



2018 CLM Construction Conference

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“Emerging Issues in High Rise and Mixed-Use Housing”

I. Overview

The revitalization of inner cities has dramatically increased the volume of properties being adaptively reused for commercial and residential use. The adaptive reuse of properties can also involve the conversion of properties with significant industrial history to mixed commercial and residential use, requiring the resolution of environmental hazards. For new or more recent construction, where water or fire losses have occurred, there are significant environmental issues to be evaluated and resolved between the homeowner and the Homeowner’s Association (“HOA”) or Condo Association. Resolving these issues can increase the costs to the HOA and the insurance carrier, to reduce contaminant release, fungal impact, and subsequent secondary damages.

While the damages we are discussing can be part of the property insurance coverage, many times, there are sub-limits for environmental contaminants (mold, asbestos, lead) or there are specific exclusions. This panel will discuss the issues that arise in claims and litigation regarding environmental damages, and the work necessary to resolve these issues. The discussion will also detail federal regulatory triggers of further compliance with prevailing environmental laws that impact public/private partnerships and multi-family developments. At the end of this discussion, attendees will understand the specific triggers regarding these matters and will have knowledge regarding litigation issues and consequences concerning these matters.

II. Federal Regulation of the Environment

As environmental awareness began to grow and eventually become a national issue in the US in the 1960s, few envisioned the eventual impact on the global insurance industry. CERCLA and other environmental laws, and the regulations thereunder, require property owners to respond to demands for information and investigation, and eventually to clean up, or pay for the clean-up of, contaminated property. As a result, numerous claims for coverage were submitted under liability insurance policies during the 1980s and 1990s. The number of claims continues to rise as real estate developers convert historic buildings to residential and commercial use, where environmental contaminants are typically found.

III. Defining the Environmental Issues in Construction and Renovation Projects

The impact of environmental issues on construction and renovation projects has been escalating since the 1970s. There has been an analogous increase in first-party and third-party claims from damages caused by environmental contaminants.

Claims for damages due to environmental contamination can arise in a number of situations and can be asserted by property owners, homeowner's associations, and individuals affected in a variety of ways. If a residential or commercial building was built several decades ago, there is a good chance there may be mold present, lead in the paint, and/or asbestos present in the building's flooring, ductwork, popcorn ceilings, roofing, and HVAC system. Left undisturbed some of these contaminants aren't harmful, however if a construction or renovation project calls for scraping or cutting these materials, the powder or dust can be very hazardous.

Similarly, the historical use of the property can be an indicator regarding whether a construction or renovation project will contaminate the environment. Sites once used for industrial purposes and even small businesses, where hazardous chemicals were in heavy use such as: dry cleaners, gas stations, car repair facilities, and photography development centers can be breeding grounds for environmental contaminants and pose a range of unanticipated exposures for owners, occupants, and insurers.

Although the presence of environmental contaminants in a construction or renovation site increases the risk of contamination claims, conflicts also arise after a sudden, accidental flood, or leak from a plumbing system. Older buildings were built using clay or cast-iron piping, which are susceptible to rusting, cracking, separating, and deterioration. New construction uses PVC piping. Although PVC piping is far more durable than materials used in the past, all piping can be damaged during construction when heavy equipment is used. This damage often leads to sewer backups, which ultimately triggers a claim for environmental contamination. Additionally, construction or renovation on older buildings can lead to water intrusion, which in the right circumstances results in mold development. This also results in environmental contamination claims when the mold is discovered.

Along with considering the environmental condition of the older building being renovated, the location of the construction or renovation project can be an issue in first-party and third-party contamination claims. As an example, a single release of a contaminant can have a far-reaching impact and yield extensive claims where a construction project is conducted in mixed use buildings with high concentrations of customers, workers, residents, and delivery persons. Environmental contamination resulting from a construction or renovation project can render facilities unusable, causing business interruption losses, loss in rental income, and costs associated with relocation.

IV. Considerations from the Insurance Carrier's Perspective

Adjusting a claim for environmental contamination requires insurance carriers to consider several components of the insurance policy. First, insurance carriers must understand the contaminant that caused the alleged loss. Using science-based assessment to identify the hazardous material at issue will allow an insurance carrier to determine if the contaminant is covered under the insurance policy.

Insurance carriers must also consider whether the claimant timely notified the insurance company of the loss. Most insurance policies require that the insured or claimant notify the insurer of a loss promptly. Determining whether a notice of loss requirement has been satisfied requires establishing when the loss occurred. While losses typically occur on a known date, property damage caused by more gradual processes that may not be apparent to an insured or claimant until after damage began can raise more difficult, fact-intensive issues. Analysis of the nature and timing of the damage, along with investigation into the insured's or claimant's knowledge of the damage, may be appropriate. Lastly, insurance carriers must always consider if the loss occurred during the policy's active term.

As discussed, damages caused by environmental contamination occurs in many ways. In determining whether coverage is extended for environmental damage, the policy language must be examined and evaluated. Specifically, insurance carriers must carefully assess policy exclusions. Pollution exclusions are commonly used in general liability insurance policies, which vex policy holders, claimants, and insurers alike. Pollution exclusions are the most litigated portions of insurance policies, so fully understanding the insurance language is critical in determining whether a loss is covered. Sub-limits can also reduce the insurance carrier's obligations to pay when certain perils strike.

Case Study

Pesticides have generally been held to be within contamination and pollution exclusions in insurance policies. In *Haman, Inc. v. St. Paul Fire and Marine Insurance Company*, a federal district court applied a property policy's pollution and contamination exclusion to hold that there was no coverage for financial losses incurred when the Environmental Protection Agency ("EPA") ordered closure and decontamination of the insured's hotel after an exterminator had used methyl parathion, a highly toxic and restricted pesticide, in the hotel. The exterminator responsible for the hotel damage was sentenced to prison for illegally using the pesticide as a residential extermination. Under the terms of the insured's insurance policy the pesticide used was termed a pollutant, irritant, or contaminant in the policy and the insurance carrier was able to deny coverage.

V. Insurance Coverage Issues that Arise in Litigation of Contamination Claims

Owned Property Exclusion

The meaning of the owned property exclusion has become an important issue in the context of disputes over insurance coverage for the cost of cleaning up hazardous waste sites. Generally, when environmental contamination is centered upon a piece of property, claimants often look first to the property owner's insurer to finance the costs of investigating and remediating the contaminated site. However, the owned property exclusion precludes the property owner from advancing a claim for coverage under its own policy for damages resulting from environmental contamination.

Now consider what happens when the contamination, located on a property, migrates off site and pollutes the adjacent property. There has been considerable litigation regarding whether the owned property exclusions still preclude the property owner from recovering under its own insurance policy where the contamination on its property is in danger of migrating to adjacent properties and causing further damage.

Owned Property Exclusion Case Study

In *Broadwell Realty Services v. Fidelity & Casualty Co.*, an often-cited case from the New Jersey Superior Court, the policyholder, Broadwell Realty Services, Inc. ("Broadwell"), owned a piece of property which contained underground storage tanks. A hazardous substance escaped from the tanks and migrated to adjacent property not owned by Broadwell. New Jersey's Department of Environmental Protection ("DEP") subsequently investigated the contamination and ordered Broadwell to undertake "remedial activities to eliminate the source of the continuing pollution at the adjacent properties." Broadwell then demanded that its insurer, Fidelity & Casualty Co. of New York ("Fidelity"), pay for the clean-up costs which Broadwell incurred on its own property in order to respond to the DEP's order. Fidelity denied coverage to Broadwell, relying upon the owned property exclusion contained in the insurance policy at issue. Fidelity maintained that the remedial activities which took place on Broadwell's

own property were intended to alleviate the contamination on the policyholder's own property, and, therefore, there was no coverage.

The court held that the remedial activities undertaken on Broadwell's property were designed to prevent the continued release of contamination onto the non-owned adjacent property and was not solely to remedy damage to Broadwell's own property. As such, the court stated that the purpose of the owned property exclusion, which was to "exclude from the insurer's indemnification obligation claims by the insured based upon damage or loss to its own property," was not implicated. Therefore, the owned property exclusion did not bar the insured's coverage.

In *Fireman's Fund Insurance Co. v. Ex-Cell-O Corp.*, various insurers sought a declaration from the United States District Court for the Eastern District of Michigan that they were not obligated to defend their policyholder, Ex-Cell-O Corporation ("Ex-Cell-O"), against potential liability for allegedly contributing to environmental contamination at 22 locations owned by it. Among other grounds, the insurers argued that the exclusion for damages to property owned by the policyholder contained in each of the policies at issue precluded coverage. The court held that the owned property exclusion did not preclude coverage because the claims of environmental contamination at the sites owned by Ex-Cell-O included property damage claims that pollution had migrated onto adjoining landowners' properties.

See Robert A. Whitney, *Application of the Owned Property Exclusion to Insurance Coverage Claims: Can the Threat of Harm to the Property of Others Ever Get Real?* 27 N. Ky. L. Rev. 505, 507–08 (2000).

Exposure Theory, Manifestation of Loss Theory, and Continuous Trigger Theory of Coverage

In lawsuits involving environmental contamination, claimants are sometimes seeking liability for contamination or injuries that occurred over a substantial period of time. In these instances, a dispute often arises between an insurer whose policy is in effect when the damage is discovered and the insurer whose policy was in effect when the damage occurred. The dispute is intensified by the fact that certain types of damage or injury-causing occurrences, like toxic contamination from mold or asbestos, are often undetectable until significant damage has been suffered. Courts must then decide which insurer has a duty to defend by determining which trigger theory of coverage is at issue.

Under the exposure theory of triggering coverage, exposure to the environmental contaminant that eventually produces the loss, such as inhalation of asbestos dust, triggers insurance coverage. The continuous trigger theory treats continuous or repeated exposure to the same condition as one occurrence, as the injury "occurs continuously from exposure to manifestation." Under this theory, all policies from the time the loss begins until it is discovered owe coverage. However, under the manifestation trigger theory a claim that is discoverable or becomes apparent under the policy period triggers coverage. As an example, property damage commences when the reasonable person would be conscious of the existence of an actionable defect.

Diverging insurance coverage theories require insurance carriers to review policy language carefully. Some courts have used its interpretation of certain provisions of the insurance policy to determine which trigger coverage theory should be followed. As such, insurance carriers must understand how courts within its jurisdiction determine which theory of coverage controls.

Trigger-of-Coverage Case Study

In *Strauss v. Chubb Indem. Ins. Co.*, Randal and Diane Strauss constructed a home in 1994. Water infiltrated and damaged the home through a defect present since the completion of the home's construction. The infiltration was ongoing and progressive in nature, continuously occurring with each

rainfall since the home's construction. The damage went undiscovered until 2010, well after the Chubb's insurance policy expired. The Strausses submitted a claim to Chubb for the discovered damage. Chubb denied the coverage for the claim stating that the damage was not discovered during any of their policy periods. The Stausses then filed suit against their former insurer.

The appellate court held that insurance policy provided a "continuous" trigger theory, which treated the continuous or repeated exposure to the water infiltration as a single occurrence that triggered the insurer's policy despite its delayed discovery by the insured. The court found that the insurance policy at issue defined continuous or repeated exposure to substantially the same general conditions as a single occurrence with coverage applying to all occurrences that take place while the policy is in effect. Therefore, the latent water infiltration constituted a single occurrence under the policy and for all legal purposes occurred during the insurer's policy period and triggered coverage.

See Nicholas R. Andrea, *Exposure, Manifestation of Loss, Injury-in-Fact, Continuous Trigger: The Insurance Coverage Quagmire*, 21 Pepp. L. Rev. 813, 814–15 (1994).

VI. Defending Allegations of Environmental Contamination

When litigating claims resulting from environmental contamination, there are several tools an insurance carrier should use to defend these types of claims. Insurance carriers should hire an environmental consultant to determine which type of hazardous material is at issue. Insurance carriers should not rely solely on statements of the property owner estimating the loss in value due to an environmental contamination problem. An environmental consultant can investigate the risk of loss so that the insurer can adequately determine if the loss at issue is covered under the insurance policy. Experts can also provide a plan for remediation, which includes the costs associated with such remediation.

An important component of assessing a loss associated with environmental contamination is the evaluation of the actual contamination using available environmental sampling data and, in some cases, modeling studies. Insurance carriers must use accredited laboratories to analyze any sample taken from the site of the incurred loss. Accredited laboratories are designed to ensure the accuracy, precision, and reliability of the data generated, as well as the use of state and federal approved methodologies in the generation of that data. Laboratory data generated by commercial environmental laboratories will not be given the same consideration as data generated from an accredited laboratory if this data is presented at trial.

Claims for environmental contamination require a great deal of personal attention so that claims are resolved expeditiously and fairly. As such, insurance carriers should send adjusters to exam the site of the environmental contamination as soon as possible. Timeliness can affect the quality of data available to make critical decisions when investigating loss associated with environmental contamination. Additionally, delays in assessing the site can increase remediation costs.

Case Study

Current and former building tenants filed suit against the owners of a multistory building, that also housed retail space, alleging that improper maintenance of the building's HVAC system caused extensive mold growth throughout the building. The owners ultimately settled the mold lawsuit by agreeing to remediate all contaminated apartments and retail space. They also agreed to pay for temporary housing and legal fees, reimburse all tenants for personal property damage, reimburse retail tenants for business interruption, rebate rents, pay actual medical expenses incurred and pay an additional lump sum payment of several thousand dollars to each resident. The total cost to the building owners was more than \$10 million.