THE ORDINANCE OR LAW EXCLUSION: HOW IT (MIGHT) BAR CLAIMS FOLLOWING INSURED PROPERTY LOSS

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Rebuilding damaged or destroyed property so that it is up to code can increase costs by as much as half. Policyholders are often shocked to learn that the "Ordinance or Law" exclusion in their property insurance policy may prevent a full recovery—even when they have replacement cost coverage. One example of the Insurance Services Office ("ISO") Commercial Property Causes of Loss form's Ordinance or Law Exclusion states:

> **The insurer will not pay for loss or damage caused directly or indirectly by …**
>
> **The enforcement of any ordinance or law**:
>
> (1) **Regulating the construction, use or repair of any property; or**
>
> (2) **Requiring the tearing down of any property, including the cost of removing its debris**.

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[1]Disclaimer: The views and opinions expressed in this article do not necessarily reflect those of the authors or the companies for which they work.

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Another ISO form Ordinance or Law Exclusion provides:

We will not pay for loss, damage, cost or expense directly or indirectly caused by or resulting from, any of the following excluded causes of loss. We do not insure for such loss regardless of: (a) the cause of the excluded cause of loss; or (b) whether occurring alone or in any sequence with a covered cause of loss; or (c) whether any cause or event contributed concurrently or in any sequence with the excluded cause of loss to produce the loss:

1. **The enforcement of or compliance with any ordinance or law;**

   a. **Regulating the construction, use or repair of any property; or**

   b. **Requiring the demolition of any property, including the cost of removing its debris.**

2. **This Ordinance or Law Exclusion applies whether the loss results from:**

   a. **An ordinance or law that is enforced even if the property has not been damaged; or**

   b. **The increased costs incurred to comply with an ordinance or law in the course of construction, repair, renovation, remodeling or demolition of property, or removal of its debris, following a physical loss to that property.**

Ordinance or Law Exclusions can impact both the Period of Restoration and the Valuation following insured damage to property.

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I. The Ordinance or Law Exclusion and the Period of Restoration

The Ordinance or Law Exclusion as it pertains to the Period of Restoration states:

Period of restoration does not include any increased period required due to the enforcement of any ordinance or law that:

a. **regulates the construction, use or repair, or requires the tearing down of any property …**

Policyholders frequently have an option to purchase additional coverage, Ordinance or Law—Increased Period of Restoration, which extends coverage:

> **to include the amount of actual and necessary loss you sustain during the increased period of 'suspension' of 'operations' caused by or resulting from a requirement to comply with any ordinance or law that**:
>
> (1) **regulates the demolition, construction or repair of any property;**
>
> (2) **requires the tearing down of parts of any property not damaged by a Covered Cause of Loss; and**
>
> (3) **is in force at the time of loss**.
>
> But coverage under this Optional Coverage 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 Optional Coverage.
>
> This extension excludes from coverage compliance with an ordinance or law involving pollutants, fungus, wet or dry rot or bacteria. It replaces the definition of the "Period of Restoration" with the following:
>
> 3. **Period of Restoration means the period of time that**:
>
> a. **begins immediately after the time of direct physical loss or damage caused by or resulting from any Covered Cause of Loss at the described location; and**
>
> b. **ends on the earlier of**:
>
> (1) **the date when the property at the described location should be repaired, rebuilt or replaced with reasonable speed and similar quality; or**
>
> (2) **the date when business is resumed at a new permanent location**.
>
> "**Period of Restoration**" **includes any increased period required to repair or reconstruct the property to comply with the minimum standards of any ordinance or law, in force at the time of loss, that regulates the construction or repair, or requires the tearing down of any property**.

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Keeping in mind that a Period of Restoration is the hypothetical time period in which the property should be rebuilt with reasonable speed, or "due diligence and dispatch," courts do not consider whether the building is actually rebuilt or replaced. *Breton, LLC v. Graphic Arts Mutual Ins. Co.*, 2010 BL 39378, 4 (E.D. Va. Feb. 24, 2010); *Fisher Commc'ns, Inc. v. Travelers Prop. Cas. Co. of Am.*, 2013 BL 307952, 5 (W.D. Wash. Nov. 06, 2013) (discussing

the "hypothetical repair period."); *UrbCamCom/WSU I, LLC v. Lexington Ins. Co.*, 2014 BL 113043, 9 (E.D. Mich. Apr. 23, 2014) (mentioning "many cases [which stand] for the proposition that the time needed to complete repairs for a business interruption claim is a *hypothetical* inquiry depending on what should have happened given the exercise of due diligence, and is not to be based on the *actual* time the insured took to make repairs.) "It is precisely the hypothetical or abstract nature of the restoration period in a case such as this that ensures the recovery granted the insured party will not be subject to contingent future events." *SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props.*, LLC, 2005 BL 44161, 4 (S.D.N.Y. Feb. 16, 2005).

As a hypothetical time period, there exist three basic possible positions.[2] On one extreme, the insurer-side viewpoint requires the deduction of all permitting time, as that time constitutes "code enforcement." On the other extreme, the policyholder-side would require the enforcement of some substantive ordinance or law before deducting that from the period of restoration. The middle view, essentially a balancing test, has many variables. It involves determining the expected time for a specific type of permit which requires an experienced project manager's determination. Once the normal, expected time is determined, any increase caused by permitting requires consideration of what caused the delay—whether the increased time involved enforcement of a substantive law or ordinance or whether it involved the discretion of the permit-issuing agency. Finally, any delay caused by other events must be considered and compared against the delay caused by the permitting process to determine whether that time will be deducted from the Period of Restoration. While very few cases address the Period of Restoration directly, the principles gleaned from valuation law and ordinance cases are instructive.

"Jurisdictions that have addressed [whether a building ordinance or law exclusion limits coverage for an insured structure by excluding costs for complying with intervening building code changes] have reached differing conclusions." *Sierra Pac. Power Co. v. Hartford Steam Boiler Inspection & Ins. Co.*, 665 F.3d 1166, 1172, 2012 BL 1752, 5 (9th Cir. 2012) ("Compare *Dupre v. Allstate Ins. Co.*, 62 P.3d 1024, 1029-30 (Colo. App. 2002), *Bering Strait School Dist. v. RLI Ins.*, 873 P.2d 1292, 1296 (Alaska 1994), *Farmers Union Mut. Ins. Co. v. Oakland*, 251 Mont. 352, 825 P.2d 554 (1992), and *Garnett v. Transamerica Ins. Servs.*, 118 Idaho 769, 800 P.2d 656 (1990) (interpreting similar language and holding perils exclusions do not operate to exclude increased costs to replace due to intervening changes in building ordinances), with *Spears v. Shelter Mut. Ins. Co.*, 73 P.3d 865, 867-69 (Okla. 2003), and *Dom-*

[2]The Period of Restoration may also be determined by an appraiser or panel of appraisers (*UrbCamCom/WSU I, LLC v. Lexington Ins. Co.*, 2014 BL 113043, 9 (E.D. Mich. Apr. 23, 2014)), but the considerations in determining when the property "should be repaired, rebuilt or replaced with reasonable speed and similar quality" are the same.

brosky v. Farmers Ins. Co. of Wash., 84 Wash. App. 245, 928 P.2d 1127 (1996) (finding exclusion does limit coverage)."

Another court described this dichotomy as such:

> The split in the case law concerns whether, after a loss from a covered peril … a first party property insurer is required to pay for code upgrades required to effectively replace the lost or damaged property, even if the required code upgrades mean the insureds effectively receive something better than they originally had. Courts have struggled with the question of whether a party whose house was noncompliant before the loss deserves a code-compliant house after the loss. The cases may be divided into two camps—"antiwindfall" versus "procompliant."

Reichert v. State Farm Gen. Ins. Co., 212 Cal. App. 4th 1543, 1548-1550, 152 Cal. Rptr. 3d 6, 10-11, 2013 BL 21508, 4-5 (App. 4th Dist. 2012). Discussing "a small but consistent body of cases" that have applied the law or ordinance exclusion, the court explains, "the exclusion has been applied even where the loss has arisen, out of some gaffe by a local government official, such as … not giving proper notice of a code violation." *Id.*

A. View 1: Insurer

On the one extreme, insurers may argue that any permitting time is deducted because it is enforcement of a law that has to do with repair. Some courts find the exclusion applies when the ordinance or law directly affects repair or construction. A prime example of this reasoning is *State Farm Fire & Casualty Co. v. Metro. Dade County*, which states: "Compliance with [the requirements of an ordinance or law regulating construction or repair] will occasion additional losses for many homeowners." 639 So. 2d 63, 66 (Fla. 3d DCA 1994). The court reasons that enforcement applies to any permitting process:

> Enforcement is 'the act of enforcing: as a: compulsion especially by physical violence b: forcible urging or argument … c: the compelling of the fulfillment (as of a law or order).' Webster's Third New International Dictionary, Unabridged, 751 (1986). The ordinary meaning of the term 'enforcement,' the urging of compliance or fulfillment, makes the exclusion directly applicable to the scenarios at issue in this action. … The threat of enforcement is the driving force behind compliance with building and construction codes and ordinances. Permits are required before construction and repairs commence. Failure to comply results in failure to receive necessary permits for further construction or occupancy. The County discovers its code violations through inspections and punishes noncompliance by imposing sanctions. Thus, by any method it chooses, the County does enforce the upgrades and improvements it requires of homeowners.

State Farm Fire & Casualty Co. v. Metro. Dade County, 639 So. 2d 63, 66 (Fla. 3d DCA 1994).

In *Brandywine Flowers, Inc. v. West Am. Ins. Co.*, the court held the policyholder was not "entitled to coverage for that portion of the rebuilding period during which Brandywine was obtaining zoning variances and building permits required by law." Civ. No. A. 92C-04-196, 1993 WL 133176, at *1 (S. Ct. Del. Apr. 19, 1993), affirmed without opinion, 633 A.2d 368 (Del. 1993). The insured had argued "that there must be a violation of land use laws before there can be any enforcement of those laws," and maintained the exclusion did not apply because it "never violated the County's zoning or construction ordinances and no governmental body ever undertook any enforcement action against Brandywine." *Id.* at *2. The court disagreed, stating:

> The primary method of enforcing New Castle County's zoning and land use laws is through the process by which landowners obtain variances and building permits. … The Building Inspector, whose responsibility is to "enforce" all laws, rules and regulations relating to the construction, use and maintenance of buildings, is also the person responsible for the issuance of building permits. Thus, it is plain that New Castle County's zoning and land use laws are enforced, in part, through the permitting process. Accordingly, the exclusion language applies to "enforcement" through building and zoning approvals.

Id. (citations omitted).

Other jurisdictions have reached the same conclusion in cases specifically addressing the Period of Restoration. In *Singh v. Amguard Ins. Co.,* the court ruled that the time it took the insured's landlord to obtain building permits to commence rebuilding was excluded from a period of restoration. No. CV 16–0618 PSG (AJWx), 2017 WL 2423795, at *4 (C.D. Cal. Feb. 17, 2017).

> [T]he Court finds that the insurance policy is clear and not reasonably susceptible to multiple interpretations. The POR explicitly excludes any "increased period" that is required by a law that regulates the "construction, use or repair" of a property. The primary way in which Huntington Park regulates the "repair" of real property in its jurisdiction is through building codes, which require landowners to submit engineering plans and calculations to the City for approval before issuing permits. Because Plaintiff could not proceed with the repair of his storefront until his landlord had complied with Huntington Park's building codes, the application of a local law necessarily increased the repair time. The Court is convinced that the Exception Provision applies to exclude this time from the POR.

Id. at 4 (internal citations omitted). In *Windowizards, Inc. v. Charter Oak Fire Ins. Co.*, the court followed *Brandywine* in concluding that for purposes of an exclusion for the enforcement of an ordinance or law, "enforcement begins with the passing of relevant ordinances and continues with either the granting or denial of a permit or the issuance of a violation." Civ. No. 13-7444, 2015 WL 1400726, at *6 (E.D. Pa. Mar. 27, 2015).

In a nutshell, the insurer viewpoint boils down to this: the existence of any law or ordinance is essential to "enforcement"—thus any act by a government official including those done during the permitting process—constitutes enforcement of a law or ordinance. As such, the time period caused by any delay for the permitting process is excluded from the Period of Restoration.

B. View 2: Policyholder

Policyholders will generally feel that deduction of time from the Period of Restoration requires more than the mere submission of plans to a government entity and delay due to discussions with the permitting group; rather, it requires enforcement of some specific mandatory code. In accordance with this view, some courts find the exclusion does not apply when the damage was not caused by the ordinance or law, but by some external factor that then leads to the need to comply with an ordinance or law. For instance, where a building was damaged by the weight of snow or wind, which made its collapse imminent, the Eighth Circuit reasoned that the loss was covered because:

> [t]he condemnation decree did not cause or increase that loss. Construing the exclusion clause to preclude recovery here would violate the reasonable expectations of the layman who purchased the policy. … one would reasonably expect that if a building was severely damaged by a windstorm or snowstorm, rendering its collapse imminent and making access to the building extremely dangerous, this would constitute a loss not due to a subsequent condemnation of the structure.

Hampton Foods, Inc. v. Aetna Cas. & Sur. Co., 787 F.2d 349, 353 (8th Cir. 1986). *See, e.g. Sentinel Mgmt. Co. v. New Hampshire Ins. Co.*, 563 N.W.2d 296, 302 (Minn. Ct. App. 1997) ("Sentinel's loss is asbestos contamination; that Sentinel might one day be required by law to remove the released asbestos does not change the nature of its existing loss into one caused by enforcement of an ordinance. Therefore, … the damage Sentinel suffered due to the release of asbestos fibers does not fall within the policy's ordinance exclusion."); *Suder-Benore Co. v. Motorists Mut. Ins. Co.*, 2012 BL 487244, 4 (Ohio Com. Pl. Nov. 20, 2012) (finding coverage where there was no "evidence establishing that the enforcement of any ordinance or law directly or indirectly caused the vandalism and theft losses for which Suder-Benore seeks coverage."); *Sun Ins. Co. of New*

York v. American Motorists Ins. Co., 723 F. Supp. 1192, 1194 (E.D. Mich. 1989) ("the defendant is not contending that the limitation applies because the loss was occasioned by governmental action. Rather, defendant contends that the loss was occasioned by contamination by hazardous substances. … [T]he mercury, i.e., the hazardous substance, was the real cause of the increase in loss in this case, not any governmental action.").

Some courts following this line of thought reason that, "compliance is not enforcement." *Haas v. Audubon Indemnity Co.*, 722 So. 2d 1022, 1029 (La. App. 3d Cir. 1998) ("it was the vandalism that caused damage to the Haas' building, not the enforcement of any ordinance or law. The costs of asbestos abatement were necessary because of the flooding which arose out of the vandalism to the building.") Others find that there is coverage when a government entity "strongly recommend[s]" the insured do something, such as demolish a building, "does not classify or a law or ordinance" at least where the demolition does not appear to be enforcement of any specific law or ordinance, and where the letter does not suggest the demolition "was required by law," meaning there is no "enforcement." *Harbor Communities LLC v. Landmark American Ins. Co.*, 2008 BL 167677, 10 (S.D. Fla. Aug. 04, 2008). In *Harbor Communities,* the court reasoned that,

> Although OSHA may have had the power to obligate compliance with the request had Harbor refused to undertake a forensic demolition, any unexercised power OSHA may have to mandate compliance with a request is not a proxy for a law or ordinance within the meaning of the enforcement of a law or ordinance exclusion. Therefore, coverage for the costs associated with conducting a forensic demolition are not excluded by the enforcement of a law or ordinance exclusion.

Id.

One court summarized the view that the exclusion does not apply because the change in building code or other ordinance made it illegal to use the property as follows:

> Because changes in building codes and other ordinances often apply only to newly built structures, it is not uncommon for a property owner to be barred from replicating a covered building after it is damaged or destroyed, even though it was perfectly legal for him to occupy and use it before the loss. It is therefore not surprising that courts confronted with this situation have often found that when building codes or other ordinances make it illegal for a property owner to replicate the lost or damaged building, the insurer must pay for the alterations necessary to make the building code-compliant, at least as to those building codes that existed at the time of the loss.

SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props. LLC, 2006 BL 2216, 9

(S.D.N.Y. Oct. 31, 2006). "The Court does not find applicable the provision in the Hartford policy relating to the enforcement of a law, ordinance or regulation. The seizure by the USDA and MDA, which may constitute the enforcement of a law, ordinance or regulation under the Hartford policy, may have caused a loss to Norquick. However, the exclusion does not apply because the ammonia contamination occurred prior to the seizure and the ammonia contamination was the principal cause of the loss, as opposed to the enforcement of a law, ordinance or regulation. Defendant is not relieved of liability as a result of this exclusion in the Hartford policy." *Federal Ins. Co. v. Hartford Steam Boiler Inspection and Ins. Co.*, 2007 WL 1007787, *12 (E.D. Mich. Mar. 31, 2007).

Another court held that additional work necessary to comply with the fire marshal's directive following a covered cause of loss was covered because "Plaintiff had no choice but to comply with the Fire Marshal's directive if it wished to occupy the building. Plaintiff's adherence to the Fire Marshal's directive resulted in increased costs and, therefore, fell under the ambit of the replacement cost policy." There, the state fire marshal "issued a directive that required the Plaintiff to retain a structural engineer to 'evaluate the remaining structure of the vocational building to ensure that the structural integrity of the remaining building is in adequate condition and future collapses will not occur.'" *Jefferson Cty. Sch. v. Tenn. Risk Mgmt. Tr.*, 2018 BL 89080, 10 (Tenn. Ct. App. Mar. 15, 2018).

The underlying concerns in these policy-holder viewpoint cases can be summarized as follows: the loss was caused by some event, but not the "enforcement of a law or ordinance" and any additional loss caused by enforcement of a law or ordinance following that initial loss is covered (this is essentially a causation approach—without the initial loss the insured would not face code enforcement issues). The same reasoning applies to delays caused by the permitting process. Without the original loss, there would be no need to obtain permits, and no need to calculate the period of restoration. Because the permitting process was caused by the initial loss (though required by law), it is covered.

C. Middle View

There is a middle view, though the authors have been unable to locate any case law along these lines. This would be to have an expert, perhaps someone experienced in project management, define the expected or normal permitting time for a project of this scope, then have the court determine whether the permitting process took longer than expected, and finally consider what caused the increased time. Then the court must consider whether that delayed the project as a whole or whether other delays in fact caused a delay that was at least as great. This appears to be the fairest method, as the expected permitting process, particularly in a large project, may

in fact exceed the entire amount of time that it would have taken even using reasonable speed to complete construction or repair.

This middle view has some setbacks, including the determination of the "normal" permitting process time. However, this should be no more difficult than determining the hypothetical period of restoration. Due to the nature of construction—the fact that parts may be manufactured or delivered at a later date than usual, for instance, or necessary *force majeur* delays from inclement weather, or any number of other things that can delay a Period of Restoration—it makes sense to look at the time involved in the permitting process and compare it to the overall reconstruction time.

D. Hypothetical

Imagine an explosion at a manufacturing plant that destroys essential equipment. The entire repair takes seven months from the date of the explosion. The insurer claims that the entire time for negotiation on one key permit—four weeks—is excluded from the Period of Restoration. However, considering the entire project, those four "permitting" weeks are subsumed by a six-week delay caused by manufacturing and delivering critical equipment without which the policyholder would be unable to return to normal production. The six-week delay consisted of expected time for manufacture, plus an unexpected delivery delay caused by ice storms. When considered as a whole, the delay caused by negotiations for the permit did nothing to extend the time it took to complete reconstruction because of the delay for the vital equipment.

Result?

Now, assume the permitting negotiation had nothing to do with anything actually required by code, but instead fell under the discretion of the permitting agency to make the policyholder design something better or safer than it had originally proposed. The original design admittedly met all code requirements.

Result?

II. The Law and Ordinance Exclusion and Valuation

An insurance policy values covered property damage at either replacement cost ("RCV") or actual cash value ("ACV"). How ACV is determined is—absent a policy's definition—state-dependent. Courts have determined ACV based on, for example, market value, replacement cost less depreciation, and the "broad evidence rule."[3] RCV is generally the cost to replace damaged property with like kind and quality. But, what if the policy contains the

[3]Under the "broad evidence rule," a court may consider a variety of factors/evidence regarding the correct value of insured property at the time of loss, including original cost, cost of replacement, and the owner's opinion regarding the property's value.

Ordinance or Law Exclusion: How does application of that exclusion impact the *valuation* of the covered property damage? Courts have arrived at different results:

- The exclusion only applies where claimed damage was caused by the enforcement of an ordinance or law, i.e., a building under construction or renovation that must be demolished because it fails to comply with building codes, but was not otherwise damaged by a covered peril (fire, vandalism, water, etc.), is not covered.

- Indemnification for covered property damage at RCV is limited to the value of property *pre-loss*—no consideration is given for costs related to updated building codes, or for costs related to demolition or debris removal.

- Indemnification for covered property damage at RCV, notwithstanding ordinance or law exclusion, *includes* costs related to bringing entire building up to code.

- Indemnification for covered property damage at RCV, notwithstanding ordinance or law exclusion, *includes* costs related to bringing *only damaged* property up to code.

SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props. LLC discusses the exclusion at length, as well as optional coverage for, "[t]he increased cost to repair, rebuild or construct the Covered Property caused by the enforcement of building, zoning, land use or any other ordinance or law when the Covered Property is insured for replacement cost." 2006 BL 2216, 9 (S.D.N.Y. Oct. 31, 2006) (noting that the ISO Building and Personal Property Coverage Form has "virtually identical" language.) The court held "[s]eparately and together, the provisions unambiguously establish that the most the Insureds can recover on a replacement cost basis is the amount it would cost to reproduce the WTC beam-for-beam, pane-for-pane, as it stood early on the morning of September 11, 2001."

The court reasoned that replacement cost "'as of the time and place of loss' dictates that the relevant benchmark is the amount it would cost to reproduce the WTC as of the time and place of loss—i.e., as it existed early on the morning of September 11, 2001." Continuing, the court said "[t]his reading is also consistent with the history and purpose of replacement cost coverage in the insurance industry."

The court discussed New York courts' findings, which were "consistent with … other state and federal courts that have confronted the question of whether replacement cost policyholders can recover for expenses related to changes in the design and material of the replaced property. When courts have allowed such recovery, these changes have, virtually without ex-

ception, been mandated by law." The court reasoned:

> Because changes in building codes and other ordinances often apply only to newly built structures, it is not uncommon for a property owner to be barred from replicating a covered building after it is damaged or destroyed, even though it was perfectly legal for him to occupy and use it before the loss. It is therefore not surprising that courts confronted with this situation have often found that when building codes or other ordinances make it illegal for a property owner to replicate the lost or damaged building, the insurer must pay for the alterations necessary to make the building code-compliant, at least as to those building codes that existed at the time of the loss.

Id.

A. Pro-Policyholder View: Ordinance or Law Exclusion Is Somehow Limited

In *Sierra Pac. Power Co. v. Hartford Steam Boiler Inspection & Ins. Co.*, the Ninth Circuit considered the dispute over the value of a dam that was destroyed by a 1997 flood within the context of an ordinance or law exclusion. 490 Fed. Appx. 871 (9th Cir. 2012).

In Sierra,

> [t]he Farad Dam was completely destroyed by a flood in 1997, and Sierra filed a claim for the damage with the Insurers. A dispute arose over the value of the dam, and whether Sierra could recover replacement cost of the dam or only actual cash value since the dam had not yet been rebuilt. Following bench trial, the district court concluded that Sierra was entitled to the dam's actual cash value of $1,261,200, but that Sierra could recover replacement cost if the dam was actually rebuilt within three years … The court determined that the replacement cost of the dam was $19,800,000. Sierra appeals the trial court's ruling that the actual cash value … is $1,261,200. The Insurers appeal the rulings that (1) Sierra can recover $4 million it spent so far in preparation for replacing the dam, (2) the replacement cost available to Sierra includes costs for building ordinance changes, and (3) Sierra has three years to replace the dam and still recover the replacement cost of the dam.

Id. at 873–74.

On the second issue regarding "costs for building ordinance changes," the Ninth Circuit in *Sierra*, noting a split in California law but faced with the California Supreme Court's refusal to answer the Ninth Circuit's certified question (*see* 665 F.3d 1166 (9th Cir. 2012)), opted to follow *Fire Ins. Exch. v. Super Ct. (Altman)*, 116 Cal. App. 4th 446, 10 Cal. Rptr. 3d 617 (Cal. Ct. App. 2004).

The *Altman* court explained that because the ordinance and law exclusion in

its case was within a long list of "excluded perils," the policy intended to exclude a *peril*, but not to put any limit on replacement cost. 10 Cal. Rptr. 3d at 634. "Thus, an insured might reasonably construe the exclusion as referring to such perils as the forced demolition or repair of a dilapidated, encroaching, or nonconforming building or part of a building, by civil authorities." *Id.* The *Altman* court found the ordinance and law exclusion to be ambiguous, and because the insurer did not offer the only reasonable interpretation, the court resolved the case in favor of the insured. *Id.* at 636.

The *Sierra* court followed suit: "We hold, following *Altman*, that the exclusion at issue here [the ordinance or law exclusion] excludes damage caused by the peril of building ordinances, but not the increased construction costs caused by intervening building ordinances when the loss itself is caused by a covered peril." 490 Fed. Appx. at 876-77.

B. Pro-Insurer View: Ordinance or Law Exclusion Applies as Written

In *Bischel v. Fire Ins. Exchange*, 1 Cal. App. 4th 1168, 2 Cal. Rptr. 2d 575 (Cal. Ct. App. 1991), the California appellate court considered the policyholder's claim under a homeowners policy for damage to a boat dock adjacent to the insured home. In *Bischel*, the insurer indemnified the insured to rebuild damaged dock to pre-loss condition, but refused to pay benefits to rebuild dock to upgraded municipal code standards; the *Bischel* court reversed the trial court which ruled in favor of insured, holding that under ordinance or law exclusion, the cost of construction upgrades required by ordinances or laws must be paid by the insured, rather than the insurer. 1 Cal. App. 4th at 1178.

In *Reichert v. State Farm General Ins. Co.*, 212 Cal. App. 4th 1543, 152 Cal. Rptr. 3d 6 (Cal. Ct. App. 2012), the California appellate court held that the policy's ordinance or law exclusion applied after the insureds' home was demolished by order of a city after building inspectors determined that the remodeling project underway of the insureds' home did not comply to floodplain regulations.

In *Spears v. Shelter Mutual Ins. Co.*, "[t]he precise issue … is whether the "ordinance or law exclusion" effectively limits defendant's liability to $1700 [the cost to repair the section of wiring directly damaged by lightning as opposed to the cost to rewire the entire house as required by code]" 73 P.3d 865, 867(2003). There, the court found "the loss [wa]s to be calculated as if there were no new building codes affecting the situation" and limited coverage to the $1,700 for the wiring that was physically damaged by lightning. *Id.* at 869. The court reasoned that the language was unambiguous because it was "clear, straightforward and understandable from the point of view of an objectively reasonable insured." *Id.* at 870.

In *Cohen Furniture Co. v. St. Paul Ins. Co. of Illinois*, a fire destroyed a furniture store. The store, which was built in 1971, lacked a fire suppression system. 214 Ill. App. 3d 408, 413–416, 158 Ill. Dec. 38, 41–42, 573 N.E.2d 851, 854–855 (App. 3d Dist. 1991). In 1978 the building code was amended to require fire suppression systems in all new buildings similar to the furniture store. The policyholder replaced the store and "included a $54,000 fire suppression system. The cost of the new building was less than the policy's limit on building coverage." The insurer paid replacement costs less the fire suppression system, and deducted a depreciation allowance of $19,581. The court reasoned that the city ordinance required a new fire suppression system to be installed, and thus "[t]his increased cost of rebuilding is a direct result of the enforcement of the ordinance and falls squarely within the terms of the building laws exclusion." *Id.*

1. Exclusion Only Applies to Property Actually Damaged

In *Dupre v. Allstate Ins. Co.*, a Colorado appellate court reversed the trial court's application of the homeowners policy's ordinance and law exclusion. 62 P.3d 1024 (Colo. Ct. App. 2002). In *Dupre*, after the insured's 91-year-old home was damaged by a fire, the insurer indemnified the insured at an amount to "repair the house to its prefire condition;" but this amount did not take into account costs related to compliance with current building codes. *Id.* at 1026–27. The insurer concluded those costs were excluded. *Id.* at 1027.

The court in *Dupre* first held that the ordinance and law exclusion would only apply to "'physical loss' caused by enforcement of building laws," (*id.* at 1029), which was not present here, and, second, that "replacement cost" does not "limit[] [the insured's] recovery to the cost of restoring her house to its prefire condition." *Id.* at 1030. The only limit that the *Dupre* court placed on the insured under the ordinance or law exclusion was to exclude code upgrade coverage for those portions of the home that were *not* damaged by the fire: "Any code upgrades required in areas not damaged or destroyed by the fire would fall outside the replacement cost coverage." *Id.* at 1033.

Another court found there was coverage for only part of the damaged roof in a case involving a building code requiring replacement of the entire roofing system or section if more than 25% is repaired, replaced or recovered within a 12 month period. *El-Ad Residences v. Mt. Hawley Ins. Co.*, 2010 BL 400453, 13–14 (S.D. Fla. Sept. 28, 2010). In *El-Ad*, the insured had to replace the entire roof because hurricane Wilma damaged more than 25% but not the entire roof. Holding that the exclusion and cost of replacement provisions limited the insurer's liability to repairing only those portions of the roof that were damaged by the hurricane, the court reasoned that the exclusion was unambiguous, and found "[t]he application of the cost of replacement provision is equally straightforward." *El-Ad Residences v. Mt. Hawley Ins. Co.*, 2010 BL 400453, 13–14 (S.D. Fla. Sept. 28, 2010).

C. Hypothetical

Imagine that an insured commercial property was under renovation when, upon inspection by local municipal inspectors, it was determined that the renovation plans were not compliant with local codes. The city, shortly thereafter, issued a demolition order. The policyholder filed an insurance claim with its first party property carrier that had issued a policy containing an ordinance or law exclusion.

Result?

Now imagine that *prior* to demolition, but after the insurance carrier issued its coverage decision denying coverage for the demolition under the ordinance or law exclusion, the commercial property was completely destroyed by fire.

Result? What coverage is the policyholder entitled to now?

Now imagine that *prior* to demolition, but after the insurance carrier issued its coverage decision denying coverage for the demolition under the ordinance or law exclusion, the commercial property was only partially damaged by water.

Result? What coverage is the policyholder entitled to now?

III. Key Factors Courts Considered

Although courts have arrived at different results regarding the application of the ordinance or law exclusion, certain opinions demonstrate the central issues on which courts have focused:

- The policy's plain language;
- The expectations of the insured in connection with the insurance coverage purchased, i.e., replacement cost coverage; and
- The desire to reach a middle ground, or what the courts may perceive as the most "fair" result, sometimes outcome-oriented.

Application of the policy's plain language generally means that the policyholder will not receive insurance coverage for any amount related to code upgrades, even where the policyholder has replacement cost coverage. As the court in *Spears* held, the policyholder is entitled to recovery for the property was that physically damaged only, irrespective of any applicable building code.

The expectations of the insured in connection with its purchase of replacement cost coverage typically yields a "procompliant" result by the court. In other words, courts look to what replacement cost coverage is—i.e., coverage for a new building—and find that the insured would not expect to receive a new building that does not comply with current building codes.

Finally, the middle ground approach, is best seen in those cases where courts have allowed a policyholder to receive code upgrades as part of replacement cost coverage for the property was that was physically damaged, but not the entire site, if portions were not in need of repair or replacement.