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Builders Risk Insurance & Weather Related Claims

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I. BUILDERS RISK POLICIES

- A. Builder's Risk policies are specialized insurance policies designed to cover property losses associated with construction projects. "[B]uilder's risk policies are used to insure the building while it is in the process of being built." *Ajax Building Corp. v. Hartford Fire Ins. Co.* 358 F.3d 795, 799 (11th Cir. 2004).
- B. Builders risk policies cover the structure under construction, including materials, fixtures, supplies, machinery and equipment to be used in construction as well as the property of others for which an insured may be liable.
- C. Builders risk policies are available either on an all risk or a named perils basis. Named perils coverage insures specified losses whereas all risk coverage pays for losses other than those caused by an excluded peril.

II. DEDUCTIBLES

- A. Builders risk policies cover projects during construction, therefore, the value at risk increases as the project progresses.
- B. Policy deductibles for certain perils are sometimes determined by taking a percentage of the value of the property in place and at risk.
- C. Case Study: *Turner Construction Company v. Ace Property and Casualty Insurance* 429 F.3d 52 (2005). In *Turner*, a construction project was damaged by rain that entered through openings caused by wind during the policy period. The policy provided for a \$10,000 deductible, generally, but by

endorsement provided that “[a] wind deductible of 1% of the value in place at the covered property location at the time of loss applies subject to a \$100,000 minimum.” If the wind deductible applied, the deductible would exceed the \$1.3 million claim for damages.

The court held that the wind deductible applied to damage directly caused by wind and that the damages in this case were directly caused by rain and only indirectly caused by wind. Thus, although wind created the opening through which the rain entered, it was rain alone that caused the damage at issue, and the high wind deductible did not apply.

III. RAIN EXCLUSION

A. The standard builders risk policy rain exclusion provides:

“We will not pay for a “loss” caused or resulting from:

Rain, snow, sand or dust, whether driven by wind or not, to the interior of any building or structure or the property inside the building or structure, unless the building or structure first sustains damage from a covered peril to its roof or walls through which the rain, snow, sand or dust enters.”

B. According to the rain exclusion, damage from rain is not covered unless the roof or walls are damaged first from a covered peril. However, builders risk policies cover buildings under construction which will almost never have a permanent roof. The question then becomes whether damage to temporary coverings (tarp, plywood etc.) constitutes damage to a roof for purposes of the exception to the rain exclusion.

C. Case Study: *Homestead Fire Insurance Company v. De Witt*, 245 P. 2d 92 (1952). In *Homestead*, a temporary canvas roof constituted a roof for purposes of the exception to the rain exclusion in a builders risk policy. In *Homestead*, the insured took out an insurance policy to cover the construction work done to add onto a school. During construction, it was necessary to create an opening while the roof of the new building was attached to the roof of the old building. In order

to protect the old building, a canvas cover was put over the opening. A sudden storm arose and wind blew the canvas covering off, allowing rain to enter and damage the interior of the old structure.

The policy covered wind, but had a rain exclusion with an exception for rain that enters when the property insured first sustains actual damage to the roof or walls by the direct force of wind. The policy also provided that materials, equipment, supplies and temporary structures of all kind, incident to the construction were covered. Under those circumstances, the Oklahoma Supreme Court held that it was the contemplation of the parties to cover all risks incurred in connection with the construction of the addition. The opening in the roof was necessarily made in order to join the roof of the two buildings. This opening was covered by a temporary canvas through which came the damaging rain. The temporary canvas roof was considered to be adequate by the contractors; thus, the Court held the damage was covered because the opening had been adequately closed.

D. Case Study 2: *Aginsky v. Farmers Insurance Exchange*, 409 F.Supp.2d 1230 (OR Dist. Ct. 2005). In *Aginsky*, the Court held that a temporary tarp placed by a roofing contractor to protect an apartment building while the roof was completely removed was not a roof within the meaning of a property insurance policy. The insurer was not liable for damage to the interior of the building as a result of rain water entering through the roof area intended to be protected by the tarp. However, the Court noted that the insurance company issued a property insurance policy to cover the apartment building. At the time the policy was issued, the apartment had a permanent roof in-place. Seven years later the plaintiff decided to re-roof the apartment building and hired a roofing contractor who removed the roof in order to replace it with a new one. During a storm, “due to high winds” rain water penetrated the tarp and rain entered the building. Thus, *Aginsky* involved a property insurance policy where the insurer did not intend to insure the risk of having the roof removed.

IV. MOLD

A. Damage from mold is usually excluded or limited. A sample builders risk mold exclusion provides:

“The following types of damage (including but not limited to Damage and Contingent Damage) and resulting Time Element are not insured under any circumstance, regardless whether caused by or resulting from an Insured Cause of Loss: Bacteria, fungi, virus, mold, spores, wet or dry rot.”

B. Claims for mold and water damage should be kept separate so that when property must be removed due to water damage regardless of subsequent mold growth, it is not automatically excluded by a mold exclusion.

V. HURRICANES AND POTENTIAL COVERAGE GAPS

A. Most builders risk policies cover hurricanes and other major weather events. However, contractors and owners could be exposed to increased costs with uncertain coverage under their builders risk policy. Builders risk policies cover the “risk of direct physical loss to covered property.” A question arises as to whether or not the increased cost to complete a project after the project has sustained direct physical loss is covered. An increase in costs for materials and labor to rebuild a wall that was knocked down is covered, but what about the remaining walls that are now more expensive to install? What if the physical damage resulted in higher costs to complete the project because the price of labor and materials increased during the repair period?

1. Timing

Generally, replacement cost coverage requires the insurer to pay the actual cost of repair. *State Farm and Casualty Co v. Patrick* 647 So.2d 983 (Fla. App. 1994). Thus, if the loss had occurred at or near the project’s completion, there would be no question that the cost to rebuild the structure, including the market price increases for labor and materials, would be covered. However, when a project is damaged

early or midway through, there can be a significant gap in coverage for the increased costs that would not have been incurred but for the physical damage which caused the project to take longer to complete. In either case the direct physical damage (a covered cause of loss) is the cause of the increase in project costs.

2. Increased Cost of Labor and Material

Most builders risk policies provide that the “[insurer] will pay the actual cost to repair, replace or rebuild the damaged property with substantially identical materials ...” Arguably, the damaged property includes the to-be-built portion. In other words, in terms of assessing the “loss”, it is improper to artificially segregate the covered property between the built portion and the to-be-built portion. Rather, the entire project sustained a loss.

3. The Delay Exclusion

Alternatively, does the additional time to finish the project and related increases constitute excluded delay costs? The delay exclusion refers to consequential losses which typically pertain to business income. For example, a claim related to delay would involve lost revenues due to the delay in time to list the property for sale. Lost revenue is different than the increased costs resulting from direct physical loss and subsequent increased costs in labor and building materials for the construction and rebuilding of the covered property (i.e. “hard costs”¹).

VI. ON THE JOB CONSIDERATIONS

- A. Track the value in place on a project during construction.
- B. Ensure that temporary roof coverings are adequate.
- C. Keep water damage separate from mold damage in the claim process.
- D. Understand the extent of your builder’s risk coverage.

¹ “Hard costs represent the amount it would take to physically repair or replace those items of constructed property damaged in the event of a loss. Soft costs include additional interest expense, property taxes, and advertising expense. Business income includes losses of rent during the period of reconstruction.” RLI Ins. v. Highlands of Ponce, LLC 2006 WL 1827456 (Ga.App. 2006).