



Bulletin

Insurance for Catastrophes

INTRODUCTION

When a business suffers catastrophic losses, its owners' first recourse is to file a claim with the company's insurer. When several businesses suffer similar catastrophic losses and file claims, insurance companies may take certain measures to prevent insolvency, such as canceling policies, significantly increasing premiums, or limiting certain kinds of coverage.

In recent years, businesses and their insurers have experienced catastrophic losses resulting from incidents involving terrorism, environmental impacts, mold, asbestos and defective workmanship. Adding to the insurance industry's financial pressures was the downturn in the stock market which negatively affected one of the insurance industry's safety nets, its investment income.

As a consequence, pressure has increased on business insurers to limit the availability of certain coverages, substantially increase the cost of others, and reduce claims.

TERRORISM INSURANCE

The September 11, 2001 terrorist attacks cost the insurance industry up to \$50 billion in insurance claims¹. As a

consequence, thousands of companies with expiring commercial property and business owners insurance have received notices that their policies will not be renewed as written.²

Although the standard policy will still provide coverage for losses due to fire and smoke, theft, water damage, and general liability, insurers are either excluding coverage for losses due to terrorist actions or strictly limiting covered losses due to such incidents.³

If coverage is available, the price is substantial. A 40 to 50 percent increase in premiums for policies with terrorism coverage included is not unusual. In areas close to the site of the terrorist attacks, premium hikes of 200 to 400 percent are common.⁴

The construction industry is not considered at high risk for terrorism, but is, nevertheless, experiencing the effects of a shakier marketplace. Lenders are reluctant to approve loans to businesses without terrorism coverage. Customers are refusing to consider project bids without the coverage or at levels considered adequate.⁵

¹"Terrorism Insurance: Pray as You Go," Russ Banham, CFO Magazine (February 4, 2002, <http://www.cfo.com>).

² Ibid.

³ Ibid.

⁴ "Weak Foundation: Lack of Insurance Against Terrorism Hinders Existing Commercial Buildings and Future Construction," Newsday (9/16/02).

⁵ Ibid.

Solutions

The commercial real estate market is reportedly adjusting from the terrorist attacks in New York City and Washington, D.C., and transactions are going forward.

The federal government has also provided the insurance industry with a safety net in the event of a future terrorist-related catastrophic event. On November 26, 2002, President Bush signed into law legislation that established a temporary federal backstop plan for terrorism insurance coverage. This law provides financial assistance to insurers when a catastrophic act of terrorism causes insurers to exceed their deductibles. This will allow insurers to offer terrorism insurance to their insureds. The law does not, however, provide a reduction in the costs of purchasing insurance, but terrorism coverage will not be excluded from insurance policies. To learn more about the federal insurance backstop bill visit: <http://www.congress.org>.

While the market and the insurance industry adjust to the new reality, businesses can take the following steps to protect themselves:

1. Review your business's insurance policy for terrorism coverage. If your company is involved in projects that are sensitive and therefore have a high risk exposure (i.e., national defense, utilities, hazardous substances, financial services buildings), consider whether additional coverage is needed. Be prepared for possible significant costs associated with the purchase of this additional line of coverage.
2. If your insurer is unwilling to provide additional or any terrorism coverage, discuss options.

3. Assess new business terms of your company's associated exposure to terrorist-related risks and your existing insurance coverage for those exposures.
4. Continue due diligence in knowing the background on your existing employees and checking on new hires.
5. Create an emergency evacuation plan and daily attendance record for your employees. Preparing your project site for unexpected emergencies can reduce liability costs and exposure. If an incident should occur involving terrorism and your employees' lives are lost, your workers' compensation coverage will pay benefits to their families. (For further explanation of workers compensation benefits by state/jurisdiction you may visit: <http://www.dol.gov/esa/regs/compliance/owcp/wc.htm>).

ENVIRONMENTAL LIABILITY

Insurance coverage for environmental accidents, exposures, and liabilities is an important part of a business's insurance package. Although such incidents are infrequent, when they occur, the financial effects can be substantial and devastating to the principal companies involved. Fortunately, environmental insurance is readily available in a variety of packages at surprisingly affordable rates.

Contractors seeking new or additional coverage will find, however, that the insurance industry has yet to agree on terminology, standards, and policy forms for this kind of insurance.

Most policies are available in the following basic forms:

Environmental Impairment Liability (EIL) covers losses from active release of pollutants, sudden and gradual, from insured locations.

Property Transfer EIL Insurance is designed to be used when property is bought and sold. These policies may be used in place of the seller's indemnity for cleanup costs and third party claims for bodily injury and property damage when property ownership transfers.

Secured Creditors Environmental Insurance was designed to back collateral interest lenders. The policy pays if the borrower defaults on a loan and there is an environmental incident at the insured location.

Storage Tank Insurance, required by federal law (Resource Conservation and Recovery Act), owners/operators of fuel or hazardous materials storage tanks must demonstrate their financial ability to pay damage costs if the tank should leak. Insurance provides one kind of demonstrated financial responsibility. Underground storage tank insurance covers third party liability claims for bodily injury, property damage, offsite as well as onsite cleanup costs and legal costs.

Contractors Environmental Impairment Liability Insurance provides coverage for contractors performing environmental remediation services on contaminated sites. However, this kind of policy also insures against environmental losses of traditional contractors as well, and covers their operations and completed operations.

Environmental Professional Errors and Omissions Insurance resembles traditional E&O policies, but should contain a coverage grant or the definition of loss for damages and cleanup and eliminate or modify the pollution exclusion.

Remediation Stop-Loss Insurance (also known as cost cap coverage)

insures remediation costs that exceed the projected or anticipated costs. The policy pays the cost overrun expenses that exceed the deductible that the insured incurs in completing a remediation project at a specified location. To limit a company's exposure to environmental risks, the company should establish an environmental compliance program that may exist in the storage and disposal of hazardous wastes, previous and present uses of property, underground storage tanks, and contractual obligations.

MOLD

Mold is everywhere and lately, it's become a major cause of claims against contractors in several areas of the country. The problem concerns the appearance of mold in residential, commercial and public buildings due, in large part, to modern building materials and techniques that have made these structures "air tight" and more energy efficient, but also vulnerable to mold infestation.

In addition to the property damage concerns, an increasing number of recent claims are blaming molds for serious health problems, such as coughing, congestion, shortness of breath, respiratory infections, nausea, headaches and skin rashes. Further, there are more serious health problems such as coughing of blood, lung damage, chronic fatigue, and even brain, kidney and liver damage. Medical experts have yet to confirm the relationship between these illnesses and molds, but the claims persist.⁶

The claims are not only increasing in number, but also in awards. In Texas, the Department of Insurance reported

⁶ "Don't be a Victim of Mold," William Atkinson, Contractor, August 2002.

that insurers in that state paid \$1 billion in mold-related claims in 2000 and 2001. In a particularly onerous case, a jury awarded a Texas homeowner \$32 million, including \$12 million in punitive damage, \$8.9 million in legal fees, \$6.2 million to replace her 22-room home and possessions and \$5 million for mental anguish.⁷

Root causes of the mold infestations are faulty installations, faulty repairs, release of mold spores during work or repairs, and improper clean-up and remediation.

Mold can exist where the following three criteria are satisfied:

1. Temperature climate (typically above 70 degrees Fahrenheit).
2. Existence of nutrient source such as wood, paper, or other cellulose, or carbon based material; and
3. Moisture is present (high humidity, rather than pooled or running/dripping water is sufficient.)

Note: When these criteria are satisfied, mold growth can begin within 48 hours.

To assume your General Liability (GL) Insurance policy will cover a mold claim may be a costly assumption. Coverage of a mold claim under a GL policy depends on how the claim is brought, the jurisdiction the claim was filed in and the “specific” policy language in the policy. Insurers often cite the “absolute” pollution exclusion as a basis for denying coverage for mold-related claims.

The “absolute” pollution exclusion excludes coverage for:

- a. bodily injury or property damage which results in any manner from the discharge, dispersal, release, or

escape of:

- i. vapors, fumes, acids, toxic chemicals, toxic liquids, or toxic gases;
- ii. waste materials or other irritants, contaminants or pollutants.

The standard GL policy insures against damages caused by the contractor’s operations or by the contractor’s past work or services performed in the past. They will not pay for or replace poor quality products or work. However, they will pay for damages to other property and “consequential damages” caused by poor quality work products or work.

Consequential damages are defined as follows:

Consequential Damages which flow from the loss or harm – consequential damages are of the same nature as special damages. These damages do not arise as a result of the wrongful act or omission itself, but arise due to the circumstances after the loss or harm has occurred. Special damages include out-of-pocket items that can be documented, such as the need to rent replacement property (such as a car rental) or the cost of services (such as the cost to have property valued or appraised).

An example of consequential damages: A mechanical contractor installs a piping system in a high rise office building. The piping system ruptures as a result of improper installation on the fifteenth floor. The leak floods a conference center on the fourteenth floor. The building owner had reserved the conference center for a national convention. The meeting that was to be held in the conference center had to be relocated to a nearby hotel. The hotel charged the building owner \$15,000 for the rental of a conference room and hotel coordination. In addition to the costs to repair the pipe line rup-

⁷ Ibid.

ture and the damage caused by the water, the building owner also sustained consequential damages when the national convention had to be relocated to a nearby hotel.

Consequently, if mold infestation results from defective or deficient contractor work, depending on the circumstances of the situation and the nature of the claim, the policy may or may not pay the claim.

Solutions

Because mold claims are increasing, insurers are either modifying the mold provisions in existing general liability policies, placing severe restrictions on those provisions, or excluding them altogether. Some insurers are canceling policies completely or pricing them so high that affected contractors are at risk of losing their business since state law requires that they carry these policies.

Contractors can take steps to protect themselves by:

1. **Avoid errors.** Double-check or even exceed the code, and take the extra steps necessary to be sure the job is right the first time.
2. **Use high quality materials.** Saving a buck on materials may cost you your business later, so buy good quality up front.
3. **Don't duck a problem.** If a client reports a problem, do the repairs and replace any damaged materials as soon as possible. Talk with your client and be sure you have agreement on steps to be taken and the schedule for completing them. Ignoring the problem may lead to far more expensive problems later.
4. **Offer a warranty.** If a client makes a claim under warranted work, fix it immediately to avoid a lawsuit.

5. **Monitor new installations.** Check back on new installations for leaks and evidence of moisture. If any occur, fix the problem, clean up the leak and replace the damaged materials as soon as possible.

6. **Review your insurance policies.** See if they include the "Pollution Condition." Below is the definition of "Pollution Condition" as provided by a leading pollution underwriter:

Pollution Condition *"means the discharge, dispersal, release, seepage, migration, or escape of smoke, vapors, soot, fumes, ...or other irritants, contaminants or pollutants into or upon land, or structures thereupon, the atmosphere, or any water-course or body of water including groundwater."*

Mold is still evolving as an issue for the contracting industry. Claims and costs will likely continue to rise because of mold remediation and the possible bodily injury claims associated with mold. Protect your business by reviewing your insurance coverage, and respond quickly to complaints from customers when water damage is involved.

It may be prudent to establish a business relationship with a restoration company. In the event of a water leak, restoration companies can provide emergency water clean-up with the utilization of commercial water extraction equipment and dehumidification devices, thus reducing the volume of damage and the environment for mold growth.

ASBESTOS

Asbestos cases are on the rise once again. Many claimants are pursuing previous employers/contractors since many of the manufacturers have filed for bankruptcy as a result of litigation and the award of lawsuits. Between January

2000 and August 2001, there were a recorded 41 asbestos-related Chapter 11 bankruptcies, including eight major firms.

Depending on how the claim is filed and the jurisdiction, a contractor may be liable for an asbestos claim/lawsuit based on the exposure period. Or depending on the jurisdiction, the claim/lawsuit can be filed against the last known employer. In some jurisdictions, claims can be apportioned among all employers or the claim can be isolated to just one employer.

The Asbestos Alliance, the coalition consisting of business interests, employers, insurers and plaintiffs' counsel, is lobbying Congress to change the way asbestos-related illnesses are handled. This organization is advocating legislation that would place a specific statute of limitations on the filing of asbestos-related claims, ban consolidations of claims that include many people that are not ill, and prohibit the filing of cases in jurisdictions that are not related to the claims.

To learn more about the Asbestos Alliance Coalition, visit its website at: www.asbestossolution.org.

Asbestos Claim Coverage

Typically, asbestos claims are covered under workers' compensation coverage and/or general liability coverage.

However, contractors performing asbestos and lead abatement are required by law to maintain appropriate insurance coverage for such work. In addition to Commercial General Liability insurance, a contractor can purchase Asbestos/Lead Abatement Liability Insurance. Contact your insurance broker to obtain rates for coverage. Insurance limits can be set based on an each-occurrence basis.

An insurance broker may request the following documentation when providing an Asbestos/Lead Abatement Liability insurance quotation:

- a. Asbestos/Lead Abatement Liability Application.
- b. Financial statement.
- c. Standard operating manual.
- d. Contractor certification.
- e. Employee training procedures.
- f. Listing of completed projects.
- g. Asbestos, Lead and General Liability (GL) claims information. Typically, Asbestos /Lead Abatement insurance is obtained by Asbestos/Lead Abatement Contractors, Property Owners and General Contractors.

Solutions

Since the incubation period for asbestos-related illnesses ranges from 30-40 years, it is difficult to prevent claims from arising for work performed years past. For current work, steps can be taken to prevent asbestos exposure:

1. Employ an Asbestos/Lead Abatement Contractor to remedy asbestos situations. Such specialty contractors are required by law to carry specific insurance coverage for the performance of their work.
2. Specialty contractors have the training, tools and equipment to abate the affected work areas without exposing your employees.
3. Discuss with your insurance carrier the types of coverage which can be offered to protect against asbestos claims.

SUMMARY

The catastrophic losses that businesses have experienced during the last few years due to terrorism, mold infestation,

environmental accidents, and asbestos exposure have shaken the climate under which the insurance industry and its clients do business. Business insurance coverage for catastrophic losses is more limited and much more expensive than it was and some basic coverages have become more strictly defined.

If you have not done so already, meet with your insurance broker to review your current business policy for the adequacy of coverage for such catastrophic events. Don't wait until tragedy strikes before determining what levels of losses your policy will/will not cover.