



CLM 2018 Annual Conference  
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**In the Eye of the Storm**  
**Navigating Construction Claims Arising from Natural Disasters**

**I. Hurricanes and population movement**

According to the Insurance Information Institute, in 2016 insured natural disasters in the United States accounted for more than \$23.8 billion in damages. Worldwide, the total estimated damages attributable to natural disasters was \$175 billion. 2016 marked the end of the four year downward trend in damages from natural disasters since Hurricane Sandy in 2012. In 2017, the coastal regions of Texas, Florida, Puerto Rico and surrounding areas were impacted by consecutive, devastating storms which are estimated to have caused over \$300 billion in damages.

In 2012, Superstorm Sandy caused damage in excess \$70 billion in the New York and New Jersey area, causing damage to more than 650,000 housing units. Insured losses amounted to \$25.85 billion either through private insurance or the National Flood Insurance Program. Accordingly, less than 40% of the damages sustained were covered by insurance.

Similarly, in 2005, Hurricane Katrina caused more than \$108 billion in damages. Private insurance paid claims in excess of \$41 billion, while the National Flood Insurance Program paid an additional \$16.3 billion in claims. Overall, 53% of the damage caused had insurance coverage.

While natural disasters can strike in any part of the country at any time, according to census data and the NOAA more than 50 percent of the country's population now lives in coastal watershed counties. These counties are generally defined by the NOAA as counties with at least 15 percent of the total land area located within the coastal watershed. The NOAA estimates that this population will grow by an additional 8% by 2020.

With growth of the coastal population, it would reason that much of the nation's construction and development will continue to occur in coastal areas. Housing, infrastructure, and business will inevitably grow to accommodate this growth, thus leading to damage scenarios similar to Superstorm Sandy and Hurricane Katrina likely to happen again, if not expand.

Review of this demographic shift serves as a perfect segue to examine the type of losses that may occur during the course of this growth and development. While the majority of the losses which will occur will impact completed homes, businesses, or infrastructure, projects that are

under construction will not be immune, and, in fact, may be more susceptible given that various elements of the project may be vulnerable to damage from extreme weather events.

## **II. A hypothetical project**

Given that we are sitting in Houston, one does not look far to see construction projects the were caught in the midst of Hurricane Harvey's record rainfall. In a period of a few days, more than 60 inches of rain fell on the Houston area. This represents more than 275 trillion pounds of water, such a significant amount that it shifted the earth's crust, pushing Houston's elevation down by two centimeters. Florida and Puerto Rico, on the other hand, dealt with record storms and sustained wind speeds of 155 mph and more than ten feet of storm surge that washed across the keys during Hurricanes Irma and Maria.

To have a context for this discussion, we are using a hypothetical project similar to San Francisco's Hunter's Point Shipyard, which is a reclamation project of a former Naval Base and nuclear research/testing facility. Ultimately, more than \$8 Billion will be spent on the project to develop office, retail, commercial and multi-family housing in the area. While San Francisco has its own concerns regarding earthquakes, imagining the project in development in the Houston or Miami area provides us with a context to discuss how contractors, brokers, carriers and adjusters must take into account concerns about hurricanes as those areas continue to grow.

## **III. From an Underwriting Perspective**

### **Pre-Project**

As we evaluate construction-based risks, whether it's for a casualty, property or professional line of business, underwriters will not only focus on project controls and site management, but the surrounding environment and how the location of a project could impact the exposures to the construction site and its workers.

Natural disasters are obviously hard to predict and can strike at anytime, anywhere. But since rebounding from the financial crisis, we've witnessed significant growth in construction starts in coastal cities and in areas – such as Florida, Texas and California – that are more prone to natural disasters. Coupled with more extreme weather patterns over recent years, underwriters are asking more questions to owners and contractors about site plans and procedures to address a potentially catastrophic event.

The level of preparedness identified in these responses could easily dictate the level of competitiveness and/or policy language offered through our pricing, terms, conditions and coverages.

Every account we underwrite has a pricing provision for what we call DTEC. This is effectively a line-item for CAT-based losses, for which the premium collected goes into a separate bucket within the company's reserves to handle these types of losses.

The risk evaluation and susceptibility to natural disasters will vary by line of business and coverage, but it's worth noting that policies such as General Liability, Workers Compensation,

Builders Risk, Professional Liability and Surety all have the potential to react to a catastrophic event.

In some cases, such as a hurricane to tropical storm, there is at least a few days warning. But in other situations there could be little-to-no warning, such as with an earthquake or a tornado. Underwriters will want to know what the appropriate procedures are in case a crane needs to be secured or taken down with enough due notice – This became a problem in NY during Sandy, and most recently in South Florida during Irma.

What material is being used to build a building? Is the structure designed properly to withstand an event? How do we safeguard our workers in case of an event? Are the curtain wall systems going through extreme weather testing? There a few labs around the country that do this. It's not cheap, but worth it – not only for the potential downstream impact to claims costs, but also for upfront premium savings.

### **Disaster Hits**

If a natural disaster or series of disasters hit, there comes a period of anxiety and uncertainty for the underwriting community as we try to get an understanding of the extent of the damage caused. How will policies react and what could be the financial and resource ramifications of such an event? And there's also the emotional side of it - Contrary to popular belief, underwriters are not robots, and there is a genuine concern for the safety and well-being of our people and our clients' people.

The speed and effectiveness in our how our claims colleagues react makes a huge difference in the overall loss costs of a natural disaster - and the level of responsiveness and empathy displayed also has significant impacts to the health and success of our business relationships. So while we as underwriters are evaluating the level of preparedness our clients have in safeguarding their sites for natural disasters, we're also supporting our claims and rapid response teams to ensure they are equally as prepared to address a disaster once it does hit.

### **IV. Disaster and catastrophe claims during construction**

In the context of completed projects or existing structures, the primary area for coverage is generally through property and casualty insurance. In some instances, additional claims or coverage may exist under general liability or professional liability policies where a property owner brings claims against a builder, architect or engineer for defects in the structure that allowed further damage. For ongoing projects, however, the primary area of coverage is through Builder's Risk policies.

In nearly all construction projects, builders obtain Builder's Risk policies to protect their project from losses which may be incurred during the construction phase. These policies cover the structures and/or buildings being built, as well as on-site materials, fixtures, supplies, machinery, and other equipment to be incorporated into a project. Builder's Risk policies typically exclude coverage for existing structures on the site, tools and equipment used by the contractors, and the actual land upon which the project is being built. Moreover, materials and equipment in storage awaiting delivery, such as the items stored on site in the flooded trailers, and property in transit may very likely not be covered under the Builder's Risk policy.

Unlike property and casualty policies, a Builder's Risk policy is intended to terminate when the work has been completed and the property is ready for use or occupancy, although some minor finishing work might remain. Because a precise project completion date is difficult to predict, the language contained in the policy, as well as the contract documents, is critical. Builder's Risk policies will usually terminate coverage when any of the following events occur: (a) the policy expires or is cancelled; (b) the insured's insurable interest in the property ceases; (c) the named insured abandons the project, and does not intend to complete it; or (d) the project is accepted by the owner/purchaser.

In most situations, Builder's Risk policies are designed to protect the project from events leading to damage which are outside of the builder's control. These policies are typically written on two bases: (a) "named peril"; and (b) "all-risk". Natural events such as earth movement and floods are almost universally listed as exceptions to Builder's Risk policies, affording no coverage unless the builder obtains supplemental coverage.

"Named peril" policies provide coverage for losses which arise from specific causes delineated in the policy. For instance, the ISO short form identifies eleven covered perils: fire; lightning; explosion; windstorm or hail; smoke; aircraft or vehicles; riot or civil commotion; vandalism; sprinkler leakage; sinkhole collapse; and volcanic action. In order for coverage to trigger under these policies, the insured builder must demonstrate that the loss was the result of one of the covered perils.

Conversely, "all-risk" policies are broader and provide coverage for losses not specifically excluded or limited by the policy. In this instance, the insured builder bears the initial burden of demonstrating coverage is triggered, thereafter shifting the burden to the insurer to demonstrate exclusion or ambiguity is applicable. Yet, even where a loss is covered, particular attention must be paid to exclusions and limitations on coverage in the policy, particularly as it relates to catastrophic property damage due to natural or storm related disasters. For instance, Builder's Risk policies that specifically cover hurricanes or "named storm" events, may limit the coverage available by imposing sub-limit coverage and/or including a higher deductible. Thus, though coverage may exist for these occurrences, the full limit of coverage may not.

These policies may also contain concurrent causation exclusions which precludes coverage for concurrent causes of a loss (one covered and one not covered) regardless of what they are or how they contribute to the loss. The inclusion of concurrent causation exclusions in Builder's Risk policies could negate coverage for losses which would otherwise exist but not for the contributing secondary cause.

Through use of the hypothetical, the panel will examine key issues related to Builder's Risk policies when catastrophic weather events take place. The panel will examine and discuss the various coverage and exclusion options contained in these policies and how they will impact the parties in the hypothetical example provided. Through the hypothetical scenario, variables can be changed to demonstrate the impact that can occur to the insureds and carriers alike.

In addition to the Builder's Risk coverage questions for the general contractor and owner, there may be exposure questions to consider for the architects and engineers on the project. Where

gaps in coverage exist under the Builder's Risk policy, a builder/ owner could turn to the architect or engineers if the damage can be attributable to an omission by the design professionals. For instance, if the architect selected windows or surfaces with inappropriate wind and storm ratings, or the engineer failed to consider flood history or storm surge potentials when designing levees, berms, or seawalls, risk shifting may be a possibility.

Typically, Builder's Risk policies exclude coverage for professional liability of its insureds and would not include architects and engineers as named insureds on the policy. In some instances, design professionals may be listed as additional insureds on a Builder's Risk policy; however, most claims against an architect or engineer for the provision of professional services are covered by the design professional's own Professional Errors and Omissions policy. The design E&O policy will not offer coverage to other parties on site nor will it provide coverage for damage to property on site unless the damage specifically arises from a "wrongful act" or the "negligent" provision of professional services depending on the policy language.

As with the Builder's Risk policy, E&O professional policies have a number of exclusions that limit coverage which may vary from carrier to carrier and state to state. They generally include willful/reckless acts, liquidated damages or general conditions, faulty work by the contractor, pollution, and contractual liability based on risk transfer that does not arise from the provision of professional services. Importantly, E&O policies often have eroding coverage, meaning that the policy limits include the defense costs and expenses paid on a claim.

Through use of the hypothetical building project, the panel will examine the various factors which could implicate design professionals, and, in turn, impact their available insurance coverage.

Additionally, the panel will look at the impact on incomplete construction projects damaged by natural catastrophes due to code changes. Normally, code changes do not occur so quickly as to change mid-project; however, it is not unheard of for regulations to arise during construction, especially in response to catastrophic events. For instance, if the locality where the project was located adopted updated environmental regulations following the catastrophic event, but before the project was completed, then those codes could be required to be met prior to the issuance of any re-construction approval or certificates of occupancy. In response to natural disasters cities or counties regularly address or update portions of building codes to prevent similar issues from occurring in the future. Unfortunately, if components of the project are not damaged by the weather event, but rather, are required to be replaced due to code changes, the Builder's Risk policy may cover this cost.

A final aspect to consider in regard to code standards involves LEED certified structures. With significant tax benefits, incentives or credits offered to new construction that attains various LEED levels, maintaining that certification can be vitally important to a project on an economic basis. To that end, a project damaged by a catastrophic weather event may result in its LEED status being downgraded or lost altogether due to having to demolish or replace parts of the work and how those sections are reconstructed. As with permitting issues, none of the references insurance types will cover remedial or additional efforts to maintain a desired LEED certification; however, several carriers offer separate policies that will provide coverage to these additional costs or expenses as well as time delays related to the same.

## V. Claims following completion

When a catastrophic weather event occurs, the insurance industry has to rapidly deploy response teams to the affected areas. For context, more than 80,000 flood insurance claims were made in the wake of Harvey. By some estimates 400,000 vehicles were destroyed by Harvey's waters and as many as 1,000,000 damaged. By the time of submission for these materials, almost 1,000,000 property claims had already been made in Florida in response to Hurricane Irma. Each of those claims needs to be adjusted and the damage verified prior to payment.

The sheer volume of such claims in a natural disaster makes processing them difficult; however, the complex nature of large construction projects creates a much higher burden for adjusters. This is especially true when considering the level of attention that may be needed to examine construction details that may escape inspectors under normal circumstances. As an example, if a storm hits during window installation of a project, it may not be possible for an adjuster to check behind caulking or under sill plates to see how much water intrusion occurred.

The resulting damage that occurs may take years to manifest in the form of poorly sealed windows, mold, rusted connectors and additional water intrusion. Similar concerns can be raised in regard to sheetrock, building finishes, fixtures, plumbing and electrical fixtures. While each of the materials and component parts for each of these systems may be properly rated for a coastal environment, this does not guarantee that the manufacturer intended for them to withstand being doused with saltwater and rain pushed into a building at 145 M.P.H., which may also impact the potential for any warranty claims for construction materials.

While Builder's Risk policies are called on to provide coverage for these projects during construction, it will be difficult to argue that such coverage is appropriate once the project has been completed. This may be especially true if a great deal of time has passed since the completion of the project.

Generally, CGL policies will be called on to respond to such claims under a traditional construction defect analysis. This will include concerns as to whether the damage has occurred during multiple policy periods as well as how to divide the loss among multiple carriers.

The greatest issue for such claims in many states will be coverage and risk transfer concerns. In regard to the window example above, coverage for the window installer may be excluded due to the "Your Work" exclusion in many states. Whether there has been resulting damage to parts of the project that are not covered under such exclusion is generally the focus of coverage and litigation.

Additionally, property owners and general contractors will work quickly to move responsibility for the claims on to subcontractors and carriers through risk transfer via indemnity and additional insured status.