attic, built on a small, narrow lot.

Zoning codes have changed numerous times since the house was built and the structure is now non-conforming. If Sam & Hilda were to build a new house on the lot, they would have to abide by the new set-back requirements. Current homes have been "grandfathered" and do not need to meet the code requirements. However, if an existing home is more than 50% destroyed, it cannot be repaired. In such a case, the building must be torn down and replaced with a structure that meets the current building code.

Three weeks after closing on the house, Sam set the house on fire while attempting to repair the furnace. Over sixty percent of the building was damaged. Now Sam and Hilda must tear down the undamaged portion, clear the lot, and rebuild according to current zoning requirements and building codes.

- *How much have Sam & Hilda lost?*

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- *How much is covered under their Homeowners policy, assuming the contract contains an Ordinance or Law Exclusion? What does Sam expect his policy to cover?*

- *Could Sam have purchased coverage to pay for the additional expense he will incur?*

Dudley DoRight, CIC, the agent who wrote the Homeowners policy, gives Sam and Hilda the bad news. Their policy will pay only for repair of the portion of the building that was damaged by the fire and the cost of hauling away the debris of the damaged portion. Although the building is a total loss, Sam and Hilda will not be able to access the entire limits of their policy, because of the Ordinance or Law Exclusion. Needless to say, they are not happy!

THE UNCOVERED DAMAGE

Whenever the Ordinance or Law Exclusion comes into play, whether it is on a Homeowners policy or a commercial contract, there are three possible areas of uncovered loss.

1. **The Undamaged Portion of the Building**

   Following a partial loss a property owner may not be allowed to repair a non-conforming building because of a local ordinance. The portion of the building left standing must be torn down and the site cleared. Unfortunately, when the Ordinance or Law Exclusion is included in the policy, the insurance will only pay for the damaged portion of the building. The undamaged portion of the building will be a loss to the owner, but will not be covered by the insurance.

   Assume the property policy is written for 100% of the replacement cost of the building. In this case, the insured has limits adequate to cover the value of the undamaged portion. Unfortunately, the total limits of the policy cannot not be accessed because of the exclusion. An insured who gets upset when limits are inadequate, is likely to become livid when adequate limits, bought and paid for, are inaccessible because of an exclusion the agent never mentioned.

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Does the exposure only exist with a total loss? Not necessarily. Imagine a smaller fire, confined to two bedrooms. It does significant damage, but the windows are not damaged. In repairing, the owner discovers that, because of their size, the undamaged bedroom windows must be replaced. The exposure is a loss to the undamaged portion of the building due to the enforcement of an ordinance or law.

2. Demolition

The second possible area of uncovered loss is the cost of demolition of the undamaged portion of the building. The debris removal coverage, included in property policies, provides for the removal of covered property when damage is caused by a covered cause of loss. It does not cover the demolition of the undamaged portion of the building because the cause of loss of this portion of the claim is the enforcement of an ordinance or law.

With this portion of the exposure, the exclusion is not the only issue. Equally important is the issue of limits. Even if there were no exclusion, the policy limits would probably not be adequate to pay both the cost of demolition and the expense to rebuild.

3. Increased Cost of Construction

The valuation clause of most replacement cost policies is "like construction." The policy does not include coverage for the improvements required by current codes. This additional expense may include such things as:

- Installing a sprinkler system, or other fire protection equipment, in a previously unprotected building
- Rebuilding with a heavier class of construction, i.e., fire resistant construction replacing frame construction
- Redesigning the structure to meet earthquake or hurricane-resistant standards
- Paying the cost of architects' and engineers' fees needed to determine what will be required to meet current codes

With increased cost of construction, there are also two issues involved: the exclusion in the policy and the adequacy of the policy limits.

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THE AGENT'S ROLE

Every day agents work at identifying exposures to loss:

- Asking the personal lines client about business-in-the-home exposures
- Probing commercial clients for off-premises property exposures
- Discussing the implications of a change in a federal or state statute

Exposure identification is a primary responsibility of the professional agent. Any agent helping clients with the ordinance or law exposure must be prepared to recognize and discuss the three possible areas of uncovered loss.

ANOTHER EXAMPLE

Fred and Frieda's 1950's suburban ranch caught fire when they finished the gallon of eggnog and decided to light the candles on the Christmas tree. The damage was significant, requiring extensive repairs, including the replacement of the roof.

When coordinating the repair of the building with the requirements of current building codes, Fred discovered the new roof would have to be built with additional supports. The exposure is one of ***Increased Cost of Construction****. The amount is the difference between "like construction" (the loss settlement basis of a standard replacement cost policy) and the improved construction required.*

The home has a two car attached garage that was not damaged in the fire. Unfortunately, the building code also requires Fred replace the garage roof with one that will meet current specifications. The loss of the value of the current garage roof is an excluded exposure because it is an ***Undamaged Portion of the Building.*** *Removing the roof is a* ***Demolition*** *exposure and is also excluded. The difference between the cost of "like construction" for the garage roof and the improved construction dictated by the ordinance would be an* ***Increased Cost of Construction*** *exposure. With this example, all three possible uncovered exposures are present.*

THE TWO ISSUES

Whenever the Ordinance or Law Exclusion comes into play, there are three possible areas of uncovered loss. In addition, there are potentially two issues that must be addressed.

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One issue is the exclusion itself. The second issue is the adequacy of limits. Unfortunately, many agents fail to realize this.

In Wisconsin, for example, the Ordinance or Law Exclusion is not applicable on Homeowners policies written to cover owner-occupied dwellings located in the state. The mandatory amendatory endorsement, added to all Homeowners policies in Wisconsin, removes the exclusion, as dictated by state statute.

Does this mean a Wisconsin agent need not be concerned about the ordinance or law exposure on a dwelling covered by a Homeowners policy? Not at all. The exclusion is no longer a problem, but the adequacy of policy limits is an issue that must still be addressed.

The rule of thumb that applies is that when there is an Ordinance or Law Exclusion on a property policy, there are always three possible areas of uncovered loss and two issues that must be addressed.

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THE CONSTRUCTIVE TOTAL LOSS

Dudley DoRight, CIC is writing the Builders Risk policy on a 12 story apartment building under construction in downtown Cleveland. Dudley is concerned about the Ordinance or Law Exclusion on the Special Cause of Loss form he has on the policy.

This is the question Dudley poses: Imagine a fire on a lower floor so damages the integrity of the structure that the city authorities require the demolition of the entire structure. Will the Ordinance or Law Exclusion come into play?

Dudley is not concerned about the increased cost of construction exposure because the building is designed to comply with current ordinances. He is, however, worried about the value of the undamaged portion of the building and the cost of demolishing and removing it. Does he need to add ordinance or law coverage to the Builders Risk to properly handle the exposure? What would you tell Dudley?

AN ANSWER

Dudley need not be concerned about the Ordinance or Law Exclusion in this case because the situation he describes is a simple case of total loss. In his example, it is not the enforcement of a law or code that adds to the loss, but the fact that the building was so damaged as to be construed a total loss. The fire has so damaged the structural integrity of the building that it cannot be repaired.

It is not uncommon, with a total loss, for a portion of the building to remain standing, undamaged. The value of the undamaged portion of the building, as well as the cost of demolishing it, are part of the total loss and are covered under the basic policy, without any endorsements.

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The Ordinance or Law Exclusion applies to the additional expense a building owner incurs, after a loss, due to laws or codes enacted after the building of the structure, but which the owner must now comply with in rebuilding his building.

CASE LAW MAKING THE DISTINCTION

Two court cases in the 1990's deal with this distinction between a total loss caused by a covered peril and an ordinance or law exposure.

> In *Digravina v. Merchants Mutual Ins. Co*., a 1991 New York case, a heavy rain and windstorm caused a portion of the insured building's roof to collapse. A civil engineer's report stated that the collapse of the entire roof was imminent and that the building should be condemned. The report further stated that if the roof were to collapse, there was a "real danger" that the masonry sidewalls could explode outward with great force. The report conclude, "It did not appear to be economically feasible to attempt to repair the roof and walls of the building, and ... that the building should be razed." The municipality notified the insured that the building was an unsafe structure and ordered the insureds to demolish the building.
>
> The insurance policy contained the standard ISO concurrent causation exclusionary lead-in language, as well as an Ordinance or Law Exclusion. The insured made claim for the entire $430,000 cost of replacement of the structure. The insurance company moved for a summary judgment limiting its payment to $94,000, representing the cash value of the repair or replacement of that portion of the building roof actually damaged by the partial collapse.
>
> The insureds argued that the storm so damaged the building that the only practical course of action was to raze the entire structure. The court agreed and awarded the entire $430,000 to the insureds. The court held that "the storm, and not the town's subsequent action, constitutes the cause in fact of a constructive total loss of the insured building... an independent engineer concluded that the building must be razed before the town issued its demolition order. The town's action was not causally related to the constructive total loss of the building. The storm caused the loss."

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The second case is *Norfolk & Dedham Mutual Fire Ins. Co. v. DeMarta*, a 1993 case from Pennsylvania. In this case the insured's claim for loss of their house, when it was demolished by the city, was covered by a Homeowners policy because the loss was actually caused by collapse due to hidden decay, a covered peril. The court held that the decay had already started prior to the city's demolition, undertaken to avoid further damage. According to the court, the demolition merely recognized the collapse that had already occurred because of the hidden decay. The Ordinance or Law Exclusion was held to be inapplicable under these circumstances.

THE IMPACT OF A VALUED POLICY LAW

Twenty states currently have valued policy laws on the books. A valued policy law impacts payment of a property claim when there is a total loss. These state statutes vary as to the type of property and the perils covered under the law. The valued policy law applies when property covered under the law (building, personal property, or both) is destroyed by a peril stipulated in the law.

With a total loss, the valued policy law requires the full amount of the policy must be paid, irrespective of the property value at the time of loss. For example, assume a building with a replacement cost of $100,000 is insured for $120,000. In case of a total loss, with a valued policy law in force, the insured will collect the $120,000 policy limit, despite the fact that this is more than the replacement cost of the structure.

A valued policy law is a consumer-protection statute based on the belief that if an insurance company wants to negotiate the value of property, it should do so at the time the policy is being written, not when the insured has just suffered a significant loss.

Valued policy laws can impact a claim's settlement when the building in question is a pre-existing, non-conforming structure. Courts have recognized an exception to the general application of the Ordinance or Law Exclusion in states with valued policy laws. In the case of a partially damaged building that must be demolished to satisfy a building or zoning law - resulting in a loss to the insured equaling or exceeding the value of the structure - the laws in most of states consider this to be a constructive total loss, despite the Ordinance or Law Exclusion. They then require payment of the full limit of the building insurance.

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However, it must be remembered that even in valued policy states, no more than the limit of insurance is payable. Unless a high enough limit has been selected to cover the cost to replace, in compliance with current codes, plus demolition cost, the insurance will be inadequate to cover the entire exposure.

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VALUED POLICY LAWS
BY STATE

STATE	KINDS OF PROPERTY SUBJECT TO VPL	PERILS SUBJECT TO VPL
Arkansas	All except personal property	Fire
California	Buildings or structures and scheduled personal property	All perils covered by the policy
Florida	Any building, structure, mobile home, or manufactured building	All perils covered by the policy
Georgia	One or two family residential building or structure	Fire
Iowa	Any building	All Perils
Kansas	Improvements upon real property	Fire, tornado, windstorm, or lightning
Louisiana	Inanimate property immovable by nature or destination	Fire policy causes of loss
Minnesota	Buildings	Fire, lightning or other hazard
Mississippi	Buildings and structures	Fire
Missouri	Real and personal property	Fire
Montana	Improvements on real property	All Perils
Nebraska	Real Property	Fire, tornado, windstorm, lightning, explosion
New Hampshire	Buildings	Fire or lightning
North Dakota	Real Property	Any covered cause of loss
Ohio	Any building or structure	Fire or lightning
South Carolina	All property except chattels or personal property. Mobile homes	Fire All insured perils
South Dakota	All real property	Fire, lightning and tornado
Tennessee	Any building or structure	Fire
Texas	All except personal property	Fire
West Virginia	Real Property	All policy perils
Wisconsin	Owner occupied one to four family dwellings, including one family condos	All policy perils

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DEALING WITH THE EXCLUSION

With recent disasters it has become apparent that the Ordinance or Law Exclusion comes into play far more often than the insurance industry had ever anticipated. This can be attributed to a proliferation of new laws that regulate the repair and reconstruction of a building. When we combine this with the fact that this exclusion is found in all standard property policies, the problem becomes apparent. Today, every agent must master the concepts involved, and learn the steps to take, to deal effectively with the issue. There are two basic steps involved:

Step #1: IDENTIFY THE EXPOSURES

One of the primary responsibilities of an agent is to uncover possible exposures to loss. With the ordinance or law exposure this is a matter of identifying the three possible areas of uncovered loss. The question to ask is "If there were a covered physical loss here, is it possible the insured would also incur:

- The loss of the value of the undamaged property
- The cost of demolition of undamaged property
- The additional expense to repair or rebuild according to code

Answering this question requires a familiarity with both the construction and occupancy details of the property involved and the local and state building and zoning laws. It may mean consulting with the city or county building department, as well as someone familiar with the requirements of the federal statutes that could come into play.

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This first step is one of exposure identification. Some agents will complete this step themselves; others will explain the concepts to their client, leaving the responsibility on the client's shoulders. A discussion of the agent's area of responsibility will be addressed in a later section of this work.

Regardless of who does the work, some basic questions should be raised:

- Do any existing codes prohibit rebuilding with present construction, occupancy, size or at this location? Does the code require demolition if more than a given percentage of the building is damaged? What percentage?

- Since the present building was constructed or operations began, have there been changes in any of the codes that could adversely affect the property or operations? What are they? What would be their probable effect in the event of a severe loss?

- What will be the impact of the American with Disabilities Act? Of the Clean Air Act and EPA pollution regulations?

Given answers to these questions, it is then possible to construct a "worst case scenario" involving the impact of these laws at the time of a property loss.

Step #2: ADDRESS THE TWO ISSUES INVOLVED

The second step, in properly addressing the ordinance and law exposure, is to deal effectively with the two issues that are always present when the Ordinance or Law Exclusion is included in an insurance contract. The exclusion must be dealt with and the need for additional limits must be addressed. Based on the worst case scenario, appropriate insurance can then be arranged.

The professional agent plays an integral role in this two-step process. Even the agent, who leaves exposure identification to the client, will become involved in finding insurance solutions to the problems uncovered. A good working knowledge of the coverages and endorsements available with each of the standard property policies is essential. We now move on to Section III of this work to present the products created by the insurance industry to address these exposures.

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SECTION III:
COVERING THE EXPOSURES

Today, there are two fundamentally different approaches for dealing with the exposures created by the Ordinance or Law Exclusion.

- **Remove Exclusion and Increase Property Limit**
  With some lines of business, the Ordinance or Law Endorsement available to cover these exposures is short and to the point. An example is the 1991 edition of the Homeowners policy. With this contract, the endorsement simply removes the exclusion and allows the insured to access their existing policy limits. Then, to provide adequate funds for the increased exposure, the insured must increase the dwelling limit. In the 1980's this simple method of providing coverage was also used on the Commercial Property Policy.

- **Provide Additional, Separate Amounts of Insurance**
  With the 1994 revision of the ISO Homeowners policy, the approach to handling the ordinance or law exposure was changed. With that policy a separate limit of insurance is provided for the exposure. If the limit supplied is not used for this purpose, it is lost. Coverage under the Commercial Property Policy has been provided on this basis since 1990.

These are the two methods available to deal with the Ordinance or Law Exclusion. Which is better? The first approach has the advantage of blanketing the coverage for ordinance or law in with the building limit. The limit provided can be used for either purpose. While this is generally preferable, it is no longer available with many contracts.

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COMPANY "THROW-INS"

Many companies deviate from ISO in their property coverages. With the Homeowners contracts of some companies, there is no ordinance or law exclusion. Chubb's Masterpiece Policy, Fireman Fund's Prestige Plus and the Travelers contract have all provided Homeowners coverage without an ordinance or law exclusion in the past, and may continue to.

Some companies are automatically providing a limited amount of coverage for ordinance or law in their property policy enhancements. Coverage is found on the broadening endorsements of many companies writing commercial property. One should always analyze these "throw-ins" with care. In some cases, only limited coverage is provided - often only for the increased cost of construction exposure. When the additional coverage is labeled Ordinance or Law, but only limited coverage is provided, confusion can result.

A second problem can arise when the coverage appears to be complete ordinance or law coverage, but it contains an exclusion. The following coverage enhancement is found on the Homeowners policy of one national, stock company.

> ***Building Ordinance or Law Coverage***
> *Damage to building or personal property we cover caused by a Peril Insured Against will be settled on the basis of any ordinance or law that regulates the construction, repair or demolition of this property.*
> *This coverage does not apply:*
> *a. to loss to any undamaged portion of the building or personal property we cover;*
> *b. unless you choose to repair or rebuild your home at its present location.*

What will happen if the insured is in a non-conforming building and will not be allowed to rebuild on the premises? In that case, it appears there will be no compensation for the undamaged portion of the building.

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ISO CHANGES

In the 1990's, the insurance industry made changes, in the area of ordinance or law, to all the standard property policies:

The exclusion in the Homeowners policy was revised, a new Additional Coverage was added, and the Ordinance or Law Endorsement was revamped. Something similar was done on two of the three Dwelling Property forms.

- On the Businessowners Policy (BOP), an Additional Coverage was added, but it is not as broad as the one added to the Homeowners. In addition, a newly-introduced endorsement provides an opportunity to broaden the coverage afforded by the unendorsed contract.

- With the ISO Commercial Property Policy (CPP) no additional coverage was automatically extended. With this contract, the exclusion on the Cause of Loss form was revised and the endorsement to provide coverage for direct loss was changed, with some significant improvements.

In this section, we look at the Homeowners, Dwelling Property, Commercial Property Policy and Businessowners policies, highlighting the recent changes made in the area of ordinance or law. The discussion will focus on the Ordinance or Law Exclusion, the additional coverage provided, and the available endorsements, comparing the forms of the early 1990's with the recent revisions.

This work then goes on to discuss setting limits and addresses the pollution issue. We conclude with a discussion of the agent's legal and moral responsibility in properly dealing with these exposures.

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THE HOMEOWNERS POLICY

In the wake of Hurricane Andrew, many Florida homeowners learned the impact of the Ordinance or Law Exclusion. Those with homes damaged or destroyed by the force of the winds and water, soon discovered the policy they thought covered everything would not cover the entire loss.

Many of the damaged dwellings were built on slabs. Under portions of the south Florida building code, a dwelling located in a flood plain and damaged 50% or more, needs to be elevated before it can be certified for occupancy. Few homeowners had purchased the optional coverage that had been available for years.

A Florida court found the Ordinance or Law Exclusion on the State Farm Homeowners to be ambiguous and ruled it could not be applied. The case captured the attention of the entire insurance industry. There was a collective sigh of relief from the industry when the court's finding was subsequently overturned on appeal.

Florida lawmakers responded by passing a law requiring all insurance companies, doing business in the state, to offer replacement cost coverage. The new law goes on to require a mandatory offer of ordinance or law coverage, with a minimum amount equal to 15% of the Coverage A limit.

Unfortunately the possibility for a repeat disaster exists today. Many homes, rebuilt after Andrew, do not meet the new building codes. Many homeowners were given special variances by local governments when they repaired or rebuilt. If they were to sustain another loss today, they could once again incur significant expense in repairing to code. Many still do not carry ordinance or law coverage.

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Florida is not the only area of the country where the Ordinance or Law Exclusion has created a problem. With the California disasters of the 1990's - earthquakes, wildfires, and torrential rains - homeowners faced similar problems. Those in the Midwest, enduring both tornadoes and flooding, also encountered building code requirements at the time of rebuilding their homes.

As a result, the insurance industry has made significant changes to the standard Homeowners contract. With a 1994 edition date, Insurance Services Office (ISO) revised the Ordinance or Law Exclusion, added an Additional Coverage, and revamped the Ordinance or Law endorsement. Not all companies have adopted the revisions, so it will benefit us to look at the standard Homeowners contact both before and after the revision.

THE HOMEOWNERS EXCLUSION: Edition date 199l

The Homeowners policy has included an Ordinance or Law Exclusion since the contract was first introduced in 1950. As reprinted below, from the 1991 edition of that policy, you can see this exclusion is simple and straightforward.

Section I - Exclusions

1. *We do not insure for loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss.*
   a. ***Ordinance or Law,*** *meaning enforcement of any ordinance or law: regulating the* ***construction, repair, or demolition*** *of a building or other structure, unless specifically provided under this policy.*

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THE HOMEOWNERS ENDORSEMENT: Edition date 199l

For property owners with an ordinance or law exposure, an endorsement can be purchased. This endorsement is short and direct.

Endorsement HO 04 77 04 91

ORDINANCE OR LAW COVERAGE

For an additional premium, loss or damage by a Peril Insured Against to covered property or the building containing the covered property will be settled on the basis of any ordinance or law that regulates the construction, repair or demolition of this property.

All other provisions of this policy apply.

This endorsement merely removes the exclusion from the contract. It does not provide an additional amount of insurance. If additional limits are needed, they can be obtained by increasing the building limit. Unfortunately, in some cases additional limits are not available.

> *On older lake home in Indiana is non-conforming. To build a new home on the lot, the property owner would have to put down pilings. Existing structures are "grandfathered," but local building codes stipulate that if an existing home is more than 50% damaged, it cannot be repaired. In such a case, the house must be torn down and a new house, on pilings, must replace it.*
>
> *The insurance company, providing the Homeowners policy, has agreed to remove the Ordinance or Law Exclusion by endorsement. This will mean the insured can access the entire policy limit at the time of a covered loss. That company will not, however, increase the amount of coverage on the dwelling. The insured faces a significant exposure; only a portion of it is insurable.*

Every agent must be prepared to explain to a client that not all ordinance or law exposures are insurable.

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THE 1994 REVISION TO THE HOMEOWNERS

The natural disasters that ravished our country in the early 1990's, and the significant losses that resulted, pointed out the fact that the ordinance or law exposure is widespread. It also emphasized the need for revisions of the Homeowners policy.

ISO introduced a 1994 revision of the Homeowners contract. With that revision, ordinance or law coverage was changed in four distinct areas:

- **The Exclusion:**
  The Ordinance or Law Exclusion found on the policy has been revised with a significant increase in size. ISO states the additional language is simply a clarification, with no intent to change what is actually excluded.

  At the same time, an abbreviated version of the exclusion has been sprinkled throughout the policy, showing up, as a reminder, in several other sections of the contract. This was obviously done so a court would not find one part of the policy contradicting another and rule the contract ambiguous.

- **Additional Coverage:**
  A new Additional Coverage was added to provide a limited amount of ordinance or law coverage. The coverage is broad, addressing all three of the possible exposures.

  It is an additional amount of insurance that is available in addition to the policy limits, but is limited to 10% of Coverage A. This new coverage can only be used to cover the ordinance or law exposures; if it is not needed in that area, it is lost. This addition gives all homeowners a basic amount of ordinance or law coverage.

- **Endorsement:**
  A new Ordinance or Law Endorsement was introduced that can be used to increase the 10% Additional Coverage to 25%, 50%, 75%, or more. Although ISO has created the vehicle to increase this coverage through the use of this new endorsement, it would be a mistake to

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assume that all companies will make it available without underwriting considerations.

- **Mobile Home:**
  A new Mobile Home Ordinance or Law Endorsement was introduced.

A discussion of each of these revisions, complete with actual policy language, follows.

THE 1994 REVISION: The Revised Exclusion

With the 1994 revision of the ISO Homeowners policy, the Ordinance or Law Exclusion has been revised and expanded. It has been changed to the following wording:

Section I - Exclusions

1. We do not insure for loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss.

a. Ordinance or Law, *meaning enforcement of any ordinance or law:*

(1) Requiring or regulating the construction, demolition, remodeling, renovation or repair of property, including removal of any resulting debris. This exclusion 1.a. does not apply to the amount of coverage that may be provided for under Additional Coverages, Glass or Safety Glazing Material or Ordinance or Law;

(2) The requirements of which result in a loss in value to property; or

(3) Requiring any "insured" or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, pollutants. Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

This exclusion applies whether or not the property has been physically damaged.

HO 00 03 01 94

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In reviewing it, two things should be noted:

1. The exclusion clearly states that it does not apply to the Additional Coverages of Glass or Safety Glazing Material or to Ordinance or Law. This is common sense. Without this exception to the exclusion, the wording here would negate the coverage added by these two coverages found in the Additional Coverage section.

2. A pollution exclusion has been added, including a definition of a "pollutant." among the other dwelling exclusions that has prevented payment for pollution- When repairing damage to the dwelling or other structures, if a law or ordinance requires the insured to respond to a real or potential pollution exposure, there is no coverage under the policy. The policy has always contained a pollution exclusion, found related expenses in the past.

In introducing this revised exclusion, ISO stated the change is simply a clarification of the way coverage was always intended to apply.

THE 1994 REVISION: The New Additional Coverage

The second change involving Ordinance or Law is the addition of a new Section I Additional Coverage. In the section of the policy titled Additional Coverages, we find ten coverages that expand the coverage provided by the policy. Among the coverages found here is coverage for debris removal, fire department service change, and landlord furnishings. ISO has now added Additional Coverage number eleven.

This new coverage provides 10% of the coverage A limit of liability to pay for increased costs incurred due to the enforcement of an ordinance or law. The 10% is an additional amount of insurance. (In the HO 00 04 and the HO 00 06, the limit automatically extended is 10% of the Building Additions and Alterations limit.) The HO 00 08 does not include this additional coverage. The wording of the new coverage is as follows:

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11. Ordinance or Law

a. You may use up to 10% of the limit of liability that applies to COVERAGE A (or for Form HO 00 04, you may use up to 10% of the limit of liability that applies to Building Additions and Alterations) for the increased costs you incur due to the enforcement of any ordinance or law which requires or regulates:

(1) The construction, demolition, remodeling, renovation or repair of that part of a covered building or other structure damaged by a PERIL INSURED AGAINST.

(2) The demolition and reconstruction of the undamaged part of a covered building or other structure, when the building or other structure must be totally demolished because of damage by a PERIL INSURED AGAINST to another part of that covered building or other structure; or

(3) The remodeling, removal or replacement of the portion of the undamaged part of a covered building or other structure necessary to complete the remodeling, repair or replacement of that part of the covered building or other structure damaged by a PERIL INSURED AGAINST.

b. You may use all or part of this ordinance or law coverage to apply to the increased costs you may incur to remove debris resulting from the construction, demolition, remodeling, renovation, repair or replacement of property as stated in a. above.

c. We do not cover:

(1) The loss in value to any covered building or other structure due to the requirements of any ordinance or law; or

(2) The costs to comply with any ordinance or law which requires any "insured" or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, pollutants on any covered building or other structure.

Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, aids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

This coverage is additional insurance.

HO 00 03 01 94

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This broadening of coverage will give all homeowners some coverage for complying with applicable building codes. Unfortunately, the limit may not be sufficient, particularly for insureds who own an older building.

In reviewing this new Additional Coverage, three things become immediately apparent:

- **What Is Included**
  Coverage is available for each of the three possible exposures: the value of the undamaged portion of the building, demolition, and increased cost of construction to bring the building into compliance. (Some of us would have preferred the use of more direct wording.)

- **The Pollution Issue**
  There is a pollution exclusion on this Additional Coverage. It would exclude, for example, the additional cost of disposing of asbestos from the undamaged portion of the building.

  Removing asbestos-contaminated debris, caused by a covered cause of loss, would be covered under Additional Coverage: Debris Removal. There is no pollution exclusion on the debris removal coverage, but there is on this Additional Coverage Ordinance or Law.

- **The Limit**
  With the HO 00 03, the limit provided is 10% of the Coverage A, Dwelling, limit. This is additional insurance and will not reduce the amount of coverage available for the dwelling. The additional 10% can only be used for the ordinance or law exposure. On the HO 00 04, the amount automatically extended is 10% of the Building Additions and Alterations limit. On the HO 00 06 it is 50% of the Coverage A limit.

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THE 1994 REVISION: The New Endorsement

Endorsement HO 04 77 06 94

ORDINANCE OR LAW COVERAGE

For the premium charged, the percentage applied to Coverage A limit of liability, or for Form HO 00 04, the percentage applied to the Building Additions and Alterations limit of liability, under Additional Coverage 11. Ordinance or Law, is increased from the 10% to the percentage shown below.

*New Total Percentage _____%**

This is Additional Coverage 10. in Forms HO 00 01 and HO 00 06.

** Entry may be left blank if shown elsewhere in the policy for this coverage.*

With the 1994 revisions of the standard industry Homeowners policy, the Ordinance or Law Coverage Endorsement (HO 04 77) has been revised. The wording of the endorsement is changed to comply with the wording of the new Additional Coverage. With this endorsement, the 10% additional provided in the Additional Coverage section of the policy can be increased to 25%, 50%, 75%, or more, for an additional premium. Although ISO provides the opportunity to increase the coverage, each company will use their own underwriting criteria to decide if they choose to extend the coverage and in what percentages.

With the HO 00 08 Homeowners form, the Homeowners policy does not include an Additional Coverage #11, providing a basic amount of coverage. Coverage for the three possible areas of uncovered loss can be obtained by using the ISO endorsement HO 23 73 06 94, Ordinance or Law Coverage, Form HO 00 08 only. With this endorsement the insured chooses a percentage of the dwelling limit- 25%, 50%, 75%, or 100% - as an additional amount of insurance that can only be used for this purpose.

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THE 1994 REVISION: Mobile Homes

A Homeowners policy can be modified, by endorsement, to cover a mobile home. When this endorsement is added to the standard Homeowners policy, Additional Coverage 11, Ordinance or Law, is eliminated. Thus, there is no automatic coverage under the Mobile Home Homeowners for ordinance or law.

Coverage for the ordinance or law exposure may be purchased by attaching Mobile Home Ordinance Or Law Endorsement, MH 04 08, in an amount equal to 10%, 25%, 50% or more of the Coverage A limit of liability, in 25% increments.

THE INDIRECT LOSS

With a recent tornado, the Freddy Fendor and his wife LaVerne have sustained a total loss to their lake home. When computing the current set backs from the high water mark, the road and the lot lines on both sides, Freddy discovers he will only be able to rebuild a house half the size of his previous home. Fortunately, they have ordinance or law coverage under their Homeowners policy.

Freddy and LaVerne have appealed to the local zoning authority and requested a variance. They have been waiting for six weeks for the city to decide on their request. Will their Homeowner insurer pay for the cost of additional living expense during this delay?

One can expect the Homeowners policy to automatically cover the indirect exposure when the direct exposure is covered. The contract provides loss of use coverage "if a loss covered under this Section. . ." The policy goes on to state "Payment will be for the shortest time required to repair or replace the damage..." One could expect the additional delay, to comply with ordinance or law requirements, to be covered.

THE IMPACT

With these changes to the ISO standard industry Homeowners contract, all homeowners will have some coverage for the exposures created by the enforcement of ordinances and laws. With proper underwriting, the coverage automatically provided can be increased by endorsement.

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This does not mean, however, that all law or ordinance exposures will now be covered. There will still be no coverage for some exposures:

- Situations where the initial cause of loss is not a covered cause of loss. For example, if the insured is required to bring the wiring up to code at a time when they are repairing flood damage, there would be no law or ordinance coverage available under this policy, because flood is not a covered peril.

- Situations where there is a pollutant involved. This policy does not intend to provide pollutant clean up except those pollutants contained in the debris of covered property when loss is caused by a covered cause of loss.

- Situations where the insured has not purchased adequate limits.

- Situations where a significant moral hazard exists. The owner of the Indiana lake property will still have difficulty finding a company willing to offer the limits required to cover their exposures, because of the significant moral hazard involved. Some exposures are simply not fully insurable.

One of the lessons from recent disasters has been that the Ordinance or Law Exclusion comes into play far more often than anyone realized. As a result, the industry has taken steps to provide basic coverage for all homeowners and created tools for increasing the coverage. The challenge the industry now faces is that of educating the public and helping them purchase appropriate coverage. A great deal of that responsibility falls to the agent.

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THE DWELLING PROPERTY FORMS

With the 1994 revision of the Homeowners policy, ISO changed the Ordinance or Law Exclusion, added an Additional Coverage, and revised the applicable endorsement. At the same time, it made similar changes to the Dwelling Property forms. With the 1994 edition of these policies, you will find the following:

- **The Exclusion**
  The revised exclusion found on the Dwelling Property policies mirrors the Ordinance or Law Exclusion found on the Homeowners policy.

- **The Additional Coverage**
  Additional Coverage: Ordinance or Law has been added to two of the dwelling forms: DP 00 02 and DP 00 03.

- **The Coverage:** In the event of a covered loss, this Additional Coverage provides coverage for all three of the possible exposures identified earlier. The costs to test for or clean up pollutants are not covered.

  The Limits: For the dwelling owner, this Additional Coverage provides a limit of 10% of the Coverage A limit of liability. If there is no coverage on the policy for a dwelling, but there is coverage on other structures, up to 10% of the limit that applies to Coverage B, Other Structures, is available. If the insured is a tenant, the policy provides 10% of the limit of liability applying to additions, alterations, and betterments. On both the DP 00 02 and the DP 00 03 this is an additional amount of insurance. This coverage is not included in the DP 00 01.

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- **The Endorsements**

  Two new endorsements are now being offered:

  1. **Building Ordinance or Law Coverage Endorsement DP 04 71** is available for use with the DP 00 02 or the DP 00 03. This endorsement allows the insured to increase the 10% given in the Additional Coverage to 25%, 50%, 75% or more.

  2. **Building Ordinance or Law Coverage Endorsement DP 04 72** is used to add coverage to the DP 00 01. It can only be added when the DP 00 08, modified loss settlement endorsement, is not attached to that policy. The insured can choose to add 10%, 25%, 50%, 75%, or more of the appropriate policy limit.

The forms used with the Dwelling Property policies are so similar to the Homeowners forms previously discussed, that we have not included the wording in these pages.

While ordinance or law coverage has been available on the Dwelling Property forms for some time, in the past, providing coverage has been accomplished by adding a Homeowners endorsement to the dwelling policy. With the 1994 revision to the dwelling forms, the DP 00 02 and DP 00 03 now include some automatic coverage; with all three forms coverage can be provided by using one of the new endorsements created specifically for the dwelling forms.

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THE COMMERCIAL PROPERTY POLICY

Until the simplification of the commercial lines forms in the mid 1980's, the New York Standard Fire policy was the foundation for all the commercial property policies. That policy included an Ordinance or Law Exclusion when it was first introduced in 1886.

This Ordinance or Law Exclusion has always precluded coverage for the extra costs associated with compliance with state statutes as well as local building codes and ordinances. Today, it also prevents recovery for the additional costs associated with compliance with the American with Disabilities Act and EPA clean-air compliance. The exclusion, today, has a much more universal applicability, impacting both older and newer buildings and both large and small businesses.

Just as the insurance industry has made revisions in the personal lines contracts in the 1990's, it has also made changes in the commercial policies. In response to the introduction of the ADA, and in light of what was learned from recent disasters, the Ordinance or Law Exclusion, and the endorsement used to buy back the coverage, have been revamped.

In this section we will first look at the Ordinance or Law Exclusion before the most recent ISO revision (Edition date 10-90) and then the revised exclusion (Edition date 6-95). We will also review the endorsements bearing those two edition dates, but preface that with an historical perspective on the endorsement.

ISO contract revisions are always a challenge. States gradually adopt the changes, opening the way for companies to revise their contracts. In some cases the transition to widespread use takes a decade.

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With each change in standard contracts, there is a transition period, sometimes significant. During that transition, one must always check to see if the policy in force has incorporated the revisions. Because of this an agent must know both versions of the forms for a considerable time.

THE EXCLUSION

Currently, the Ordinance or Law Exclusion is the first exclusion listed in the commercial lines Cause of Loss forms. It is found in all three forms: the Basic, the Broad, and the Special Cause of Loss Form. The wording of the exclusion is the same on all three forms.

The exclusion will apply whenever a Cause of Loss form is added to a property policy. As a result, the exclusion applies to both direct and indirect losses covered by property forms.

The 1990 version of the exclusion is shown below.

B. Exclusions

1. We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.

a. Ordinance or Law

The enforcement of any ordinance or law:

(1) Regulating the construction, use or repair of any property; or

(2) Requiring the tearing down of any property, including the cost of removing its debris.

CP 10 30 10 90

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This exclusion will preclude coverage for each of the three possible areas of uncovered loss mentioned in a previous chapter:

- The undamaged portion of the building
- The demolition of the undamaged portion
- Increased cost of construction

The June 1995 edition of the Ordinance or Law Exclusion retains the wording of the previous exclusion. It then goes on to include a new paragraph specifying that the exclusion applies, not just to the cost of complying with local building ordinances after a direct damage loss, but also to the cost of complying with laws that affect construction, remodeling, or repair of buildings even in the absence of damage to the building.

B. Exclusions

(continued)

This exclusion, Ordinance or Law, applies whether the loss results from:

(1) An ordinance or law that is enforced even if the property has not been damaged; or

(2) The increased costs incurred to comply with an ordinance or law in the course of construction, repair, renovation, remodeling or demolition of property, or removal of its debris, following a physical loss to that property.

CP 10 30 06 95

Undoubtedly this new language is intended to make it clear that the Ordinance or Law Exclusion applies to, and eliminates coverage for, the cost of compliance with the American with Disabilities Act (ADA).

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THE ENDORSEMENTS: AN HISTORIC PERSPECTIVE

Prior to ISO's introduction, in the mid-1980s, of the commercial property endorsement CP 04 05, three separate coverages, each provided by a separate endorsement, were used to cover the ordinance or law exposures.

- **Contingent Liability for Operation of Building Laws**
  This endorsement covered the loss of the value of any undamaged portion of a building, destruction of which was necessary after an insured loss. No additional limit was required, but an additional rate factor was applied to the property insurance premium.

- **Demolition Cost**
  This endorsement covered the added cost of tearing down the remainder of a building damaged by an insured peril, when demolition was required by law. This endorsement required a separate amount of insurance.

- **Increased Cost of Construction (Excess of Replacement Cost)**
  This endorsement covered the additional cost incurred to rebuild according to current building codes. It was offered only with replacement cost coverage and required an additional amount of insurance beyond the amount carried for building replacement cost.

Prior to the simplification of commercial lines, the property owner, seeking to cover the ordinance or law exposure, needed all three of these endorsements.

THE INTRODUCTION OF CP 04 05

In conjunction with the adoption of ISO's simplified commercial lines forms, Building Ordinance Coverage endorsement CP 04 05 was introduced. This endorsement has gone through several revisions over the years, but since its initial introduction, it has combined the three described coverages into a single endorsement.

When it was first introduced, the endorsement provided no additional limits of insurance. The insured would simply increase the property limits to cover the additional exposure insured by adding the endorsement. Also, when first introduced, the endorsement was available only with a policy that covered the building on a replacement cost basis.

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This endorsement was revised in 1990. The three necessary coverages were still included, but, under the revised endorsement, the insured was required to set a separate limit for coverages B and C.

Let's look a little closer at this endorsement.

Endorsement CP 04 05 10 90

ORDINANCE OR LAW COVERAGE

1. Coverage A - Coverage for Loss to the Undamaged Portion of the Building

If a Covered Cause of Loss occurs to covered Building property shown in the Schedule above, we will pay for loss to the undamaged portion of the building caused by enforcement of any ordinance or law that:

a. Requires the demolition of parts of the same property not damaged by a Covered Cause of Loss;

b. Regulates the construction or repair of buildings, or establishes zoning or land use requirements at the described premises; and

c. Is in force at the time of loss.

Coverage A is included within the Limit of Insurance applicable to the covered Building property shown in the Declarations. This is not additional insurance.

Coverage A involves no additional amount of insurance but simply an additional premium and covers the loss of value of the undamaged portion of the building when it must be demolished because of code requirements. In effect, it turns a partial loss into a total loss and gives the insured access to all the policy limits.

The ordinance or law can be a building ordinance, a zoning requirement, or a land-use issue but it must be a law that is in force at the time of loss. The 80% coinsurance building rate is surcharged 15% for this coverage, and the policy's coinsurance applies. This coverage is available whether the building is covered on a replacement cost basis or an actual cash value basis.

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The valuation clause, found later in the endorsement, states that if the insured repairs or replaces, on the same or other premises, payment will be the lesser of:

> *"a. the amount you actually spend to repair, rebuild or reconstruct the building, but not for more than the amount it would cost to restore the building on the same premises and to the same height, floor area, style and comparable quality of the original property insured; or*
>
> *b. The Limit of Insurance"*

There is no requirement that the building be rebuilt on the premises, but the insured will only be paid what it would cost to restore a building of the same specifications on the same premises.

The valuation clause goes on to state that if the insured does not repair or replace, or if there is no replacement cost coverage on the policy, the insured will be paid based on the lesser of (1) Actual Cash Value; or (2) the Limit of Insurance applicable to the covered building. This is a standard policy provision.

The same endorsement provides a second coverage:

Endorsement CP 04 05 10 90

(continued)

2. Coverage B - Demolition Cost Coverage

If a Covered Cause of Loss occurs to covered Building property and a Demolition Cost Limit of Insurance is shown in the Schedule above, we will pay the cost to demolish and clear the site of undamaged parts of the property caused by enforcement of building, zoning or land use ordinance or law.

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This is demolition coverage. The insured must select a separate, additional limit of coverage for demolition. This coverage is not subject to coinsurance and the 80% coinsurance rate is used. This coverage is available on a policy that is written on either a replacement cost or actual cash value basis.

The valuation section, found later in the endorsement, states that the company will pay the lesser of:

1. the amount actually spent to demolish and clear the site, or

2. The applicable Demolition Cost Limit of Insurance shown on the schedule.

The third coverage provided by the endorsement is found next:

Endorsement CP 04 05 10 90

(continued)

3. Coverage C - Increased Cost of Construction Coverage

If a Covered Cause of Loss occurs to covered Building property and an Increased Cost of Construction Limit of Insurance is shown in the Schedule above, we will pay for the increased cost to repair, rebuild or construct the property caused by enforcement of building, zoning or land use ordinance or law. If the property is repaired or rebuilt, it must be intended for similar occupancy as the current property, unless otherwise required by zoning or land use ordinance or law.

However, we will not pay for the increased cost of construction if the building is not repaired or replaced.

The COINSURANCE Additional Condition does not apply to Increased Cost of Construction.

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This is Coverage C - Increased Cost of Construction and it pays the cost necessary to repair or replace the damaged building at today's code requirements.

This would cover such things as:

- Elevators to comply with the ADA
- Sprinklers to comply with building codes
- Wind-resistive roofing
- An additional means of egress
- More expensive scrubbers on smoke stacks to comply with EPA regulations

The revised endorsement clarifies that Coverage C applies to both the damaged and undamaged portions of the building. If the building is partially damaged and the insured is required to put in a sprinkler system in order to repair, this coverage would pay for the expense of putting the system in both the damaged portion of the building, and in the portion of the building that was not damaged.

The revised Coverage C also includes coverage for some property items that are not automatically covered under our commercial forms. The Building and Personal Property form does not automatically cover foundations, pilings, and underground pipes, flues and drains. When the insured includes Coverage C, by setting a limit for the coverage, these property items are deleted from Property Not Covered. The insured should take this into consideration and increase limits accordingly.

The insured must set a separate limit for Coverage C, Increased Cost of Construction, but, that limit is not subject to coinsurance. The 80% coinsurance rate is used.

The endorsement contains a number of requirements on Coverage C:

- If the property is repaired or rebuilt, it must be intended for similar occupancy, unless otherwise required by zoning or land use ordinances.
- No payment will be made under this coverage if the building is not repaired or replaced.
- The building must be insured on a replacement cost basis in order to obtain this coverage.

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This endorsement, CP 04 05 with an edition date of 10 90, has the advantage of providing coverage for all three of the possible areas of uncovered loss the insured may face as a result of a federal, state, or local ordinance or law.

THE NEW ENDORSEMENT

In the 1995, ISO commercial property forms portfolio, the prior direct damage coverage endorsement (Ordinance or Law Coverage, CP 04 05) has been withdrawn and replaced with a new endorsement. It possesses the same title and form number. The new endorsement differs from its predecessor in three significant ways:

- Under the previous endorsement, Coverage A was automatically provided by the endorsement. The revised CP 04 05 makes coverage A optional. ISO indicates that this approach is intended to accommodate the insured who owns or rents a newer building, although it is not difficult to imagine a scenario where a newer building would also have the exposure.

- With the old endorsement, the insured needed to set separate limits for Coverages B and C. The revised endorsement offers an opportunity to buy a blanket limit applicable to Coverages B and C combined. The combined approach will make it less likely the insured will run out of limits because of underestimating either demolition costs or increased costs of construction.

- A new restriction eliminates coverage for costs relating to an ordinance or law that the insured was required to comply with before the loss and had failed to do so. This exclusion does not apply to “grandfather” situations in which the insured is not required to comply with new building standards until after a loss occurs.

Added to the endorsement is the exclusion for the enforcement of any ordinance or law requiring any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to or assess the effects of ‘pollutants.’ Even when the insured purchases ordinance or law coverage by endorsement, this significant exposure will not be covered.

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As with the previous endorsement, there is no coinsurance applicable to either Coverage B or C, but 80 percent or higher coinsurance is required to obtain the endorsement (unless replaced by the agreed-value clause). Payment is made under Coverage C only after the property is actually repaired or replaced on the same or another site "as soon as reasonably possible after the loss or damage, not to exceed two years" (unless this time period is extended by the insurer in writing).

USING THE ENDORSEMENT

Today, every commercial building has a potential ordinance or law exposure. Each business owner must decide whether to purchase coverage or go self-insured. The professional agent must be prepared to present these options and answer any questions that may arise.

The agent, adding coverage by endorsement, must review the actual form that will be used because there are currently a variety of forms in use. Coverage A should be seriously considered and, if rejected, reviewed at each renewal. When possible, Coverages B & C should be blanketed to provide a spread of risk for setting the limits.

THE INDIRECT LOSS

Finkelstein's Futons has been shut down since the fire they sustained in April. Because the damage was not extensive, they estimated it would be back operating within two months. Unfortunately, they did not factor in the building code requirements.

Significant changes were required to comply with current building codes and the repairs have taken an additional month. Will the entire three month period be covered under the time element policy Finkelstein has?

When writing a time element coverage form, one of the choices that must be made is the selection of a Cause of Loss form. As a result, the Ordinance or Law Exclusion, found on all the ISO Cause of Loss forms, applies to the Business Income and Extra Expense coverages, as well as to the direct property coverage.

Any delay in the restoration of the premises, or the resumption of operations, caused by the need to comply with current building code requirements, zoning regulations, or the American With Disabilities Act is excluded from the business income or extra expense recovery.

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In some cases, this exclusion can have an even greater impact on the indirect loss than on the settlement for direct property loss.

- When the code requires demolition of the existing structure before reconstruction can begin, a substantial delay can be expected.

- If rebuilding on the present site is prohibited, a new location must be found, leading to an even greater delay in the resumption of operations.

- When the Justice Department adjusts the specifications of the American with Disabilities Act, an additional delay in repair or reconstruction can be expected.

INCREASED PERIOD OF RESTORATION

The impact of the ordinance or law exclusion on Business Income and Extra Expense can be overcome by use of ISO endorsement CP 15 31, the Ordinance or Law - Increased Period of Restoration endorsement. This endorsement extends the Business Income or Extra Expense Coverage to include the additional time needed to restore operations, when delayed because of the enforcement of building or zoning laws.

It is a simple endorsement that is easy to add. Unlike the property policy, where one must select from three separate coverages, this endorsement requires no such decision. It covers the additional time needed to restore operations, whatever the reason, when the delay is caused by the application of an ordinance or law.

The endorsement accomplishes this by changing the definition of the 'period of restoration.'

> *"'Period of restoration' includes any increased period required to repair or reconstruct the property to comply with the minimum standards of any ordinance or law, in force at the time of loss, that regulates the construction or repair, or requires the tearing down of any property."*

The endorsement does not provide for a specific additional amount of insurance nor a specific time period; it simply waives the effect of the Ordinance or Law Exclusion. The rates are surcharged 20% for this endorsement.

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If a significant delay is possible, the limits carried for Business Income or Extra Expense should also be adjusted. Choosing a higher coinsurance percentage, with a reduced rate, may be appropriate, so that the cost of the added coverage is not proportionate with the amount of added coverage needed.

The rule of thumb, to which there are few exceptions:

Whenever the ordinance or law endorsement is added to the property policy, the Increased Period of Restoration endorsement should be included on the time element coverages.

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THE BUSINESSOWNERS POLICY

While there has been an Ordinance or Law Exclusion on the Businessowners Policy (BOP) since the introduction of that policy, ISO has never provided a method for buying back the coverage. The prevailing theory was that the coverage would not be needed by a risk that would be eligible for the BOP, because, the industry traditionally reserved this contract for newer buildings.

With increased competition in the industry in recent years, this contract is no longer used only on newer buildings. In addition, with recent disasters we have learned that even newer buildings can have an ordinance or law exposure. This is particularly true since the American with Disabilities Act will apply to most risks insured under the BOP. Many risks insured under a BOP today have a significant ordinance or law exposure.

The ISO Businessowners policy was revised in the 1990's with an edition date of 1997. Some of the most significant changes were made in the area of ordinance or law including:

- The policy exclusion has been revised, substantially increasing the length of it, with no intent to change the coverage.

- A new Additional Coverage, Increased Cost of Construction has been added.

- An endorsement that can be used to provide broad coverage has been introduced.

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THE EXCLUSION

The revised exclusion in the 1997 form is identical to the exclusion in the commercial lines cause of loss forms.

Property Exclusions

1. We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.

a. Ordinance or Law

The enforcement of any ordinance or law:

(1) Regulating the construction, use or repair of any property; or

(2) Requiring the tearing down of any property, including the cost of removing its debris.

This exclusion, Ordinance or Law, applies whether the loss results from:

(1) An ordinance or law that is enforced even if the property has not damaged; or

(2) The increased cost incurred to comply with an ordinance or law in the course of construction, repair, renovation, remodeling or demolition of property or removal of its debris, following a physical loss to that property.

BP 00 02 01 97

Exclusionary language has also been sprinkled throughout the form, to make certain the insured realizes there is no intent to provide coverage for any of the exposures created by the requirement to comply with ordinance or laws.

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THE NEW ADDITIONAL COVERAGE

Additional Coverages

j. Increased Cost of Construction

(1) This Additional Coverage applies only to buildings insured on a replacement cost basis.

(2) In the event of damage by a Covered Cause of Loss to a building that is Covered Property, we will pay the increased costs incurred to comply with enforcement of an ordinance or law in the course of repair, rebuilding or replacement of damaged parts of that property, subject to the limitations stated in j.(3) through j.(9) of this Additional Coverage.

(3) The ordinance or law referred to in j.(2) of this Additional Coverage is an ordinance or law that regulates the construction or repair of buildings or establishes zoning or land use requirements at the described premises, and is in force at the time of loss.

(4) Under this Additional Coverage, we will not pay any costs due to an ordinance or law that:

(a) You were required to comply with before the loss, even when the building was undamaged; and

(b) You failed to comply with.

(5) Under this Additional Coverage, we will not pay any costs associated with the enforcement of an ordinance or law which requires any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of "pollutants'.

(6) The most we will pay under this Additional Coverage, for each described building insured under this Coverage Form, is $5,000.

The amount payable under this Additional Coverage is additional insurance.

BP 00 02 01 97

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With the 1997 policy revision, ISO has added a new additional coverage to the BOP, Increased Cost of Construction. There is no coverage for the other two exposures created by ordinance or law compliance, Demolition and the Undamaged Portion of the Building.

In analyzing this Additional Coverage, the following key points are evident:

- The coverage only applies to buildings insured on a replacement cost basis. This is not a major concern, because in most cases, buildings insured under a BOP are insured on this basis.

- The coverage only applies to the damaged portion of the building. If the insured is required to add sprinklers to the building at the time of a partial loss, this coverage will only pay for adding them to the portion of the building that has been damaged.

- The ordinance or law must be in force at the time of loss. It is rare that the insured would be required to comply with an ordinance or law that is implemented after a loss, but it does happen at time of a disaster. For example, after the Oakland fires, homeowners who were rebuilding needed to improve construction (tile roof, masonry construction, etc.) These requirements were established after the loss, but before the rebuilding.

- Coverage does not apply to any cost due to an ordinance or law that the insured was required to, but failed to comply with, prior to the loss. For example, if the named insured failed to install a fire escape that was required by the city, and a subsequent fire loss occurred, the insurer would not be obligated to pay the expense of installation

- The additional coverage provided will not apply to costs due to an ordinance or law which requires the insured or others to test, monitor or clean up or assess the effects of pollutants.

- The limit extended by this new additional coverage is $5000 for each described building. This is an additional amount of insurance and will not come out of the building limit.

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THE NEW ENDORSEMENT

With the 1997 revision of the Businessowners policy, Ordinance or Law Coverage Endorsement BP 04 35 has been introduced. The wording of this endorsement is almost identical to the endorsement available under the Commercial Property forms, CP 04 05 06 95. The BOP endorsement contains the following highlights:

- All three primary coverages are available.
- Coverage for the Undamaged Portion of the Building is optional. (This coverage is called Coverage A in the Commercial Property forms and Coverage 1 in the Businessowner forms.)
- Limits must be set for the other two coverages, Demolition (Coverage 2 under the BOP) and Increased Cost of Construction (Coverage 3 under the BOP).
- The option to blanket the last two coverages is available under the BOP but the word "combine" is used rather than "blanket." Despite the difference in terminology, there is no difference in coverage.
- There is no coverage for damage to the undamaged portion of the building if the ordinance was passed after the loss.
- Pollution is excluded.
- There is no coverage for the expense of complying with any ordinance the insured was required to comply with before the loss and failed to do so.

The above mentioned provisions are a part of both the endorsement used on the Businessowners policy and the Commercial Property forms.

One will find one significant difference in wording when comparing the two endorsements. The endorsement used with the Commercial Property forms includes coverage for such items as excavations, foundations, pilings and underground pipes, flues and drains when the insured purchases coverage for Increased Cost of Construction. This language is not found in the Businessowners policy and for good reason. The BOP contains a much broader definition of building and these items are always covered under the basic policy, without the need of an endorsement.

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THE INDIRECT EXPOSURE

With the 1997 revision of the Businessowners program, ISO did a good job of creating an opportunity to insure for that portion of the direct loss attributable to the enforcement of ordinance or law. In doing so, they have corrected a significant deficiency in that program.

Unfortunately, they have not created any opportunity to insure for the indirect exposure. ISO still does not have an endorsement that will increase the definition of the 'period of restoration' to include the additional delay due to complying with the requirements of an ordinance or law. Some companies that deviate from ISO, or enhance the standard contract with a broadening endorsement, do provide the coverage. It is an important addition.

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THE POLLUTION ISSUE

Angela and Bill Lingle live in a 40 year old brick ranch a mile from the city limits. The kitchen and bathroom sustained extensive fire damage on Easter morning when Angela left the ham in the oven and went to church.

In cleaning up the debris, the contractor uncovered asbestos surrounding some pipes. The asbestos must be removed and disposed of by abatement contractors, at an additional expense. Because of a local ordinance, the Lingles must also remove the asbestos from the undamaged portion of the dwelling, before repairs can be made.

Will the additional expense of removing the polluted debris be covered under their Homeowners policy? Would it be covered under a commercial contract?

If their Homeowners policy includes coverage for ordinance or law, will it cover the expense of removing the asbestos from the undamaged portion of the building? Would a commercial policy cover the exposure?

At a time when society has added a great many new laws to the books regulating the way we dispose of our waste, the pollution issue is often in the forefront at the time of loss. Many agents believe there is no pollution coverage provided under current property policies, and are surprised to learn that pollution is treated differently under debris removal coverage than it is under ordinance or law coverage.

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THE DEBRIS REMOVAL EXPOSURE

All of the standard property policies currently provide coverage for Debris Removal in a section of the policy usually entitled Additional Coverages. The coverage provided is similar in both the personal lines and commercial lines contracts. Below is the wording of this coverage as found in the current Homeowners policy:

Section I - Additional Coverages

ADDITIONAL COVERAGES

1. Debris Removal. *We will pay your reasonable expense for the removal of:*

a. Debris of covered property if a Peril insured Against that applies to the damaged property causes the loss; or

b. Ash, dust or particles from a volcanic eruption that has caused direct loss to a building or property contained in a building.

This expense is included in the limit of liability that applies to the damaged property.

HO 00 03 01 94

This additional coverage pays for the removal of the debris of covered property, caused by a covered cause of loss. For example, the expense of removing the debris of an insured building, after a fire loss, is covered under this coverage.

There are no exclusions in the Debris Removal coverage on the personal lines policies. Consequently, if the debris of covered property contains pollutants, the removal of the pollutants is included in the debris removal expense, as long as the debris removal limits are adequate. What about the pollution exclusion found in the Perils section of the policy? Those exclusions apply only to the dwelling and other structures. Those exclusions do not apply to this coverage found in the section titled Additional Coverages.

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Commercial Property Polices and the Businessowner operate in a similar manner. They will also pay for the removal of polluted debris of covered property caused by a covered cause of loss, as long as the limits for debris removal are adequate.

With the commercial contracts the Additional Coverage: Debris Removal does contain a limited pollution exclusion. These contracts do not cover the removal of pollutants from land and water under the Debris Removal coverage. Another Additional Coverage provides $10,000 for this exposure.

THE LIMITS ON DEBRIS REMOVAL

How much coverage do our standard contracts provide for debris removal? With all the standard contracts, the debris removal expense comes out of the limit of liability for the property. A home insured for $100,000 that sustains a fire doing $10,000 damage, will have the remainder of the dwelling limit, $90,000 available for debris removal.

With commercial policies, the entire remaining policy limit is not available. Debris removal is limited to 25% of the direct property loss. A commercial building insured for $100,000 that sustained a $10,000 fire could access only $2500 of the building limit for the removal of debris.

In either of these cases, a commercial loss or a personal loss, the amount paid for debris removal comes out of, and reduces, the amount available to replace the property. In addition to the property limits that can be accessed, most standard contracts contain an additional, limited amount of coverage, available for debris removal if necessary. With the Homeowners policy there is an additional 5% available; but, there is no additional limit provided on the dwelling fire policies. With the commercial policies, there is an additional $5000 ($10,000 on the newer forms) and that can be increased by endorsement.

THE BOTTOM LINE ON DEBRIS REMOVAL:

The expense of the removal of damaged property, caused by a covered cause of loss, is covered under our property polices. This includes the additional expense incurred to dispose of polluted debris. The primary concern is limits. With each of our standard contacts, there are opportunities to increase the amount of debris removal coverage. In most cases, it should be considered, particularly where there is a possibility of the debris containing pollutants.

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THE ORDINANCE OR LAW EXPOSURE

If the insured must remove polluted debris of covered property, caused by a covered cause of loss, the additional expense will be covered under Additional Coverage: Debris Removal. What if, at the same time, they must remove pollutants from the undamaged portion of the building? Will ordinance or law coverage pick up this cost? The answer is a resounding "NO!"

With the Homeowners contracts from some companies, there is no ordinance or law exclusion. However, these contracts do contain a pollution exclusion on building coverage. This exclusion will preclude the payment of removing the pollutants from the undamaged portion of the building. Even when ordinance or law coverage is purchased by endorsement, the endorsements available today all contain a pollution exclusion. Typical wording is as follows:

> *We will not pay under this endorsement for the costs associated with the enforcement of any ordinance or law which requires any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of 'pollutants'."*

All property policies now carry a pollution exclusion. All endorsements, providing coverage for the ordinance or law exposure, also contain wording similar to that found above.

THE BOTTOM LINE ON ORDINANCE OR LAW:

Even if there is coverage provided under the property contract for the enforcement of ordinance or law, do not expect it to include the cost of removing pollutants from the undamaged portion of the building. The industry considers this to be an exposure that is uninsurable under our standard property policies and does not provide a method for covering it.

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SETTING LIMITS

Once the need for ordinance or law coverage is established and the three types of coverage are understood, the question must be raised:

How much of each coverage is needed?

And, the following-up question:

Who bears the responsibility of setting appropriate limits?

In this chapter we will address the first question; in the next chapter we will discuss the second one.

THE FACTORS:
There are several factors that can influence the cost of complying with ordinances or laws at the time of a property loss.

- **Age of Building**
  The age of a structure may influence the cost of complying. The ordinance or law exposure is created by laws that are changed or enacted after the structure is built. The longer the building has been around, the greater the chance that new laws have been passed.

- **Location**
  The exposures will vary greatly, depending on the location:

  The ordinances that apply in one state, county, or city will not apply to property in the neighboring one.

  Two adjacent municipalities, with identical building codes, can vary in enforcement.

  The granting of a variance may be a distinct possibility in one area and a mere pipe dream in another.

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- **Type of Business**
  With commercial risks the exposures can vary greatly, with the type of business being conducted. The cost of complying with the requirements of the American with Disabilities Act will be significantly more for the restaurant, than for the dry cleaner, because the restaurant has more public areas that must be made accessible to the disabled. Likewise, the Clean Air Act can be of greater concern to one business than another.

- **On the Water**
  Buildings set on the shoreline of a river, lake or ocean have an increased exposure as modern society evaluates the appropriateness of such buildings and tightens the regulations that apply. Any property owner with a water front exposure should spend some time researching the existing codes and then keep current on any changes.

- **Disaster-Prone Areas**
  Both the government and the insurance industry are working to reduce the impact of disasters. Anyone with a building in a known disaster-prone area is likely to face more restrictions on repair and rebuilding.

When setting limits, these factors must be considered and should be combined with both a preliminary investigation as to existing codes and ordinances and a projection of the worst probable scenario.

PERSONAL LINES

One advantage of the ordinance or law endorsements available in personal lines is that they combine coverage for the three exposures into one coverage limit. With the forms prior to the 1994 revisions, that limit is blanketed in with the dwelling limit. If the additional limits provided for ordinance or law are not needed at the time of loss, the coverage can be applied to the replacement of the dwelling, if needed.

With the newer forms, there is an automatic 10% of the building limit provided and the insured must decide on any appropriate increase. If the coverage is not needed for ordinance or law exposures, the coverage is simply lost.

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There is no appropriate, scientific method for setting these limits. It is similar to putting away something for a rainy day. How much should one put away? Who really knows? The needs are very individualistic.

COMMERCIAL LINES

With commercial lines, setting limits is more challenging. Let us look at the three coverages available and discuss each separately:

Coverage A: The Undamaged Portion of the Building

To have adequate limits for Coverage A, the insured must simply insure for 100% of the replacement cost of the building (or, 100% of the Actual Cash Value, if the contract is written on an ACV basis). Additional limits are not necessary. With this coverage the question is not adequacy of limits, but, rather, the ability to access the limits purchased.

This coverage is of particular importance if the building is non-conforming and a partial loss would become a total loss in the eyes of the local building inspector who would then prohibit repair. However, a smaller loss could also activate this coverage. For example, in order to repair the building, the sprinkler system must be improved, in both the damaged portion of the building and the undamaged portion. The insured, in this case, has a distinct need for Coverage A. The coverage should always be considered.

Coverage B: Demolition

The above-mentioned risk with the sprinkler loss will need some demolition coverage also. Demolition coverage will pay for removing the existing sprinkler from the undamaged portion of the building. However, the insured with the non-conforming building that cannot be repaired if damaged more than 50% will have an even greater need.

With the non-conforming building that is currently “grandfathered” one must first determine what percentage of loss will require demolition - 50%? 60%? 75%? Then, assume, under the worst loss situation, that the damage just reaches that percentage, so that demolition is required. Insure for the estimated cost of demolition of the difference -- 50 % of the property value, 40%, or 25% as the

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case may be. A demolition contractor can probably give at least a rough estimate of what this cost might be.

Coverage C: Increased Cost of Construction

For Coverage C, the problem involves ascertaining the kind of upgrading that will be required to meet current code requirements. In an article found in *Adjusting Today*, the newsletter published by Adjusters International, one finds the following two options recommended:

> 1. Arrive at a "ball park" figure for possible upgrade to code requirements and buy a little more than this figure to be safe. (Will an unsprinklered building require sprinklers? Will additional parking be required? Will earthquake resistant construction be required? etc. etc. And, what, in round figures, is the probable additional cost?); or
>
> 2. Do an elaborate study of the current codes as they relate to the present property, obtain cost figures for compliance, and buy the amount of coverage these figures call for (or a little bit more). This method fits nicely into a well-designed disaster plan, as it does much of the work before a loss that would otherwise have to be done hastily after a loss occurs.
>
> In setting limits for Coverage C, one must be careful to identify the full extent of the possible exposure. For example, often included in this cost will be extensive architects' and engineers' fees needed to determine what will be required to meet current code requirements. Because time is usually of the essence in getting construction under way, premium prices will often be involved in this work. This alone can substantially increase the cost of construction on a building after the loss.
>
> How much coverage will be needed to cover the increased cost of construction in order comply with requirements at the time of loss? Often, it is impossible to predict the limit that will be necessary at the time of loss with any accuracy. Only a very good psychic would be able to answer that question accurately.

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THE AGENT'S RESPONSIBILITY

One of Dudley DoRight, CIC's long-term clients is a dry cleaning operation on the west side of town. The business is run by Calvin Clavin, who has over 30 years experience in the dry cleaning business.

Each year, at renewal, Dudley points out the pollution exclusion included in the company's insurance program and tries to discuss the pollution exposure of a typical dry cleaning operation. Each year, Calvin simply yawns.

Last month Calvin attended a dry cleaner's convention in Las Vegas, renewing industry contacts and taking advantage of the educational workshops offered. The presenter in one session detailed the extent of the pollution exposure in a dry cleaning operation and Calvin was stunned.

Two days after returning to town, Calvin called Dudley to set up an appointment. "I'd like you to stop by, as soon as possible. I want to give you a tour of the plant so that you can identify everything that could potentially be a pollutant, determine how much it would cost to clean it up, and then get me a quote for insurance to cover the expense."

How would you suggest Dudley respond?

Do clients ever have unrealistic expectations about the level of service you should be providing?

Do they ever demand too much from you?

Are you willing and able to set the boundaries?

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At a time when E&O claims are on the rise, and client loyalty is on the decline, every agent must reevaluate how he/she handles difficult coverage areas and be prepared to set limits.

THE NATURE OF THE ORDINANCE OR LAW EXPOSURE

Properly covering the ordinance or law exposure is a significant challenge. To accomplish it one must:

- Understand the exposures created by ordinances and laws in modern society.
- Analyze the individual business to identify the exposures that are present.
- Determine the coverages that are needed and set appropriate policy limits.
- Monitor changes in ordinances or laws and changes in the cost of complying on an ongoing basis.

Many clients, not willing or able to do the work involved, will look to their agent to accept the responsibility. Each agent must determine how much of this work he/she will do and set boundaries. And, because, in today's litigious society, doing a good job is not enough, the agent must have documentation to prove the limitations on their responsibility were communicated to the client. Let us look, briefly, at the three primary areas of responsibility for an agent.

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THE ROLE OF THE AGENT

Whether helping a client identify pollution exposures or those created by laws and ordinances, an agent has three primary areas of responsibility:

1. DETERMINE:

One of the responsibilities of the agent is to help the insured identify exposures to loss and then determine how to properly cover them. In order to do that an agent needs to learn about the insured's circumstances and know the contract.

Dudley DoRight must set limits on what Calvin can expect of him. Dudley has not been trained, nor is he paid, to survey Calvin's operation, identifying every potential pollutant. Dudley can, however, point out the exclusion on the insured's policy and explain the exposures that are left uncovered. Then, if Calvin identifies the potential exposures that exist in his business and gives Dudley coverage amounts, Dudley can determine the basis on which the coverage can be obtained.

Everyone who is a party to the transaction must be clear that the agent's responsibility is simply to determine exposures to loss and not to determine adequate limits. Only the insured can choose limits.

2. DISCUSS:

The second obligation of the agent is to discuss. This obligation has two components. First, the agent must learn to effectively communicate with the insured using terminology that can be readily understood by anyone. Any explanation of ordinance or law should be prepared using non-industry jargon and should include examples that have relevance to the particular insured involved. The communication burden falls to the agent.

The second aspect of the obligation to discuss is the communication of responsibility. The agent must make clear the areas of responsibility in any decisions that are made. From an E&O standpoint, the goal of the agent is to give the insured enough of the right kind of information so that the insured can make their own decision on what is best in their unique circumstances. When this is accomplished the insured accepts responsibility for being adequately insured.

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There is a natural tradeoff between the obligation to Determine and that to Discuss. When the agent cannot accept the responsibility of determining (for example, the issue of setting proper limits), the key responsibility is to explain the issues that must be taken into consideration in making a decision. This can best be accomplished by becoming very good at discussing.

3. DOCUMENT:

The best way to avoid E&O is to adequately cover all exposures. However, when that is not possible or the insured chooses not to do that, documentation becomes the key defense. The agent must document the discussion, the insured's decision, and any subsequent reminders. In an E&O case, documentation is the key defense.

THE BOTTOM LINE

In an increasingly competitive industry, every agent is looking for ways to add value to the insurance transaction, gain a competitive advantage, and distinguish themselves from the competition. In our increasingly litigious society, the challenge is to accomplish that without increasing the standard of care required of an agent and the E&O exposure involved. Today, every agent faces that challenge on an ongoing basis.

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