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OVERVIEW OF BUILDING CODE UPGRADE COVERAGE FOR THE RECONSTRUCTION OF EXISTING BUILDINGS

Presented by
Property Insurance, Reinsurance, Excess and Surplus Lines, and Extra-Contractual Liability Sections

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AS BUILDING CODE IMPLEMENTATION AND ENFORCEMENT CONTINUES TO INCREASE, THE LIKELIHOOD OF INSURANCE CLAIMS FOR INCREASED COSTS OF CONSTRUCTION AS A RESULT OF COMPLIANCE WITH CURRENT BUILDING CODES, OR "CODE UPGRADES," CONTINUES TO INCREASE AS WELL. BECAUSE BOTH BUILDING CODE STANDARDS AND THE ENFORCEMENT OF THOSE CODES HAVE BECOME STRICTER IN RECENT YEARS, IT IS LIKELY THAT THE RECONSTRUCTION OF DAMAGED STRUCTURES THAT WERE BUILT AS RECENTLY AS THE YEAR 2000 MAY REQUIRE ADDITIONAL COSTS TO MEET CURRENT CODES. NOT ONLY CAN ORDINANCES OR LAWS INCREASE THE COST TO REPAIR OR REPLACE DAMAGED OR DESTROYED PROPERTY, BUT ALSO, THE TIME TO REPAIR OR REBUILD IN ACCORDANCE WITH CURRENT CODES CAN TAKE LONGER THAN IT MIGHT OTHERWISE TAKE IN THE ABSENCE OF NEW CODES. THIS INCREASED PERIOD TO REBUILD OR REPAIR PROPERTY CAN INCREASE BUSINESS INTERRUPTION OR EXTRA EXPENSE LOSS. AS A RESULT, A WORKING KNOWLEDGE OF BOTH THE APPLICABLE BUILDING CODES AND THE POTENTIAL COVERAGE ISSUES ASSOCIATED WITH CODE UPGRADES IS IMPERATIVE TO DETERMINE THE PROPER AMOUNT OF COVERED LOSS ASSOCIATED WITH CODE COMPLIANCE.

MOST PROPERTY INSURANCE POLICIES CONTAIN AN "ORDINANCE OR LAW" EXCLUSION THAT EXCLUDES FROM COVERAGE THE COSTS CAUSED BY THE ENFORCEMENT OF ANY ORDINANCE OR LAW REGULATING THE CONSTRUCTION, USE, REPAIR OR DEMOLITION OF A BUILDING OR OTHER STRUCTURE, UNLESS SPECIFICALLY PROVIDED FOR IN THE POLICY. SEE, E.G., ISO FORM CP 10 30 04 02 § B.1.a. TO AVOID THIS EXCLUSION, OPTIONAL COVERAGE IS AVAILABLE TO PROVIDE A GIVEBACK OF "CODE UPGRADE" COVERAGE FOR COSTS INCURRED BECAUSE OF THE ENFORCEMENT OF BUILDING CODES THROUGH ORDINANCE OR LAW COVERAGE ENDORSEMENTS OR DEMOLITION AND INCREASED COST OF CONSTRUCTION COVERAGE PROVISIONS. SEE, E.G., ISO FORM CP 04 05 04 02. THE GENERAL PRINCIPLE BEHIND THIS CODE UPGRADE COVERAGE IS TO COVER ANY INCREASES IN CONSTRUCTION COSTS ASSOCIATED WITH THE ENFORCEMENT OF NEW BUILDING CODE STANDARDS FOR THE REPAIR OR REPLACEMENT OF A COVERED STRUCTURE.

THE KEY TO WHETHER AN INSURANCE POLICY WILL COVER INCREASED COSTS INCURRED AS A RESULT OF THE ENFORCEMENT OF BUILDING CODES DEPENDS ON WHETHER COVERED DAMAGE CAUSED THE ENFORCEMENT OF BUILDING CODES THAT LED TO THE INCREASED COSTS OF CONSTRUCTION. THIS PAPER PROVIDES A GENERAL OVERVIEW OF BUILDING CODE ENFORCEMENT FOR DAMAGED STRUCTURES AND IMPORTANT
considerations for the adjustment and coverage of code upgrades associated with the repair of covered damage. Case examples from Texas, Florida, and other jurisdictions are referenced in these materials.

I. OVERVIEW OF APPLICABLE BUILDING CODES

Building codes establish minimum requirements to safeguard life, health, property and public welfare by regulating and controlling the design, construction, use and occupancy and locations of all structures. Historically, three separate organizations— the Building Officials and Code Administrators International, Inc. (BOCA), International Conference of Building Officials (ICBO), and Southern Building Code Congress International, Inc. (SBCCI)—each developed separate sets of model codes used throughout the United States. In 1992, Hurricane Andrew struck Florida causing over $17 billion in damage. As a result, a push was made to improve building codes. The nation's three model code groups responded by creating the International Code Council. The ICC was established in 1994 to develop a single set of comprehensive and coordinated national model construction codes without regional limitations.\(^1\) It is then left to each jurisdiction to adopt and amend the model codes promulgated by the ICC.\(^2\)

The International Codes generally regulate new or proposed construction. They have little application to existing buildings unless the existing building undergoes reconstruction, rehabilitation, renovation, or alteration, or if the occupancy category of the building is being changed. In addition to the International Codes, other codes also regulate the construction, renovation, alteration, or repair of a structure. For example, the Americans with Disabilities Act and state enacted accessibility codes govern the accessibility of new and existing structures. FEMA floodplain regulations and local land development regulations govern the construction and placement of structures in floodplains and coastal areas. The applicability and enforcement of all of these codes for the repair of

\(^1\) A complete discussion of the origins of the ICC can be found at http://www.iccsafe.org/AboutICC/ (last visited Nov. 16, 2010).

\(^2\) A list of the adoption of the model codes by state and by jurisdiction can be found at http://www.iccsafe.org/gr/Documents/stateadoptions.pdf (last visited Nov. 16, 2010) and http://www.iccsafe.org/gr/Documents/jurisdictionadoptions.pdf (last visited Nov. 16, 2010).
damaged structures depends on the extent of the damage to the structure and the type of repair proposed.\(^3\)

A threshold issue in determining whether and to what extent a policy covers an insured’s “code upgrade” claim is determining whether the alleged “code upgrade” – if justified – was triggered by the work performed on the damage caused by an insured peril. While certain states, such as Florida, have a comprehensive statewide building code, analysis of building codes in Texas presents unique challenges because, as of right now, only cities have the power to draft and enforce building codes, and they do so unevenly. Each municipality in Texas has its own set of codes, which may vary significantly from the model codes. Further, coastal structures that are eligible for state windstorm insurance are subject to the codes promulgated by the Texas Department of Insurance. Structures located in unincorporated areas in Texas are not subject to any building codes other than the Texas Residential Construction Commission’s recommendations, which are not mandatory building codes.\(^4\)

While each municipality in Texas enacts and enforces its own code, the Texas legislature has set minimum requirements. The 2003 International Building Code applies to any new construction or alteration, remodeling, enlargement, or repair of a commercial building in a municipality. Tex. LOCAL GOV’T CODE ANN. § 214.216 (Vernon 2007). The 2000 International Residential Code applies to all construction, alteration, remodeling, enlargement, and repair of residential structures in a municipality. For electrical systems, the 1999 National Electric Code applies all residential and commercial structures in a municipality. Id. § 214.214. Texas law grants a municipality generous authority (1) to amend these model codes, (2) to adapt later versions of these codes, and (3) to apply alternate codes to the alteration, remodeling, enlargement, or repair of existing structures. Id. §§ 214.214-216. Further, the Texas Department of Insurance has adopted the 2006 IRC and IBC as amended by the Texas Revisions for the Texas Windstorm Building Code for structures insured under the

\(^3\) For example, FEMA floodplain management regulations only affect existing buildings that are substantially damaged. “Substantial damage” means damage of any origin sustained by a building when the cost of restoring the building to its pre-damaged condition would equal or exceed 50 percent of the market value of the building before the damage occurred. 44 CFR §59.1 Definitions.

\(^4\) This may change in the future because the Texas House Select Committee on Hurricane Ike released a report which recommended counties be given the authority to enact and enforce building codes, and that new buildings within 80 miles of the coast be designed to withstand a Category 3 hurricane’s winds.
Texas Windstorm Insurance Association. Therefore, building code standards may vary widely from jurisdiction to jurisdiction.

II. OVERVIEW OF THE RELEVANT PROVISIONS OF THE INTERNATIONAL BUILDING CODE

A. The General Interpretive Scheme for the Code

Because most jurisdictions have adopted a form of the International Building Code, a review of the regulatory scheme of the model code will demonstrate the analytical steps necessary to determine whether a code upgrade claim is covered. While the definitions and code requirements may vary from jurisdiction to jurisdiction, these general steps should apply. It is important to first understand the relevant code provisions in the International Building Code (Building) (“IBCB”) and International Existing Building Code (“IEBC”). The IBCB applies to “the construction, alteration, movement, enlargement, replacement, repair, equipment, use and occupancy, location, maintenance, removal and demolition of every building or structure or any appurtenances connected or attached to such buildings or structures.” IBCB § 101.2. The IBCB has a prescribed manner in which the code volumes are to be interpreted and broadly distinguishes the IBCB from the International Existing Building Code. See, e.g., IEBC §§ 101.4, 201.3. In addition, the IBCB emphasizes that the more specific and more applicable provisions govern compliance versus more general provisions. See IBCB § 102.1.

The IBCB, however, expressly excepts from its application “[e]xisting buildings undergoing repair, alterations or additions and change of occupancy.” IBCB, § 202. An “existing building” is defined to mean “[a] building or structure or portion of a building or structure which has been previously legally occupied or used for its intended purpose.” Id. The IBCB instructs that such existing buildings must comply with the IEBC (Chapter 34 of the IBCB). Id. Consequently, the IEBC is both the starting and end point in determining the code provisions that apply to an insured’s reconstruction of an existing building, but the IEBC may expressly require the insured to comply with other provisions of the IBCB. IEBC, § 101.2 (“The provisions of the International Existing Building Code shall apply to the repair, alteration, change of occupancy, addition, and relocation of existing buildings”) (emphasis added). Such a scheme is consistent with

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5 Notably, the City of Houston has not adopted many portions of the International Model Codes, including the International Existing Building Code.
the underlying purpose of the IEBC, which is to grant property owners some leeway to perform necessary work on existing buildings: (1) without the need to perform the comprehensive renovations that the IBCB requires of new construction; and, thus, (2) without the costs of such work being so burdensome so as to render such work cost prohibitive.

The basic regulatory framework of the IEBC is relatively straightforward. The IEBC establishes the following relevant classifications for work performed on an existing building:

(1) Repairs;
(2) Level 1 Alterations;
(3) Level 2 Alterations; and
(4) Level 3 Alterations.\(^6\)

These work classifications for an existing building dictate the code requirements (under the IEBC and/or the IBCB) applicable to such work. IEBC, § 302.1, 303.1, 304.1, 305.1. For example, a “repair” must comply with the requirements in Chapter 4 of the IEBC and a “Level 1 Alteration” must comply with the requirements in Chapter 5 of the IEBC. Therefore, the critical inquiry for the purpose of determining the code requirements for the reconstruction of an existing structure is whether such work constitutes a Repair, a Level 1 Alteration, a Level 2 Alteration, or a Level 3 Alteration.

B. The Evaluation Of An Insured’s “Code Upgrade” Claim Requires A Determination As To Whether The Work In Question Constitutes A “Repair” Or “Alteration”

Section 202 of the IEBC defines “repair” as “the restoration to good or sound condition any part of an existing building for the purpose of its maintenance.” IEBC, § 202; see also IEBC, § 302 (“Repairs, as defined in Chapter 2, include the patching or restoration of materials, elements, equipment, or fixtures for the purpose of maintaining such materials, elements, equipment, or fixtures in good or sound condition”). Essentially, if the work only “fixes” what was previously there, then it is classified as

\[^6\] IEBC, § 302, 303, 304, 305. While there are other classifications of work – namely, “Change of Occupancy,” “Additions,” “Historic Buildings,” and “Relocated Buildings” (IEBC, §§306, 307, 308, 309) – these will not be addressed by this paper.
“repair” work. Repair materials do not necessarily have to comply with code requirements for new construction. Structural damage, whether minor or substantial, will be required to comply with the provisions for new construction. Section 202 of the IEBC defines an “alteration” as “[a]ny construction or renovation to an existing structure other than repair or addition.” IEBC, § 202 (emphasis added). There are three levels of alteration under the IEBC: Levels 1, 2, and 3. IEBC, §§ 303, 304, 305; see also id. at §§ 501, et seq., 601, et seq. & 701, et seq. Level 1 alterations involving new construction are the least intrusive on existing construction and Level 3 is the most intrusive. Those levels are defined with a brief description of the code work required as follows:

- **Level 1 Alteration:** “Level 1 alterations include the removal and replacement or the covering of existing materials, elements, equipment, or fixtures using new materials, elements, equipment, or fixtures that serve the same purpose.” IEBC, § 303.1.

  A Level 1 alteration is similar to a repair except that newer materials, elements, equipment or fixtures are installed that provide the same purpose of the previous items. Replacement equipment and materials comply with IBC and work triggers a very limited extent of upgrade.

- **Level 2 Alteration:** “Level 2 alterations include the reconfiguration of space, the addition or elimination of any door or window, the reconfiguration or extension of any system, or the installation of any additional equipment.” IEBC, § 304.1.

  Level 2 alterations must comply with the requirements for Level 1 alterations, as well. Additional limited improvements to systems such as floor openings, smoke barriers, interior finishes, guards, fire protection systems, means of egress, structural, mechanical/plumbing/electrical are triggered.

- **Level 3 Alteration:** Level 3 alterations are Level 2 alterations "where the work area exceeds 50 percent of the aggregate area of the building.” IEBC, § 305.1.

  “Work area”: is defined to mean “That portion or portions of a
building consisting of all reconfigured spaces as indicated on the construction documents. Work area excludes other portions of the building where incidental work entailed by the intended work must be performed and portions of the building where work not initially intended by the owner as specifically required by this code.” IEBC, § 202.

Level 3 alterations must comply with the requirements for Level 1 and Level 2 alterations and substantial improvements to building systems are triggered.

In addition to these work classifications, if the damage to the building is such that the building is too dangerous or unsafe or unreasonable to repair, the building may be demolished at the code official's discretion. IEBC, § 117.

Each of these work classifications directs application of specific provisions of the IEBC the IBCB, or both. This is a fact specific determination that depends on the specific damage to a particular structure; therefore, an analysis of the code implications of each of these work classifications is impractical for the purposes of this paper. Regardless, it is important to verify that the insured has properly classified the work when seeking any plan approvals and permits. Further, it is extremely important to quantify any work that the insured is performing that is not covered by the policy because this additional work may change the work classification and trigger additional code requirements, which would increase the cost of reconstruction.

III. WHILE THE CODE DETERMINES CONSTRUCTION STANDARDS, THE POLICY DETERMINES COVERAGE

A. Policies Typically Exclude Code Upgrade Coverage

Generally, manuscript commercial property policies and ISO causes of loss forms exclude coverage for any additional costs to repair or replace a building that are necessary because of an ordinance or law that regulates the construction, repair, or use of a building. They also exclude coverage for the additional costs that may arise because property must be demolished due to building codes or other ordinances. Further, ISO building and personal property form CP 00 10 04 02 excludes coverage for the increased cost of enforcing any ordinance or law regulating the construction, use, or repair of properties that have been damaged by a
covered cause of loss. The exclusionary wording exists in the loss payment, valuation, and replacement cost optional coverage sections as follows:

4. Loss Payment

b. The cost to repair, rebuild or replace does not include the increased cost attributable to enforcement of any ordinance or law regulating the construction, use or repair of any property.

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7. Valuation

b. If the Limit of Insurance for Building satisfies the Additional Condition, Coinsurance, and the cost to repair or replace the damaged building property is $2,500 or less, we will pay the cost of building repairs or replacement. The cost of building repairs or replacement does not include the increased cost attributable to enforcement of any ordinance or law regulating the construction, use or repair of any property.

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G. Optional Coverages

3. Replacement Cost

f. The cost of repair or replacement does not include the increased cost attributable to enforcement of any ordinance or law regulating the construction, use or repair of any property.

Despite these exclusions, the ISO commercial property form adds back a limited amount of coverage for such increased costs of construction arising from building codes under Section 4. Additional Coverages, but there are several notable limitations. First, it applies only when the insured selects replacement cost coverage. Second, it is limited to the lesser of $10,000 or 5 percent of the limit of insurance applicable to the building, or, in the case of blanket coverage, the lesser of $10,000 or 5 percent times the value of the damaged building at the time of loss times any applicable coinsurance percentage. Third, it does not cover any code or law that was in place prior to the loss with which the insured was required to comply before the damage. Fourth, there is no coverage for any ordinance or law involving testing for, or remediation of, pollutants or fungus. Fifth, the insurer will not pay the additional code upgrade amount until the property is actually repaired or replaced, and repairs or replacement must be completed within two years, unless the insurer agrees to extend the period in writing. Finally, the insurer will pay no more than the increased cost of construction at the same premises, even if the insured elects to rebuild at a different premises.

Examples of courts enforcing code upgrade exclusions: Southeast Real Estate Inv. Corp. v. Nationwide Mut. Ins. Co., No. 1:07cv1197, 2008 WL 4939748, at *3 (S.D. Miss., Nov. 17, 2008) (exclusion applied to code upgrade costs); Spears v. Shelter Mutual Insurance Co., 73 P.3d 865 (Okla. 2003) (where lightning damaged insured’s 60-year old home and current building codes required replacement of the 60-year old wiring, the court found that the exclusion applied and the loss was to be calculated as if there were no new building codes); Farrell v. Royal Ins. Co. of Am., 989 F.Supp. 159, 166 (D Conn. 1997) (exclusion precluded coverage for costs to remove corroded underground fuel tank which was required by local
ordinance); State Farm & Casualty Co. v. Metropolitan Dade County, 639 S.2d 63 (Fla. Dist. Ct. App. 1994) (exclusion precluded coverage for code upgrade costs).

Examples of courts declining to enforce code upgrade exclusions: Dupre v. Allstate Ins. Co., 62 P.3d 1024, 1029-30 (Colo. Ct. App. 2001) (coverage for building code upgrades not precluded where “there was no ‘physical loss’ caused by the building code requirements); Garnett v. Transamerica Insurance Services, 800 P.2d 656 (Idaho 1990) (where a fire destroyed a commercial building, the court found no exclusion for the cost of code upgrades; exclusion only applied where the loss itself is caused by law or ordinance, not where a law or ordinance required upgrades after a loss); Bering Strait School District v. RLI Insurance Co., 873 P.2d 1292 (Alaska 1994) (exclusion did not apply because insured’s “reasonable expectations” in buying replacement cost coverage was that the insurance would cover the cost to build a replacement code-compliant building).

B. Optional Coverage Is Available To Create Code Upgrade Coverage

To obtain additional coverage, Increased Cost of Construction provisions in manuscript forms and the optional ISO Building Ordinance or Law Coverage endorsement CP 04 05 04 02 provide a giveback of broader ordinance or law coverage. The endorsement provides coverage if:

B. Application of Coverages

1. The ordinance or law:

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

   b. Is in force at the time of loss.

But coverage under this endorsement applies only in response to the minimum
requirements of the ordinance or law. Losses and costs incurred in complying with recommended actions or standards that exceed actual requirements are not covered under this endorsement.

The coverage under the endorsement is triggered by an ordinance or law that "regulates the demolition, construction or repair of buildings, or establishes zoning or land use requirements at the described premises; and is in force at the time of the loss." It covers only the minimum requirements of the ordinance or law, and it will not apply to any suggested or recommended repairs or rebuilding that exceeds the ordinance's actual requirements.

The endorsement provides code coverage under two possible scenarios. First, there is coverage if the building sustains direct physical damage that is covered under the policy, and the damage results in enforcement of a building code. The second scenario applies if there is both a covered cause of loss and an excluded cause of loss, such as wind and flood. If damage caused by both of these perils results in additional code requirements, the entire amount of code costs are not covered. See All Saints Catholic Church v. United Nat. Ins. Co., 257 S.W.3d 800, 802 (Tex. App.-Dallas 2008, no pet.). The only covered cost is the proportion of the covered direct physical damage to the total direct physical damage. If the wind damage alone would have triggered the code upgrade, then the entire amount would be payable. Id. In the event that only the excluded cause of loss triggers code upgrades, there is no code upgrade coverage even if there is covered direct physical damage. Under the doctrine of concurrent causation, which is applicable in Texas, where covered and non-covered perils combine to create a loss, the insured is entitled to recover only that portion of the damage caused solely by the covered peril. Travelers Indemnity Co. v. McKillip, 469 S.W.2d 160, 163 (Tex. 1971). Therefore, non-covered perils cannot create code upgrade coverage.

There are three possible coverages under this endorsement:

**Coverage A — Coverage for Loss to the Undamaged Portion of the Building.** This covers the loss of value of the undamaged portion of the building when it must be demolished to comply with code requirements.
Coverage B — Demolition Cost. This covers the cost to demolish and clear the site of the undamaged portions of the covered building, where the law requires its demolition.

Coverage C — Increased Cost of Construction Coverage. To the extent of an otherwise covered cause of loss and when increased cost is a consequence of the enforcement of an ordinance or law, if the building is repaired, reconstructed or remodeled, this covers the costs of (1) the repair or reconstruction of the undamaged portions of the building; and/or (2) the reconstruction or remodeling of the undamaged portions, whether demolition is required or not. This coverage also applies to the increased cost of repair or reconstruction of: excavations, grading, backfilling and filling; building foundation; pilings; and underground pipes, flues and drains. These items of property, however, remain as property not covered against their physical loss or damage under the building and personal property and other applicable coverage forms.

If Coverage A is invoked, there are two loss settlement possibilities. If the insured has chosen replacement cost coverage, and the property is being repaired or replaced on the same or another premises, the policy may cover the lesser of: (a) the amount the insured would actually spend to repair, rebuild or reconstruct, but not more than it would cost to restore the building to the same height, floor area, style and comparable quality of the original building; or (b) the limit of insurance applicable to the damaged building. The second possibility applies if the insured has chosen replacement cost coverage but elects not to repair or replace the building, or if the insured has not chosen replacement cost coverage. In this event, the policy will reimburse the lesser of the actual cash value of the building at the time of the loss, or the limit of insurance applicable to the damaged building.

If the insured has selected Coverage B, the policy covers the cost to demolish and clear the site of undamaged parts of the same building because of enforcement of any ordinance or law requiring demolition of the undamaged portions of the building. The coinsurance additional condition does not apply to this coverage. The policy covers the lesser of the amount the insured actually spends to demolish and clear the site, or the applicable limit of insurance shown for Coverage B.

Coverage C, which may be combined with Coverage B, addresses code upgrades to existing buildings. It covers: (a) the increased cost to repair
or reconstruct damaged portions of a covered building that has sustained loss from a covered cause of loss; or (b) the cost to reconstruct or remodel undamaged portions of that building, whether or not demolition is required; or (c) both (a) and (b). The coverage applies only if the restored building has a similar occupancy as it had prior to the loss, unless the occupancy would be prohibited by ordinance or law. If the building is not repaired, restored, or remodeled, then the coverage provides no payment. If the building is repaired or replaced at the same premises, or if the insured decides to rebuild at another premises, the most the policy will cover is the lesser of the increased cost of construction at the same premises or the limit of insurance for Coverage C. If the ordinance or law requires relocation, the most the policy will cover is the lesser of the increased cost of construction at the new premises, or the limit of insurance for Coverage C. As noted earlier, it is possible to choose a combined limit of insurance for both Coverage B demolition cost and Coverage C increased cost of construction. If this is the case, the policy will not cover more for demolition costs than the amount actually spent to demolish and clear the site. The policy does not cover any increased costs of construction until the repair or replacement is completed at the same or other premises.

C. Important Limitations In Code Upgrade Coverages

The fundamental rule for code upgrade coverage is that code upgrades that are not caused by a covered cause of loss are not covered. MarkWest Hydrocarbon Inc. et al. v. Liberty Mutual Insurance Co. et al., 558 F.3d 1184 (10th Cir. 2009). It is also important to remember in evaluating the code upgrade work that policies generally do not cover any costs for compliance with a code the insured was required to comply with prior to the loss, but failed to do so. In other words, the policy does not cover any loss due to an ordinance or law that the insured failed to comply with if the compliance was required before the loss. See St. Paul Fire & Marine Insurance Co. v. Darlak Motor Inns, Inc., No. 3:97-CV-1559, 1999 WL 33755848 (M.D. Pa. Mar. 9, 1999) (while the code violations may not have been discovered absent the fire, the fire did not cause the code violations); 61 Jane Street Tenants Corp. v. Great American Insurance Co., No. 00 Civ. 1049 (GEL), 2001 WL 40774 (S.D. N.Y. Jan. 17, 2001) (where, by ordinance, after a fire, the gas service to building could not be restored until old valves and preexisting leaks were repaired; such repairs were not covered by insurance); Chattanooga Bank Associates v. Fidelity & Deposit Co. of Maryland, 301 F.Supp.2d 744, 779-80 (E.D. Tenn. 2004) (where the court found that “to permit a building owner to insure against discovery of existing code violations” would be contrary to “the public
policy concern for public safety”); but see, Commonwealth Insurance Co. v. Benihana of Tokyo, Inc., No. 3:96-CV-0826-R, 1997 WL 361617 (N.D. Tex. June 19, 1997) (where fire damaged four non-code compliant ventilation hoods, court found that insurer also had to replace 12 undamaged ventilation hoods under the policy’s code upgrade coverage).

Further, both standard and manuscript forms generally do not provide coverage for enforcement of any ordinance or law requiring demolition, repair, replacement, reconstruction, remodeling, or remediation of property because of contamination by pollutants (as defined in the policy) or because of the presence of fungus (as defined in the policy). See Laird v. CMI Lloyds, 261 S.W.3d 322, 330 (Tex.App.-Texarkana 2008, pet. dism’d w.o.j.). These limitations govern costs for which insureds often attempt to seek coverage.

IV. BECAUSE COVERAGE OF CODE UPGRADES DEPENDS ON ENFORCEMENT, IT IS IMPORTANT TO UNDERSTAND HOW ENFORCEMENT WORKS

Building owners often have great leeway in how building reconstruction plans are submitted to local building officials for approval. Importantly, building officials do not: (1) independently inspect a building damaged by a hurricane and determine what work needs to be done to address such damage; and (2) then determine whether the work in question constitutes a Repair or Level 1, 2, or 3 Alteration. Instead, the owner of the damaged building determines what work needs to be performed and then submits that proposal to the local building official. It is that owner-prepared proposal that local building officials rely on to determine with which provisions of the Building Code the owner must comply. Thus, property owners can manipulate the system in such a manner to make it appear that a building official required certain code upgrades, which in reality were not caused by any covered cause of loss. By reclassifying a Repair under the IBC as an Alteration, an insured may make improvements to a structure and attempt to seek coverage for these improvements as a code upgrade to undamaged portions of structures under the guise that they were required by the Alteration requirements of the existing building code.

A building official is not the appropriate gatekeeper to prevent this practice. Building officials are charged with requiring upgrades to existing buildings to the extent required by the code. See State Farm Fire & Casualty Co. v. Metropolitan Dade County, 639 So. 2d 63, 66 (Fla. Dist. Ct. App. 3d Dist. 1994). A building official will seldom question an owner
that designates more upgrades than the code requires and would likely not challenge an owner’s statement that the repairs being done qualify as Alterations because Alterations trigger more code upgrades than repairs. That choice is not covered by the insurance policy, which expressly provides that it only covers losses due to code upgrades that are required. Therefore, it is imperative to quantify the code upgrades that were actually required by a covered cause of loss and monitor the actual reconstruction plan that is submitted to a code official.

V. INDEPENDENT ANALYSIS DURING THE ADJUSTMENT IS OFTEN REQUIRED TO DIFFERENTIATE COVERED CODE UPGRADE FROM NON-COVERED CODE UPGRADES, REGARDLESS OF ANY APPROVAL FROM BUILDING OFFICIALS

Generally, the interpretation of building codes is a question of law. *Perez v. City of Dallas*, 180 S.W.3d 906 (Tex. App.-Dallas 2005, no pet.). That being said, a building code official’s interpretations of those codes may be important in a coverage dispute. As long as a building code official’s interpretation is reasonable and consistent with the code, a court will strongly consider an agency’s interpretation of a statute, and courts generally will defer to the local enforcement agency’s interpretation of the code. *Continental Cas. Co. v. Downs*, 81 S.W.3d 803, 807 (Tex. 2002), *Seibert v. Bayport Beach & Tennis Club Ass’n*, 573 So. 2d 889, 892 (Fla. Dist. Ct. App. 2d Dist. 1990). Furthermore, in the event that a coverage dispute arises, experts may not be permitted to provide opinion testimony as to the meaning of the code. *Seibert*, 573 So. 2d at 891. Therefore, in the event that an insured is able to show that a building official approved code upgrades that were not caused by any covered cause of loss, it will be important to show that these code upgrades (1) were not required by any covered damage or (2) that the code official did not require the code upgrades, but simply approved the code upgrades.

In the event that an insurer can show that a building official did not specifically enforce or require a code upgrade, an insured may attempt to argue that it was the reasonable expectation of the insured that any code upgrade approved by a building official should be covered. Most courts have rejected this reasonable expectations doctrine and enforce the terms of the policy as written, unless the terms of the policy are ambiguous. See, e.g. *Spears v. Shelter Mutual Ins. Co.*, 73 P.3d 865 (Ok. 2003). The reasonable expectations of the insured should not matter in the face of unambiguous policy provisions, and a court will apply the terms of the
policy as written to require that code upgrade coverage only applies to required code upgrades. \textit{Id.} An insured may also argue that the threat of enforcement of the code upgrade is sufficient to trigger coverage in the absence of actual enforcement. \textit{State Farm Fire \\& Casualty Co. v. Metropolitan Dade County,} 639 So. 2d 63, 66 (Fla. Dist. Ct. App. 3d Dist. 1994). This argument appears to contradict the plain meaning of unambiguous policy language; therefore, it would likely not be successful.

VI. CONCLUSION

In a complex loss in which it appears that the insured is making renovations as well as damage repairs, it may be advisable to hire a licensed architect or engineer to assist with the analysis. This professional can assist in the initial threshold question of which building codes apply. The professional can also assist in determining the classification of the repair work under the building code. Further, the professional can assist in determining whether the insured has submitted the minimum code upgrades required to repair any covered damage to the building official or whether the code submission includes code upgrades associated with non-covered causes of loss or renovations. Proper analysis and monitoring during the adjustment can ensure that the code upgrades to a damaged building are properly allocated between covered and non-covered losses, and prevent an unfavorable analysis from a building official that may be difficult to challenge at a later date.

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In 1995, Barclay R. Nicholson obtained his Bachelor of Arts degree from the University of Texas at Austin, where he graduated with honors. In 1999, he graduated *magna cum laude* from the University of Houston Law Center. He was Associate Editor of the *Houston Law Review*. After receiving his J.D. and prior to joining Fulbright & Jaworski, L.L.P., Barclay served as Briefing Attorney for Justice Alberto Gonzales and Chief Justice Thomas R. Phillips, both of the Texas Supreme Court. Barclay is currently licensed to practice law in the State of Texas, the State of New York, the State of Colorado, and in the United States District Courts for the Southern, Northern, Western, and Eastern Districts of Texas as well as the Fifth Circuit Court of Appeals.

Barclay’s practice at the law firm of Fulbright & Jaworski has centered on complex litigation matters involving energy, insurance, commercial, and construction issues. He has been named a “Texas Rising Star” for commercial litigation and one of Houston’s top Lawyers by *H Texas Magazine*.

Barclay is active in the Houston Bar Foundation, Houston Bar Association, Houston Young Lawyers Association, Houston World Affairs Council, Texas Association of Defense Counsel, and Texas Supreme Court Historical Society.