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## INSURANCE COVERAGE FOR BUILDING CODE UPGRADES

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## I. INTRODUCTION

When a building has been damaged or destroyed, the building owner may face an additional loss because of the application of building laws and ordinances governing the repair, reconstruction, or demolition of the building. Indeed, most building laws and ordinances require that repairs to or reconstruction of damaged buildings comply with current building codes.<sup>1</sup> In some cases, this requirement also extends to undamaged portions of buildings.<sup>2</sup> These requirements are commonly referred to as building code upgrades.

Building code upgrades may be required in everything from the building's wiring and plumbing to its foundation and roof.<sup>3</sup> As examples, a building owner may be required to install a sprinkler system,<sup>4</sup> build retaining walls or deeper pilings for a hillside home,<sup>5</sup> raise the building above flood

1. See generally 2 LINDA G. ROBINSON & JACK P. GIBSON, *COMMERCIAL PROPERTY INSURANCE* VI.F.2 (2008). For example, the 1994 Uniform Building Code provided that all buildings and structures that are "structurally unsafe or not provided with adequate egress, or which constitute a fire hazard, or are otherwise dangerous to human life" are deemed "unsafe." UNIFORM BUILDING CODE § 102 (1994). All unsafe buildings and structures are declared public nuisances and must be "abated by repair, rehabilitation, demolition or removal in accordance with the procedures set forth in the Dangerous Buildings Code." *Id.* Under the prior (1991) building code, all additions, alterations, or repairs to existing buildings and structures had to comply with the building code. UNIFORM BUILDING CODE § 104(a) (1991). Many states, counties, and cities have adopted the Uniform Building Code. See, e.g., CAL. BUILDING CODE (2001).

2. See, e.g., *Steiner v. Middlesex Mut. Ins. Co.*, 689 A.2d 1154, 1166 (Conn. App. Ct. 1997).

3. See Lynn Asinof, *Make Sure Your Homeowner's Insurance Will Bail You Out in an Emergency*, CHI. TRIB., May 4, 1998, at C1.

4. See, e.g., *Prytania Park Hotel v. Gen. Star Indem. Co.*, 896 F. Supp. 618, 623 (E.D. La. 1995) (City of New Orleans building code required installation of sprinkler system after fire damaged hotel); *Cohen Furniture Co. v. St. Paul Ins. Co. of Ill.*, 573 N.E.2d 851, 852 (Ill. App. Ct. 1991) (Jacksonville, Illinois, building code required installation of fire suppression system in reconstruction of furniture store destroyed in fire).

5. See Liz Pulliam, *Flirting with Disaster: Be Sure You Know What Is, Isn't Covered*, L.A. TIMES, Aug. 2, 1998, at D14.

level,<sup>6</sup> install fire-retardant roofing,<sup>7</sup> or make the entire building physically accessible for disabled people.<sup>8</sup>

The costs of building code upgrades can be substantial. In some cases, it may be physically and economically impractical to repair a structure to comply with all applicable building codes. In these cases, the most logical way to comply with all appropriate codes would be to completely demolish the building and construct a new one in its place.<sup>9</sup>

Because of the substantial costs involved, building owners often look to their property insurer to pay the costs of building code upgrades. This article reviews the insurance policy provisions applicable to building code upgrades. It provides an overview of the cases that have addressed insurance coverage for building code upgrades with the goal of identifying common themes and factual distinctions. As part of this review, this article examines the major issues confronting insureds, insurers, and courts regarding coverage for building code upgrades.

## II. WHAT CONSTITUTES A LAW OR ORDINANCE?

### A. Government-Mandated Requirements

Code upgrade provisions generally refer to requirements imposed by “laws” and “ordinances.”<sup>10</sup> A law is defined as “a rule or mode of conduct or action that is prescribed or formally recognized as binding by a supreme controlling authority.”<sup>11</sup> Similarly, an ordinance means “a public enactment, rule, or law promulgated by governmental authority.”<sup>12</sup>

6. Under a Dade County, Florida, law, if a home was more than 50 percent damaged, the home had to be completely torn down, raised above flood level, and rebuilt to current codes. See *Miles v. AAA Ins. Co.*, 771 So. 2d 607, 608 (Fla. Dist. Ct. App. 2000); see also *State Farm Must Pay for Upgrades*, ORLANDO SENTINEL, Dec. 15, 1993, at C1. In some areas, this meant that homes had to be raised up to ten feet, at a cost of \$30,000 to \$40,000 each, to comply with new flood protection requirements. *Id.* See generally Hugh L. Wood, Jr., Comment, *The Insurance Fallout Following Hurricane Andrew: Whether Insurance Companies Are Legally Obligated to Pay for Building Code Upgrades Despite the “Ordinance or Law” Exclusion Contained in Most Homeowners Policies*, 48 U. MIAMI L. REV. 949, 954 (1994).

7. See Leslie Berkman & Mark Platte, *Many Fire Victims Insurance Falls Short*, L.A. TIMES, Nov. 4, 1993, at A30.

8. See 42 U.S.C.A. §§ 12181–12189 (West 2005) (Americans with Disabilities Act).

9. See, e.g., *Steiner v. Middlesex Mut. Ins. Co.*, 689 A.2d 1154, 1156–57 (Conn. App. Ct. 1997).

10. See *infra* notes 61, 62, 136–38, and accompanying text.

11. WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 1279 (2002). Similarly, the U.S. Supreme Court held that laws are “rules of action or conduct duly prescribed by controlling authority, and having binding legal force.” *U.S. Fid. & Guar. Co. v. Guenther*, 281 U.S. 34, 37 (1930). BLACK’S LAW DICTIONARY defines *law* as “[t]he aggregate of legislation, judicial precedents, and accepted legal principles.” BLACK’S LAW DICTIONARY 900 (8th ed. 2004).

12. WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY, *supra* note 11, at 1588; see also BLACK’S LAW DICTIONARY, *supra* note 11, at 1132 (defining *ordinance* as “[a]n authoritative law or decree; esp., a municipal regulation”).

Consistent with these definitions, courts generally apply code upgrade provisions to any type of government-mandated requirement.<sup>13</sup> In *Bischel v. Fire Insurance Exchange*,<sup>14</sup> for example, the California appellate court found that City of Coronado specifications that required \$50,000 in additional repairs to a damaged boat dock constituted a law and ordinance even though the specifications were neither enacted by the state government nor adopted by a formal action of the city council. The *Bischel* court reasoned that an insurance policy should be read as a layperson would read it and not as an attorney or insurance expert might analyze it.<sup>15</sup> The court found it “highly unlikely the average lay policy holder would restrict the meanings of ‘law’ and ‘ordinance’ to specific” statutes.<sup>16</sup> The court then noted that the city engineer issued the specifications in question pursuant to two municipal ordinances that authorized the city engineer to issue permits for all work within a public right-of-way.<sup>17</sup> Thus, according to the court, the specifications were “regulations adopted by the City of Coronado in accordance with its municipal code.”<sup>18</sup> Finally, relying on the dictionary definition of *law*, the court concluded that “[w]e have no doubt the average lay policyholder would consider them as laws.”<sup>19</sup>

But not every directive from a governmental entity constitutes a law or ordinance. In *Harbor Communities, LLC v. Landmark American Insurance Co.*,<sup>20</sup> for example, the court found that a letter from the Occupational Safety and Health Administration (OSHA) recommending that the insured take specific measures during demolition of a collapsed building was not a law or ordinance. *Harbor Communities* involved a coverage dispute that arose out of the collapse of a condominium building under construction.<sup>21</sup> After the collapse, OSHA sent the insured a letter strongly recommending that the insured take specific measures during demolition to preserve evidence needed to determine the cause of the collapse.<sup>22</sup> Landmark, however, claimed that the costs of the forensic demolition were excluded by the law and ordinance exclusion.<sup>23</sup> But the court found that the OSHA letter was

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13. See, e.g., *Farrell v. Royal Ins. Co. of Am.*, 989 F. Supp. 159 (D. Conn. 1997) (local ordinance); *Prytania Park Hotel v. Gen. Star Indem. Co.*, 896 F. Supp. 618, 623 (E.D. La. 1995) (city building code); *Bradford v. Home Ins. Co.*, 384 A.2d 52, 53 (Me. 1978) (state plumbing code).

14. 2 Cal. Rptr. 2d 575 (Ct. App. 1991).

15. *Id.* at 579.

16. *Id.*

17. *Id.* at 580.

18. *Id.*

19. *Id.*

20. No. 07-14336-CIV, 2008 WL 2986424 (S.D. Fla. Aug. 4, 2008).

21. *Id.* at \*1.

22. *Id.*

23. *Id.* at \*8.

not a law or ordinance. It reasoned that while a federal regulation could be considered an ordinance, Landmark could point to no specific regulation, law, or ordinance that OSHA was enforcing when it sent its letter.<sup>24</sup> Therefore, the court found the law and ordinance exclusion inapplicable.

Finally, because code upgrade provisions generally require that the laws or ordinances regulate the repair or reconstruction of a building,<sup>25</sup> a law or ordinance that does not regulate the repair or reconstruction of a building does not implicate any code upgrade provisions. The case *Great American Insurance Co. v. Jackson County School District*,<sup>26</sup> provides a good illustration. There, a fire destroyed a school insured by Great American.<sup>27</sup> The insured rebuilt the school with a girl's locker room that was substantially larger than the one in the destroyed school.<sup>28</sup> The insured claimed that that Title IX required these costs and, thus, they were covered by the policy's code upgrade coverage.<sup>29</sup> The court, however, concluded that Title IX was not a law or ordinance that regulated the construction or repair of buildings and, hence, there was no coverage for the additional cost.<sup>30</sup>

A similar result can be seen in *MarkWest Hydrocarbon, Inc. v. Liberty Mutual Insurance Co.*<sup>31</sup> There, MarkWest's liquid natural gas pipeline developed a small hole where the wall had been thinned by corrosion.<sup>32</sup> The escaped contents caught fire, resulting in an explosion that damaged a small section in the sixty-five-mile long pipeline and five adjacent homes and caused numerous injuries.<sup>33</sup> The Office of Pipeline Safety (OPS), a division of the U.S. Department of Transportation, issued a corrective action order, requiring MarkWest to pressure test the entire sixty-five-mile long pipeline and to repair any areas of the pipeline that failed the pass the test.<sup>34</sup> MarkWest sought to recover the costs of complying with the OPS corrective action order and the business interruption losses associated with the shut down of the pipeline pursuant to a code upgrade endorsement that provided coverage for the increased costs of repair to comply with any law or ordinance "regulating of repair or construction of the damaged"

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24. *Id.*

25. See *infra* notes 136 to 138 and accompanying text.

26. Nos. 06-3035-AP, 06-3042-PA, 2008 WL 2477576 (D. Or. June 16, 2008).

27. *Id.* at \*1.

28. *Id.* at \*2.

29. *Id.* Title IX of the Education Amendments of 1972 provides that "No person in the United States shall, on the basis of sex, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any education program or activity receiving Federal financial assistance . . ." 20 U.S.C.A. § 1681(a) (West 2000).

30. *Great Am.*, 2008 WL 2477576, at \*3.

31. 558 F.3d 1184 (10th Cir. 2009).

32. *Id.* at 1186.

33. *Id.*

34. *Id.* at 1186-87.

property.<sup>35</sup> In affirming summary judgment for the insurers, the court held that the order did not regulate the repair or construction of the damaged pipeline. Rather, the court found that the order required MarkWest to test and take remedial action to maintain the safety of its pipeline: “OPS was hardly concerned with telling MarkWest how to repair a broken valve stem, or how to repair broken bits of the pipeline in Ivel. That was yesterday’s problem; OPS was concerned about preventing tomorrow’s.”<sup>36</sup>

In short, references to *law* and *ordinance* in code upgrade provisions refer to government-mandated requirements. In most cases, these will be statutes or regulations enacted by a state or the federal government or ordinances adopted at the city or local level. Absent formal enactment by a governmental body, building codes are not laws or ordinances. Therefore, “building codes or standards adopted by private organizations but not adopted by a governmental body having the authority to do so” are not laws.<sup>37</sup> But where a municipal ordinance has incorporated and made mandatory guidelines promulgated by advisory bodies, such as the National Fire Protection Association, those guidelines are laws.<sup>38</sup> Of course, any law or ordinance must regulate the repair or construction of a building to trigger code upgrade provisions.

### B. *Americans with Disabilities Act*

Title III of the Americans with Disabilities Act of 1990 (ADA) created a new type of building law exposure.<sup>39</sup> Title III of the ADA is effectively a

35. *Id.* at 1188. The specific provision read in part:

In the event of loss or damage by an insured peril under this policy that causes the enforcement of any law or ordinance regulating the construction or [of] damaged facilities, underwriters shall be liable for: \* \* \*

C. Increased cost of repair or reconstruction of the damaged and undamaged facility on the same or another site and limited to the minimum requirements of such law or ordinance regulating the repair or reconstruction of the damaged property on the same site. However, Company shall not be liable for any increased cost of construction loss unless the damaged facility is actually rebuilt or replaced.

D. Any increase[] in the Business Interruption and extra expense loss arising out of the additional time required to comply with state law or ordinance.

*Id.*

36. *Id.* at 1191.

37. *See, e.g.,* Regents of the Mercersburg Coll. v. Republic Franklin Ins. Co., 458 F.3d 159, 171–72 (3d Cir. 2006) (affirming in part and reversing in part the district court decision on other grounds). In *Mercersburg College*, the insured sought coverage for the requirements imposed by the International Mechanical Code; the Building Officials and Code Administrators International, Inc. Code; the National Electric Code; the International Plumbing Code; and the standards of the American Society of Heating, Refrigeration and Air-Conditioning Engineers. *Id.* But the governing jurisdiction in which the insured property was located had not adopted any of the foregoing codes. *Id.*

38. *See, e.g.,* Mesaba Holdings, Inc. v. Fed. Ins. Co., No. Civ. 02-660RHKJGL, 2002 WL 31856384, at \*3 (D. Minn. Dec. 19, 2002).

39. 42 U.S.C.A. §§ 12181–12189 (West 2005). The ADA is comprised of separate titles that regulate in the areas of Employment (Title I), Public Services (Title II), and Public

national building code that requires public and commercial buildings to be physically accessible for disabled people. In addition to requiring that all newly constructed “public accommodations” and “commercial facilities” comply with the ADA’s accessibility requirements,<sup>40</sup> the ADA also requires that any “alteration” of a public accommodation or commercial facility comply with the ADA requirements.<sup>41</sup> The ADA does not require alterations; it simply provides that when alterations are undertaken, they must be made in a manner that provides access.<sup>42</sup> Thus, the ADA would apply where buildings must be reconstructed or extensively repaired as a result of a fire or other peril.

Many nonresidential facilities will be subject to the ADA’s accessibility requirements. Indeed, the ADA defines the terms *public accommodation* and *commercial facility* very broadly. Commercial facilities are facilities “that are intended for nonresidential use” and “whose operations will affect commerce.”<sup>43</sup> A public accommodation is essentially any place that offers goods or services to the public. This includes twelve categories of places: (1) places of lodging, (2) establishments serving drink or food, (3) places of exhibition or entertainment, (4) places of public gathering, (5) sales or rental establishments, (6) service establishments, (7) stations used for specified public transportation, (8) places of public display or collection, (9) places of recreation, (10) places of education, (11) social service center establishments, and (12) places of exercise or recreation.<sup>44</sup>

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Accommodation (Title III). Title III governs private businesses that meet the characteristics of a public accommodation as specified in § 12181(7) of the ADA. *See id.* § 12181(7).

40. *See* 42 U.S.C.A. § 12183. The ADA applies to new construction of facilities ready for first occupancy after January 26, 1993. *See id.*; 28 C.F.R. § 36.401(a) (2007). The ADA Accessibility Guidelines for Buildings and Facilities sets guidelines for accessibility to places of public accommodation and commercial facilities by individuals with disabilities. 28 C.F.R. pt. 36, app. A. Appendix B to the federal regulations contains a section-by-section analysis of the ADA and a response to comments. 28 C.F.R. pt. 36, app. B.

41. *See* 42 U.S.C.A. § 12183; 28 C.F.R. § 36.402(a). An alteration is defined as “a change to a place of public accommodation or a commercial facility that affects or could affect the usability of the building or facility or any part thereof.” 28 C.F.R. § 36.402(b). According to the federal regulations, alterations “include, but are not limited to, remodeling, renovation, rehabilitation, reconstruction, historic restoration, changes or rearrangement in structural parts or elements, and changes or rearrangements in the plan configuration of walls and full-height partitions.” *Id.* § 36.402(b)(1).

42. *See generally* 28 C.F.R. pt. 36, app. B.

43. 42 U.S.C.A. § 12181(2).

44. *See id.* § 12181(7). The statute goes on to give representative examples from each of the categories. *See id.*; *see also* 28 C.F.R. § 36.104. Although the list of categories is exhaustive, the representative examples within each category are not. *See* 28 C.F.R. pt. 36, app. B. Title III does not apply to publicly operated business, but it does apply to privately operated businesses that lease space from local, state, or federal government. *See, e.g., Fiedler v. Am. Multi-Cinema, Inc.*, 871 F. Supp. 35 (D.D.C. 1994) (movie theater leased by its operator from the federal government was a place of public accommodation within the meaning of the ADA).

Apartments and condominiums, however, do not constitute public accommodations within the meaning of the ADA.<sup>45</sup> Similarly, a private home, by itself, is not a place of public accommodation.<sup>46</sup> But it can be covered as a place of public accommodation if it is used as a facility that would fall within one of the twelve categories.<sup>47</sup> For example, if a dentist, doctor, or psychologist has a professional office in a private home, “the portion of the home dedicated to office use . . . would be considered a place of public accommodation.”<sup>48</sup>

The broad reach of the ADA is illustrated by *Regents of the Mercersburg College v. Republic Franklin Insurance Co.*,<sup>49</sup> where the court found an insurer liable for the cost of complying with ADA requirements in a private school dormitory. There, a century-old classroom and dormitory building known as Keil Hall at Mercersburg Academy, a college preparatory boarding school, sustained fire and smoke damage after a lightning strike.<sup>50</sup> Afterward, Mercersburg sought to recover from its insurer the additional costs to repair the building that were made necessary to bring the building into compliance with the ADA.<sup>51</sup> The policy provided code upgrade coverage, but Republic, the insurer, argued that the ADA did not apply because Keil Hall was not a public accommodation within the meaning of the ADA.<sup>52</sup>

The appellate court found Republic liable for the cost of complying with the ADA requirements. The court’s analysis proceeded as a three-part inquiry: (1) whether Mercersburg Academy was a “public accommodation”; (2) whether the repairs and renovations made to Keil Hall were “alterations”; and (3) whether Keil Hall is a facility that is “used as, or designed for use as,” either a “place of public accommodation” or “a commercial facility.” The court reasoned that Mercersburg is a “secondary school,” which by definition makes it a “place of education” and, accordingly, a public accommodation under the ADA.<sup>53</sup> It further reasoned that the post-fire

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45. See, e.g., *Indep. Hous. Servs. of S.F. v. Fillmore Ctr. Assocs.*, 840 F. Supp. 1328, 1344 (N.D. Cal. 1993). “An inn, hotel, motel, or other place of lodging” constitutes a place of public accommodation under the ADA. 42 U.S.C.A. § 12181(7)(A). Legislative history, however, clarifies that *other place of lodging* does not include residential facilities. H.R. REP. NO. 101-485(II), at 383 (1990), *reprinted in* 1990 U.S.C.C.A.N. 267. But similar state accessibility laws may apply to apartments. See, e.g., CAL. BUILDING CODE § 1103.1.9.3 (2001) (imposing access and adaptability requirements for the physically handicapped on apartment buildings consisting of four or more units).

46. 28 C.F.R. § 36.401(b). The ADA applies to “that portion used exclusively in the operation of the commercial facility or that portion used both for the commercial facility and for residential purposes.” *Id.*

47. See *id.*

48. 28 C.F.R. pt. 36, app. B.

49. 458 F.3d 159 (3d Cir. 2006) (applying Pennsylvania law).

50. *Id.* at 162.

51. *Id.*

52. *Id.*

53. *Id.* (citing 42 U.S.C. § 12181(7)(J)).

repairs were alterations because they included “remodeling, renovation, [or] reconstruction.”<sup>54</sup> Finally, the court reasoned that the ADA regulations expressly define dormitories as “transient lodging” and, thus, places of public accommodation.<sup>55</sup>

As illustrated by the *Mercersburg College* case, there is little doubt that the ADA constitutes a law “regulating the construction, use or repair of any property” within the meaning of a code upgrade provision. Indeed, the applicable language in many insurance policy forms is broad enough to cover ADA-type changes such as ramps, elevators, or changes to restroom facilities, which obviously affect the use of any property. Given the broad definitions of *public accommodation* and *commercial facility*, the ADA will apply to many buildings. Thus, many building owners may be required to make their buildings ADA-compliant when making repairs to a building after it sustains physical loss or damage.

### III. CODE UPGRADE EXCLUSIONS AND LIMITATIONS

#### A. Policy Provisions

Policy provisions limiting coverage for building code upgrades have been in insurance policies for more than one hundred years. The 1896 New York Standard Policy, for example, included such a limitation.<sup>56</sup> The limitation has remained in every subsequent version of the standard fire policy.<sup>57</sup> Today, many other policy forms also exclude or limit coverage for the costs of complying with building laws or ordinances.<sup>58</sup>

54. *Id.* at 165 (citing 42 C.F.R. § 36.402(b)(1)).

55. *Id.* The court cited 42 C.F.R. pt. 36, app. A, ch. 3.5, which provided that “[t]ransient lodging may include, but is not limited to, resorts, group homes, hotels, motels, and dormitories.” *Id.* at 166. Although the court found coverage for the cost of complying with the ADA requirements, the court said that there was not coverage for any alterations, renovations, or improvements that were not mandated by the ADA. *Id.* at 170. The U.S. Court of Appeals for the Third Circuit remanded the matter to the district court to determine which renovations, if any, undertaken by Mercersburg “were mandated by the ADA.” *Id.*

56. 1896 N.Y. STANDARD FIRE POLICY (quoted in *Weinstein v. Commerce Ins. Co.*, 82 S.E.2d 477, 479 n.1 (Va. 1954)).

57. The 1918 New York Standard Policy provided thus: “[This company] [d]oes insure . . . to the extent of the actual cash value (ascertained with proper deduction for depreciation) of the property at the time of loss or damage, but not exceeding the amount which it would cost to repair or replace same with material of like kind and quality within a reasonable time after such loss or damage, without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair. . . . This company shall not be liable for loss or damage caused directly or indirectly by . . . order of any civil authority.” 1918 N.Y. STANDARD FIRE POLICY (quoted in *Weinstein*, 82 S.E.2d at 479 n.2). The current New York Standard Fire Policy is reprinted in 1 INSURING REAL PROPERTY app. 2-A (Stephen A. Cozen ed., 2008).

58. See generally Thomas A. Dugan, *Basic Terms and Conditions of Property Insurance*, in 1 INSURING REAL PROPERTY, *supra* note 57, § 2.04[1].

Similarly, many business interruption coverage forms exclude or limit coverage for the additional time required to repair or reconstruct damaged property in accordance with any law or ordinance.<sup>59</sup> Some policy forms include a code upgrade exclusion. Others, like the International Organization for Standardization (ISO) business interruption forms, do not use a code upgrade exclusion but rather incorporate the exclusionary language in the *period of restoration* definition.<sup>60</sup>

Generally, two types of policy provisions limit coverage for building code upgrades. The first type is a specific exclusion. The ISO property insurance forms, for example, exclude coverage for any loss or damage caused by “[t]he enforcement of any ordinance or law: (1) [r]egulating the construction, use or repair of any property; or (2) [r]equiring the tearing down of any property, including the cost of removing its debris.”<sup>61</sup>

The second type is the increased repair cost limitation that is found in many policy forms, including, for example, the standard fire policy:

[T]his Company . . . does insure [the insured] to the extent of the actual cash value of the property at the time of loss, but not exceeding the amount which it would cost to repair or replace the property with material of like kind and quality within a reasonable time after such loss, without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair. . . .<sup>62</sup>

In contrast to the specific code upgrade exclusion, this type of provision operates as a limitation of liability.

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59. See, e.g., ISO BUSINESS INCOME (AND EXTRA EXPENSE) COVERAGE FORM CP 00 30 04 02.

60. The ISO business interruption forms provide for the payment for the actual loss of business income sustained due to the necessary suspension of operations during the period of restoration. The *period of restoration* definition specifically excludes coverage for any additional time required to rebuild as a result of law and ordinance requirements: “‘Period of restoration’ does not include any increased period required due to the enforcement of any ordinance or law that: (1) Regulates the construction, use or repair, or requires the tearing down of any property; or (2) Requires any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of ‘pollutants.’” ISO BUSINESS INCOME (and Extra Expense) Coverage Form CP 00 30 04 02, at 8.

61. ISO STANDARD PROPERTY POLICY CP 00 99 04 02, at 9–10; ISO CAUSES OF LOSS—SPECIAL FORM CP 10 30 04 02, at 1; ISO CAUSES OF LOSS—BROAD FORM CP 10 20 04 02, at 2; ISO CAUSES OF LOSS—BASIC FORM CP 10 10 04 02, at 2.

62. STANDARD FIRE POLICY (reprinted in 1 INSURING REAL PROPERTY, *supra* note 57, at app. 2-A (Stephen A. Cozen ed., 2008)). The ISO forms also include a limitation in the loss payment provision, which provides as follows: “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.” ISO STANDARD PROPERTY POLICY CP 00 99 04 02, at 14; ISO BUILDING AND PERSONAL PROPERTY COVERAGE FORM CP 00 10 04 02, at 10.

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## B. Court Interpretations

Courts have not uniformly interpreted code upgrade exclusions. Some courts have found that the exclusions clearly and unambiguously preclude coverage for building code upgrades, but others have not.

### 1. Courts Enforcing Code Upgrade Exclusions

*Hewins v. London Assurance Corp.*,<sup>63</sup> a 1903 decision, is one of the most widely cited cases upholding a code upgrade exclusion. In *Hewins*, the insureds suffered a partial loss due to fire. The issue before the appellate court was whether the referees in an appraisal hearing properly took into consideration the increased cost of building code upgrades in determining the amount of recoverable damages.<sup>64</sup> The insured had twelve separate policies, eleven of which contained no code upgrade exclusion. With respect to those eleven policies, the court found coverage for code upgrade costs.<sup>65</sup> The twelfth insurer's policy contained two provisions addressing code upgrades. The first provided that in the event of loss, the insured's recovery "shall in no event exceed what it would cost the insured to repair or replace the same with material of like kind and quality."<sup>66</sup> The second provision stated that the insurer would not be liable "beyond the actual value destroyed by fire for loss occasioned by ordinance or law regulating construction or repair of buildings, or by interruption of business, manufacturing processes, or otherwise."<sup>67</sup> The court found that taken together, these two clauses excluded coverage for the code upgrade costs.<sup>68</sup>

Since *Hewins*, many courts have upheld law and ordinance exclusions, relying on the plain and unambiguous policy language as the basis for their

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63. 68 N.E. 62 (Mass. 1903).

64. *Id.* at 63.

65. *Id.* at 64. The court wrote thus: "While it is true that by reason of their [the building laws'] existence the loss caused by the ravages of the fire was greater than it otherwise would have been, it is none the less true that the sole operating cause of the change in the building was the fire, and, as above stated, in the absence of any provision in the policy expressly excluding from the damages the part arising out of that condition, that part is not to be excluded, but is to be regarded as primarily the result of the fire, or as 'loss or damage by fire.'" *Id.*

66. *Id.*

67. *Id.*

68. *Id.* The court reasoned that when construing the two provisions together, "they modify the general rule as to the measure of the loss by fire in such a case as this, and that the fair construction of these two clauses taken together is that such portion of the damage caused by the change in the condition of the building as arises from the existence of the building laws, whether regarded as a condition or a cause, is not to be considered as a loss or damage by fire, but is to be excluded from consideration, and the loss is to be estimated as if there were no building laws affecting the situation." *Id.*

decisions.<sup>69</sup> For example, in *Spears v. Shelter Mutual Insurance Co.*,<sup>70</sup> lightning struck the insured's sixty-year-old home and caused damage to part of the electrical wiring. Because the wiring was sixty years old, the entire home had to be rewired to meet current building codes.<sup>71</sup> The policy excluded coverage for "[e]nforcement of any ordinance or law regulating the construction, repair or demolition of a building or other structure."<sup>72</sup> The Oklahoma Supreme Court found that this language was unambiguous and precluded coverage for the building code upgrades:

In our view, the only fair construction of the "ordinance or law exclusion" is that the portion of the loss to the wiring that arises from the existence of new building codes is not to be considered as a loss or damage by a covered peril, but is instead to be excluded from consideration, and the loss is to be calculated as if there were no new building codes affecting the situation. We can see no other interpretation.<sup>73</sup>

In *State Farm Fire & Casualty Co. v. Metropolitan Dade County*,<sup>74</sup> the court relied on the unambiguous language of the code upgrade exclusion to preclude coverage for code upgrade costs. After Hurricane Andrew, Dade County required "many homeowners to make structural improvements to their houses to bring them into compliance with the South Florida Building Code."<sup>75</sup> Dade County sued State Farm seeking a declaratory judgment

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69. See, e.g., *Se. Real Estate Inv. Corp. v. Nationwide Mut. Ins. Co.*, No. 1:07cv1197, 2008 WL 4939748, at \*3 (S.D. Miss. Nov. 17, 2008) (law and ordinance limitation applied to code upgrade costs); *Farrell v. Royal Ins. Co. of Am.*, 989 F. Supp. 159, 166 (D. Conn. 1997) (holding that law and ordinance exclusion precluded coverage for costs to remove corroded underground fuel tank, which was required by local ordinance); *Bischel v. Fire Ins. Exch.*, 2 Cal. Rptr. 2d 575 (Ct. App. 1991) (holding that ordinance or law exclusion excluded coverage for cost of repairing insured's dock to meet code requirements); *State Farm Fire & Cas. Co. v. Metro. Dade County*, 639 So. 2d 63 (Fla. Dist. Ct. App. 1994) (holding that ordinance or law exclusion was unambiguous and policy did not cover increased costs of repairs due to enforcement of building code); *Regency Baptist Temple v. Ins. Co. of N. Am.*, 352 So. 2d 1242, 1243 (Fla. Dist. Ct. App. 1977) (holding that ordinance or law exclusion excluded "expenditures necessary under the [municipal] ordinance to rebuild the improperly constructed portion of the roof that did not collapse"); *Bradford v. Home Ins. Co.*, 384 A.2d 52, 53-54 (Me. 1978) (holding that ordinance or law exclusion excluded upgrade requirements of plumbing code); *Hewins v. London Assur. Corp.*, 68 N.E. 62 (Mass. 1903) (holding that ordinance or law exclusion excluded coverage for increased costs of repair due to building codes); *Park City Estates Tenants Corp. v. Gulf Ins. Co.*, 823 N.Y.S.2d 127 (N.Y. App. Div. 2006) (holding that ordinance or law exclusion precluded coverage for losses relating to code-required "integrity testing" of insured building's plumbing and gas systems).

70. 73 P.3d 865 (Okla. 2003).

71. *Id.* at 867.

72. *Id.*

73. *Id.* at 869.

74. 639 So. 2d 63 (Fla. Dist. Ct. App. 1994).

75. *Id.* at 64. The South Florida Building Code required that "[r]epairs and alterations amounting to more than 50 percent of the replacement value of the existing building shall be made to conform to all the requirements for a new building." *Id.* at 64 n.1.

that State Farm's replacement cost homeowners policies provided coverage for the building code upgrades.<sup>76</sup> The State Farm policies included a specific code upgrade exclusion and an increased repair cost limitation.<sup>77</sup> The appellate court held that the two provisions were clear and unambiguous and precluded coverage for the code upgrade costs:

The first excluded event in the policy is the enforcement of an ordinance or law regulating construction or repair of a structure. Clearly, the County must enforce its construction codes and requirements. Compliance with these requirements will occasion additional losses for many homeowners. The language in the "Ordinance or Law" exclusion is susceptible of only one interpretation: no coverage is provided for losses associated with construction regulation enforcement. . . .

Similarly, the "increased cost limitation" clause . . . is susceptible of only one interpretation. The clause asserts that no coverage will be afforded for increased costs associated with enforcement of construction laws or regulations. The plain, natural meaning of the phrase alerts the reader to the fact that should enforcement of a construction regulation or law cause additional expenses, the policy does not cover them.<sup>78</sup>

Courts enforcing law and ordinance exclusions have rejected policyholder arguments that the "enforcement" of the ordinance must cause the loss in order for the exclusion to apply. The case *Prytania Park Hotel v. General Star Indemnity Co.*<sup>79</sup> is illustrative. There, a fire damaged the Prytania Park Hotel in New Orleans. A city building code required the installation of a sprinkler system in the repaired hotel.<sup>80</sup> General Star's policy included a code upgrade exclusion.<sup>81</sup> The court rejected the insured's argument "that

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76. *Id.* at 64.

77. *Id.* at 64, 65 n.4.

78. *Id.* at 65–66 (citation omitted). The trial court granted the county's motion for summary judgment, holding as a matter of law that State Farm must cover the code upgrade costs. *Id.* at 65. The trial court found the exclusionary language ambiguous and interpreted it to find code upgrade coverage. *Id.* On appeal, the appellate court also rejected the county's argument that State Farm's failure to define *enforcement* and *increased cost* in the policies rendered the provisions ambiguous. The court stated that the "mere failure to provide a definition for a term involving coverage did not necessarily render the term ambiguous." *Id.* at 65–66 (internal citation omitted). Further, the terms in the insurance policy should be given their plain and ordinary meaning. The court then relied on *Webster's Dictionary* to define the terms of the exclusion and stated that it need not resort to "legal sophistry" to interpret the provision. *Id.* at 66.

79. 896 F. Supp. 618 (E.D. La. 1995).

80. *Id.* at 623.

81. The policy's exclusion provided thus: "1. [General Star] will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss. . . . The enforcement of any ordinance or law: (1) Regulating the construction, use or repair of any property." *Id.* at 623.

the ‘enforcement’ of the ordinance must cause the loss complained of in order for the exclusion to apply.”<sup>82</sup> Relying on the “plain, unambiguous language of the policy,” the court found that the exclusion applied:

Although it is true that the fire caused the damage to the property which necessitated the repair, the policy language specifically states that losses arising from enforcement of an ordinance or regulation, such as the building code requirement for a sprinkler system, are excluded “regardless of any other cause or event that contributes concurrently or in any sequence to the loss.” In other words, the Court finds that it is inconsequential under the language of the policy whether the fire which caused the loss occurred before the repair that required installation of a sprinkler system. Plaintiffs’ costs arising from enforcement of the City of New Orleans’ building code, even though they arose from the repair of the hotel after the fire, are simply excluded according to the policy’s plain, unambiguous language.<sup>83</sup>

In sum, many courts have upheld code upgrade exclusions and have found no coverage for code upgrade costs. These courts have found the policy exclusion to be clear and unambiguous. They have also rejected the policyholder argument that the exclusion applies only where the loss is caused by acts of a governmental authority pursuant to law or ordinance.

## 2. Courts Declining to Enforce Code Upgrade Exclusions

Some courts have found code upgrade exclusions to be inapplicable for various reasons. Several courts, for example, have found that the exclusion applies only when the loss was solely caused by enforcement of a law or ordinance such as where authorities destroy a building pursuant to a law or ordinance authorizing the razing to prevent the spread of fire and not where a covered event such as a fire triggered the law’s enforcement.<sup>84</sup>

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82. *Id.*

83. *Id.* at 623–24.

84. See e.g., *Daniels v. Aetna Life & Cas. Co.*, No IP 81-1413-C, 1983 WL 13684 (S.D. Ind. June 29, 1983) (holding that ordinance or law exclusion did not exclude increased costs of disposing of chemically contaminated debris); *Dupe v. Allstate Ins. Co.*, 62 P.3d 1024, 1029–30 (Colo. Ct. App. 2002) (holding that ordinance or law exclusion did not preclude coverage for building code upgrades where “there was no ‘physical loss’ caused by the building code requirements”); *Garnett v. Transam. Ins. Servs.*, 800 P.2d 656, 666 (Idaho 1990) (holding that ordinance or law exclusion did not exclude coverage where loss itself was not caused by enforcement of a law or ordinance); *Farmers Union Mut. Ins. Co. v. Oakland*, 825 P.2d 554, 556 (Mont. 1992) (holding that cause of loss was fire and not regulations regarding asbestos removal and therefore ordinance or law exclusion did not apply); *Haas v. Audubon Indem. Co.*, 722 So. 2d 1022, 1029 (La. Ct. App. 1998) (holding that law and ordinance exclusion did not preclude coverage for asbestos cleanup required by the EPA regulations where the release of asbestos was caused by vandalism of the insured’s building); *Throgs Neck Bagels, Inc. v. GA Ins. Co. of N.Y.*, 671 N.Y.S.2d 66, 69–70 (N.Y. App. Div. 1998) (holding that cause of loss was ignition of gasoline spilled from tank truck and not building department’s order to vacate the building); *Starzewski v. Unigard Ins. Group*, 810 P.2d 58, 62 (Wash. Ct. App.

*Garnett v. Transamerica Insurance Services*<sup>85</sup> is illustrative of these cases. There, a fire damaged a commercial building owned by the Garnetts and insured by Transamerica. Local building codes required various upgrades to the building, and Transamerica denied coverage for those costs based on the policy's code upgrade exclusion.<sup>86</sup> The court narrowly read the exclusion to apply only where the loss itself is caused by a law or ordinance, not where a law or ordinance required upgrades after a loss:

As we read this provision, it does not limit Transamerica's obligation for the cost of repair or replacement of the building when a loss has occurred that is covered by the policy, but merely states that if the loss itself is caused by an ordinance or law, there is no coverage. For instance, if some safety improvement of a building to which no other loss had occurred were required by an ordinance or law, Transamerica would not be liable. However, when the cost of repairing or replacing a building that had been damaged by fire is increased by the requirements of an ordinance or law, Transamerica is not relieved of that cost.<sup>87</sup>

Other courts have reached the same conclusion by finding a code upgrade exclusion to be ambiguous. *Fire Insurance Exchange v. Superior Court*<sup>88</sup> is a recent example. There, after their homes were damaged or destroyed in the 1994 Northridge earthquake, a group of homeowners sought to recover the costs of building code upgrades.<sup>89</sup> The policies excluded coverage for building code upgrades: "We do not insure for loss either consisting of, or caused directly or indirectly by . . . 5. Enforcement of any ordinance or law regulating construction, repair or demolition of a building

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1991) (holding that insurer may not rely on ordinance or law exclusion because increased cost of repair due to code upgrades resulted from fire and not from enforcement of any ordinance or law); *see also* Unified Sch. Dist. No. 285 v. St. Paul Fire & Marine Ins. Co., 627 P.2d 1147, 1153-54 (Kan. Ct. App. 1981) (holding insurer liable for increased repair costs to school due to enforcement of building code despite ordinance or law exclusion), *overruled on other grounds by* Thomas v. Am. Family Mut. Ins. Co., 666 P.2d 676 (Kan. 1983); *Norfolk & Dedham Mut. Fire Ins. Co. v. DeMarta*, 799 F. Supp. 33, 36 (E.D. Pa. 1992) (law and ordinance exclusion inapplicable to case in which city demolished partially collapsed building where hidden decay caused collapse); *Sentinel Mgmt. Co. v. N.H. Ins. Co.*, 563 N.W.2d 296, 302 (Minn. Ct. App. 1997) (holding that release of asbestos was a covered loss and law and ordinance exclusion did not apply to preclude coverage where a law or order might require asbestos cleanup in the future).

85. 800 P.2d 656 (Idaho 1990).

86. *Id.* at 666. The policy exclusion read thus: "1. This policy does not insure against loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss[:] A. Loss occasioned directly or indirectly by enforcement of any ordinance or law regulating the use, construction, repair, or demolition of buildings or structures including debris removal expense." *Id.* at 662.

87. *Id.* at 666.

88. 10 Cal. Rptr. 3d 617 (Ct. App. 2004).

89. *Id.* at 621.

or other structure, unless endorsed to this policy.”<sup>90</sup> The court agreed that this exclusion could reasonably be read to exclude coverage for the code upgrades.<sup>91</sup> But it also found that it would be reasonable for an insured to interpret the exclusion “as describing a peril, not a type of damage or loss.”<sup>92</sup> Therefore, the court found coverage for the code upgrade costs because they were caused by the covered peril of earthquake and not by law or ordinance.<sup>93</sup>

Some policy forms have been revised to address decisions like *Garnett* and *Fire Insurance Exchange*. For example, the ISO forms specifically state that the exclusion applies when the loss was solely caused by enforcement of a law or ordinance and where a covered event such as a fire triggered the law’s enforcement:

This exclusion, Ordinance or Law, applies whether the loss results from: (1) An ordinance or law that is enforced even if the property has not been damaged; or (2) 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.<sup>94</sup>

One court has found a code upgrade exclusion inapplicable by relying on the insured’s reasonable expectations. In *Bering Strait School District v. RLI Insurance Co.*,<sup>95</sup> a ten-year-old high school building owned by Bering Strait School District was destroyed by fire.<sup>96</sup> The school district expended an additional \$206,466 in order to rebuild the school up to code.<sup>97</sup> The school district’s two all-risk insurers, RLI and Lexington Insurance Company, denied coverage for the code upgrade costs.<sup>98</sup> The appellate court found that because the insured had replacement cost coverage, the insured reasonably expected that insurance would cover the cost to build a replace-

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90. *Id.* at 627.

91. *Id.* at 627–29.

92. *Id.* at 632.

93. *Id.* at 636.

94. ISO STANDARD PROPERTY POLICY CP 00 99 04 02, at 9–10; ISO CAUSES OF LOSS—SPECIAL FORM CP 10 30 04 02, at 1; ISO CAUSES OF LOSS—BROAD FORM CP 10 20 04 02, at 2–3; ISO CAUSES OF LOSS—BASIC FORM CP 10 10 04 02, at 2.

95. 873 P.2d 1292 (Alaska 1994).

96. *Id.* at 1293.

97. *Id.* There were four types of code upgrades: architectural, structural, mechanical, and electrical. Some of the upgrades included an increase in the size and number of certain beams and joists, an increase in the nailing patterns and connectors related to new wind load standards, guardrails, and emergency lighting. *Id.* at 1293 n.1.

98. *Id.* at 1293. The insuring agreement in both the RLI and Lexington policies provided that the limit of liability would be the “cost to repair or replace the property with material of like kind and quality . . . without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair.” *Id.* at 1294. Both policies also included a specific law and ordinance exclusion. *Id.*

ment code-compliant building in the event that the original building was destroyed.<sup>99</sup> The court reasoned that “[b]uilding owners buy replacement cost insurance so that if their buildings are destroyed they can be replaced and their uses restored without cost.”<sup>100</sup> The court also concluded that the code upgrades did not result in a building of such a fundamentally different kind and quality that it fell beyond the policy’s “like kind and quality” limitation:

A reasonable insured would not expect to be denied coverage because a replacement building is not a clone of the building which was destroyed. In an important sense, replacement cost policies almost always provide the insured with a building different from that which was destroyed. The insured receives a new building, which should invariably be of better quality and worth more than the building which is replaced.<sup>101</sup>

Thus, in *Bering Strait*, the Alaska Supreme Court effectively wrote the exclusion out of the policy based on the insured’s “reasonable expectations” argument.

At least one court relied on an implied promise to replace the functional use of the insured property to avoid application of a code upgrade exclusion. In *Unified School District No. 285 v. St. Paul Fire & Marine Insurance Co.*,<sup>102</sup> a tornado damaged the insured’s high school building and school bus garage.<sup>103</sup> A Kansas statute required compliance with the Uniform Building Code whenever certain types of repairs were made to school facilities. The insurers argued that the code upgrade exclusion precluded coverage for the costs required to repair the damaged buildings in compliance with the Uniform Building Code.<sup>104</sup> The appellate court agreed with the trial court that

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99. *Id.* at 1295.

100. *Id.* The court explained the reasonable expectations doctrine as follows: “The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.” *Id.*

101. *Id.* at 1297–98. The court also agreed with the insured’s argument that the law and ordinance exclusion applied only when the loss was solely caused by enforcement of an ordinance and not where a covered event such as a fire triggered enforcement of the ordinance or law. *Id.* at 1296. The court relied upon cases from other jurisdictions that have accepted this argument and concluded that the law and ordinance exclusion “may reasonably be construed not to apply in the present case.” *Id.* at 1297. The court cited *Garnett v. Transamerica Insurance Services*, 800 P.2d 656 (Idaho 1990), *Farmers Union Mutual Insurance Co. v. Oakland*, 825 P.2d 554 (Mont. 1992); *Starczewski v. Unigard Insurance Group*, 810 P.2d 58 (Wash. Ct. App. 1991); and *Daniels v. Aetna Life & Casualty Co.*, No. IP 81-1413-C, 1983 WL 13684 (S.D. Ind. June 29, 1983), as authorities supporting the school district’s argument that the building codes did not “occasion” or cause the increased costs. *Bering Strait*, 873 P.2d at 1296–97.

102. 627 P.2d 1147 (Kan. Ct. App. 1981), *overruled on other grounds* by *Thomas v. Am. Family Mut. Ins. Co.*, 666 P.2d 676 (Kan. 1983).

103. *Unified Sch. Dist.*, 627 P.2d at 1149.

104. *Id.* at 1153. The exclusions provide that the insurer was not liable for any loss “[o]ccasioned by enforcement of any local or state ordinance or law regulating the construction,

the insurers “insured the functional use of the buildings in question as school facilities,” which were, necessarily, subject to the Uniform Building Code. As such, the insurers contractually assumed code upgrade coverage in the replacement cost endorsements.<sup>105</sup> In sum, the court found that the insurers, “having contractually undertaken to insure plaintiff’s structures as school facilities, facilities known to be subject to the Building Code, have also assumed liability for the costs of complying with that Code upon loss.”<sup>106</sup>

As illustrated by the foregoing cases, courts have not uniformly construed code upgrade exclusions. Nor is there any way to reconcile these decisions because the courts have addressed essentially identical policy language. It appears that the courts that have found the exclusion unenforceable have been largely result-oriented. These courts have wrestled with the question of who—the insurer or the insured—should bear the increased cost of construction required by laws and ordinances.

However, in placing the burden on the insurers, courts have ignored not only the intent of the parties as expressed by the policy language but also the fact that most insurers offer specific code upgrade coverage.<sup>107</sup> If an insured declines to purchase code upgrade coverage, that insured could not reasonably expect coverage for building code upgrades.

#### IV. BUILDING CODES PROHIBITING REPAIR OF DAMAGED BUILDINGS

Some building codes prohibit the repair of a damaged building, usually when it is damaged to a certain extent.<sup>108</sup> The enforceability of code upgrade exclusions in these instances depends upon whether the jurisdiction

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repair or demolition of buildings unless such liability has been specifically assumed under this policy.” *Id.*

105. *Id.*

106. *Id.*

107. In enforcing a “building laws” exclusion, at least one court has noted the availability of a code upgrade endorsement. See *Cohen Furniture Co. v. St. Paul Ins. Co. of Ill.*, 573 N.E.2d 851, 854 (Ill. App. Ct. 1991). In *Cohen Furniture*, the insured’s furniture store was destroyed by fire. A local building code require the installation of a fire suppression system in the reconstructed store. *Id.* at 852. The insurer denied coverage for the increased cost of a fire suppression system, relying on the following policy exclusion: “Building laws. We won’t cover loss that is caused directly or indirectly by the enforcement of any law governing the use, construction, repair or demolition of buildings or other structures, including removal of debris. Such loss is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.” *Id.* at 853. The court found that the “exclusion is clear and unambiguous, and does not contravene the public policy of this state.” *Id.* at 855. The court also noted that “[a]s aside we note that the record indicates that the defendant offers an endorsement which changes the basic policy to cover losses resulting from the enforcement of building laws.” *Id.* at 854.

108. See, e.g., *Danzeisen v. Selective Ins. Co. of Am.*, 689 A.2d 798, 799 (N.J. Super. Ct. App. Div. 1997) (addressing a New Brunswick city ordinance providing that “any non-conforming structure destroyed to an extent greater than fifty percent of its assessed value shall not be reconstructed”).

has a valued policy statute. A valued policy statute requires the payment of the insurance policy's face amount in the event of a "total loss."<sup>109</sup> The general rule in valued policy states is that code upgrade exclusions are inapplicable if a law or ordinance prohibits the repair or reconstruction of a damaged building; in this situation, the insured has sustained a constructive total loss, requiring payment of the policy amount.<sup>110</sup> But in cases of partial loss, courts have reached a different result and have upheld code upgrade exclusions.<sup>111</sup> These courts have reasoned that the law and ordinance exclusions do not conflict with valued policy statutes where something less than the entire insured property sustains a total loss.<sup>112</sup>

Generally, courts in non-valued policy states have enforced code upgrade exclusions in cases where a building law prohibits repair.<sup>113</sup> These courts have been careful to distinguish the cases from those arising in valued policy states where a statute supersedes the code upgrade exclusion.<sup>114</sup>

#### V. OTHER POLICY PROVISIONS PRECLUDING CODE UPGRADE COSTS

A few courts have found no coverage for code upgrade costs even in the absence of a specific law and ordinance exclusion.<sup>115</sup> In *Bresbears v. Indiana*

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109. See generally 12 LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE 3D §§ 175:103 (2005). Approximately twenty-one states statutorily mandate valued policies. *Misc. Prop., Valued Policy Laws—State Summary*, FIRE, CASUALTY & SURETY BULLS., M.125-1-M.125-4 (2002).

110. See, e.g., *Algernon Blair Group, Inc. v. U.S. Fid. & Guar. Co.*, 821 F.2d 597, 600 (11th Cir. 1987) (applying Tennessee law); *City of N.Y. Fire Ins. Co. v. Chapman*, 76 F.2d 76, 77 (7th Cir. 1935) (applying Wisconsin law); *Rutherford v. Royal Ins. Co.*, 12 F.2d 880, 882 (4th Cir. 1926) (applying North Carolina law); *Fid. & Guar. Ins. Corp. v. Mondzelewski*, 115 A.2d 697, 700 (Del. 1955); *Netherlands Ins. Co. v. Fowler*, 181 So. 2d 692, 693 (Fla. Dist. Ct. App. 1966); *Hertog v. Milwaukee Mut. Ins. Co.*, 415 N.W.2d 370, 372-73 (Minn. Ct. App. 1988); *Stahlberg v. Travelers Indem. Co.*, 568 S.W.2d 79, 84 (Mo. Ct. App. 1978); *Feinbloom v. Camden Fire Ins. Ass'n*, 149 A.2d 616, 618-19 (N.J. Super. Ct. App. Div. 1959); *Stevick v. Nw. G.F. Mut. Ins. Co.*, 281 N.W.2d 60, 63-64 (N.D. 1979); *Scanlan v. Home Ins. Co.*, 79 S.W.2d 186, 189-90 (Tex. Civ. App. 1935); *Gimbels Midwest, Inc. v. Nw. Nat'l Ins. Co. of Milwaukee*, 240 N.W.2d 140, 144-46 (Wis. 1976).

111. See, e.g., *Regency Baptist Temple v. Ins. Co. of N. Am.*, 352 So. 2d 1242, 1243-44 (Fla. Dist. Ct. App. 1977); *Bradford v. Home Ins. Co.*, 384 A.2d 52, 53-54 (Me. 1978).

112. See *Regency Baptist Temple*, 352 So. 2d at 1244 (where part of a roof collapsed under standing water because the entire roof was installed with the trusses upside down, the law and ordinance exclusion precluded coverage for the cost to replace the entire roof as required by municipal ordinance); *Bradford*, 384 A.2d at 54 (where a truck backed over a leaching field, the law and ordinance exclusion in a standard fire policy precluded coverage for the cost to obtain a septic system complying with the Maine Plumbing Code).

113. See, e.g., *Weinstein v. Commerce Ins. Co.*, 82 S.E.2d 477, 479-82 (Va. 1954) (law and ordinance provision in a standard fire policy precluded coverage for loss where local zoning ordinances prohibited repair to fire-damaged apartments).

114. *Cohen Furniture Co. v. St. Paul Ins. Co. of Ill.*, 573 N.E.2d 851, 853-54 (Ill. App. Ct. 1991); *Weinstein*, 82 S.E.2d at 479-80.

115. See, e.g., *McCorkle v. State Farm Ins. Co.*, 270 Cal. Rptr. 492, 494-95 (Ct. App. 1990); *Roberts v. Allied Group Ins. Co.*, 901 P.2d 317, 318-19 (Wash. Ct. App. 1995).

*Lumbermens Mutual Insurance Co.*,<sup>116</sup> for example, the California Court of Appeal relied on the like kind and quality limitation in the standard fire policy's insuring clause in denying the insured recovery for the code-required increased repair costs.<sup>117</sup> The court reasoned that this language does not require an insurer to provide the insured with a structurally more valuable building than was destroyed even if the structural improvements are required to bring the replacement structure into compliance with current building codes.<sup>118</sup>

The Court of Appeals of Washington in *Roberts v. Allied Group Insurance Co.*<sup>119</sup> reached a similar conclusion. There, Roberts' home was totally destroyed by fire. Although Roberts' policy included a guaranteed replacement cost endorsement, Allied, the all-risk homeowners insurer, denied coverage for the increased costs relating to building a new home conforming to current building code requirements.<sup>120</sup> Allied relied on language in the guaranteed replacement cost endorsement that limited coverage to "the cost of repair or replacement, but not exceeding the replacement cost of that part of the building damaged, for like construction and use on the same premises."<sup>121</sup> The policy defined *replacement cost* as "the cost, at the time of loss, to repair or replace the damaged property with new materials of like kind and quality, without deduction for depreciation."<sup>122</sup> In affirming the trial court's ruling in favor of Allied, the appellate court held that *like kind and quality* and *like construction* did not include code upgrades.<sup>123</sup>

Similarly, in *McCorkle v. State Farm Insurance Co.*,<sup>124</sup> the California Court of Appeal held that a replacement cost policy's "equivalent construction" provision precluded coverage for the cost to replace a fire-damaged wooden garage floor with a cement floor as required by current building codes.<sup>125</sup> The court relied on *Bresbears* and found that the *like kind and quality* language of the standard fire policy was substantially similar to the *equivalent construction* language in the McCorkles' policy.<sup>126</sup> The court also found that

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116. 63 Cal. Rptr. 879 (Ct. App. 1967).

117. *Id.* at 883. In *Bresbears*, the insured's building was extensively damaged by fire on March 10, 1963. The insured submitted a claim that included the repair costs required by the Sacramento County Building Code. *Id.* at 882.

118. *Id.* at 883.

119. 901 P.2d 317 (Wash. Ct. App. 1995).

120. *Id.* at 318.

121. *Id.*

122. *Id.*

123. *Id.* The court cited *McCorkle*, *Gouin*, and *Hewins* in a footnote to support this conclusion.

124. 270 Cal. Rptr. 492 (Ct. App. 1990).

125. The State Farm policy provided that the insurer would pay "the replacement cost of that part of the building damaged for equivalent construction and use on the same premises." *Id.* at 494.

126. *Id.* at 494-95.

its conclusion was “consistent with the purpose of fire insurance—to compensate for the actual loss sustained, not to place the insured in a better position than he or she was before the fire.”<sup>127</sup> Thus, the court found that a garage in which a cement floor cost nearly twice as much as one with a wooden floor was not equivalent construction.<sup>128</sup>

Thus far, California and Washington are the only two jurisdictions that have relied on *like kind and quality* or *equivalent construction* language to preclude coverage for code upgrade costs.<sup>129</sup> Two other jurisdictions, on the other hand, have rejected this view. In *Bering Strait*, for example, the Alaska Supreme Court, citing the reasonable expectations of the insured, accepted the insured’s argument that the building code upgrades “did not result in a building of such a fundamentally different kind and quality that it falls beyond the like kind and quality limitation.”<sup>130</sup> More recently, in *Dupre v. Allstate Insurance Co.*,<sup>131</sup> the Colorado Court of Appeals found that the equivalent construction provision could reasonably be interpreted to include the cost of returning the insured property to its equivalent or similar use as a habitable structure, which included the cost of complying with regulations necessary to render the insured dwelling habitable.<sup>132</sup>

This issue likely will arise infrequently because most property insurance policies either specifically exclude or specifically cover law and ordinance exposures; and, thus, insurers will have little reason to rely on *like kind and quality* or *equivalent construction* language to deny coverage for building code upgrades.

## VII. CODE UPGRADE COVERAGE

### A. Policy Provisions

Many commercial and some residential property policies specifically provide coverage for code upgrade costs either as part of the basic policy or by endorsement.<sup>133</sup> Code upgrade coverage provisions, of course, are intended

127. *Id.* at 495.

128. *Id.*

129. Of course, if the policy includes specific code upgrade coverage, a court will not exclude coverage for code upgrades based on the *equivalent construction* language. *See, e.g., DePhelps v. Safeco Ins. Co. of Am.*, 65 P.3d 1234, 1238 (Wash. Ct. App. 2003).

130. 873 P.2d 1292, 1297 (Alaska 1994).

131. 62 P.3d 1024 (Colo. Ct. App. 2002).

132. *Id.* at 1030–32. In *Dupre*, the insured property was a ninety-one-year-old house. After a fire damaged the property, a building inspection revealed that the property did not comply with many of the current building codes. *Id.* at 1026.

133. In some states, like California and Florida, homeowners insurers must offer code upgrade coverage. *See* CAL. INS. CODE ANN. §§ 10101, 10102 (West Supp. 2009); FLA. STAT. ANN. § 627.7011 (West Supp. 2008). Both states enacted the statutes after large-scale disasters, the 1992 Hurricane Andrew in Florida and the 1993 Oakland Hills fires in California. *See, e.g.,* Leslie Berkman & Mark Platte, *Many Fire Victims Insurance Falls Short*, L.A. TIMES,

to protect insureds from exposure to a risk of loss from the operation of building laws and ordinances.<sup>134</sup>

Under ISO's commercial property endorsement, three separate code upgrade coverages are offered, and the parties elect what coverages will apply.<sup>135</sup> Coverage A covers loss to the undamaged portion of the building caused by ordinances or laws that require demolition or that regulate construction, repair, zoning, or land use.<sup>136</sup> Under Coverage B, the insurer pays for the cost to demolish the undamaged portion of any building caused by the enforcement of any law or ordinance.<sup>137</sup> Coverage C covers the increased cost of construction when it is a "consequence" of enforcement of laws or ordinances.<sup>138</sup>

ISO's endorsement expressly excludes from coverage any loss caused by enforcement of laws requiring the insured or others to test for or clean up mold or pollutants.<sup>139</sup> The ISO endorsement also expressly excludes from coverage any costs associated with laws that the insured was required to comply with prior to the direct damage loss.<sup>140</sup>

ISO's Ordinance or Law—Increased Period of Restoration endorsement is used to add coverage for the business interruption and extra expense coverages.<sup>141</sup> This endorsement extends the compensable period of res-

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Nov. 4, 1993, at A30; *State Farm Must Pay for Upgrades*, ORLANDO SENTINEL, Dec. 15, 1993, at C1.

134. See ROBINSON & GIBSON, *supra* note 1, at VI.F.2–VI.F.4.

135. The election is indicated by the appropriate entry in the endorsement schedule. See ISO ORDINANCE OR LAW COVERAGE CP 04 05 04 02.

136. ISO's Coverage A provides in part: "1. Coverage A—Coverage For Loss To The Undamaged Portion Of The Building[:] With respect to the building that has sustained covered direct physical damage, we will pay under Coverage A for the loss in value of the undamaged portion of the building as a consequence of enforcement of an ordinance or law that requires demolition of undamaged parts of the same building." ISO ORDINANCE OR LAW COVERAGE CP 04 05 04 02, at 2.

137. ISO's Coverage B provides in part: "2. Coverage B—Demolition Cost Coverage[:] With respect to the building that has sustained covered direct physical damage, we will pay the cost to demolish and clear the site of undamaged parts of the same building, as a consequence of enforcement of an ordinance or law that requires demolition of undamaged parts of the same building." *Id.* at 2.

138. ISO's Coverage C provides in part: "3. Coverage C—Increased Cost Of Construction Coverage[:] a. With respect to the building that has sustained covered direct physical damage, we will pay for the increased cost to: (1) Repair or reconstruct damaged portions of that building; and/or (2) Reconstruct or remodel undamaged portions of that building; whether or not demolition is required; when the increased cost is a consequence of enforcement of the minimum requirements of the ordinance or law." *Id.* at 2.

139. *Id.*

140. *Id.* at 4.

141. The ISO Ordinance or Law—Increased Period of Restoration states in part: "A. If a Covered Cause of Loss occurs to property at the premises described in the Declarations, coverage is extended to include the amount of actual and necessary loss you sustain during the increased period of "suspension" of "operations" caused by or resulting from the enforcement of any ordinance or law that: 1. Regulates the construction or repair of any property;

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toration to include any additional period of time needed to repair or rebuild the damaged property in compliance with an ordinance or law that regulates the construction or repair of property or requires the demolition of undamaged portions of the property.<sup>142</sup> Like the property damage endorsement, this endorsement expressly excludes from coverage any loss caused by enforcement of laws that require the insured to test for or clean up pollutants.<sup>143</sup>

Some of the issues that may arise under code upgrade provisions are discussed below.

### B. Covered Code Upgrades

Policies with code upgrade coverage generally provide coverage for the increased cost of complying with building codes governing the repair, reconstruction, or demolition of the damaged property. But for what code upgrades is the insurer liable? Is the insurer liable for those upgrades believed by the building officials to be required or only those upgrades that the building code legally required?

The court in *Mesaba Holdings, Inc. v. Federal Insurance Co.*<sup>144</sup> considered this issue and found that an insurer is liable for the cost of complying with code upgrades actually required by the building officials. There, the insured, Mesaba Holdings, sought coverage for the cost of an upgraded fire suppression system after its maintenance hangar was damaged in a windstorm.<sup>145</sup> County officials advised Mesaba that when it rebuilt the hangar, it would have to comply with the requirements of NFPA 409, which required a “far more sophisticated fire suppression system” than existed before the loss.<sup>146</sup> Mesaba’s rebuilt hangar was considerably larger than the preexisting one, and Federal argued that the county was wrong and that Mesaba would not have been required to comply with NFPA 409 if it had rebuilt the hangar to its prior dimensions.<sup>147</sup> The county building officials, however, testified that the county’s ordinances would have required the upgraded fire suppression system even if the hangar had been rebuilt to its original size.<sup>148</sup> The court found coverage, holding that the “County has the right to interpret its own laws and Mesaba has no obligation to contest

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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.” ISO ORDINANCE OR LAW—INCREASED PERIOD OF RESTORATION CP 15 31 04 02.

142. *See id.*

143. *See id.*

144. No. Civ. 02-660RHKJGL, 2002 WL 31856384 (D. Minn. Dec. 19, 2002).

145. *Id.* at \*1.

146. *Id.*

147. *Id.* at \*4.

148. *Id.*

its decisions.”<sup>149</sup> So, here, the court found applicable the codes that were believed by the building official to apply.<sup>150</sup>

The court in *Commonwealth Insurance Co. v. Grays Harbor County*<sup>151</sup> took a slightly different approach but reached essentially the same conclusion. There, the court held that coverage should be measured by “what a reasonable lay insurance purchaser would believe the code allows the city to enforce.”<sup>152</sup> *Commonwealth* arose out of the July 1999 Satsop earthquake, which severely damaged the Grays Harbor County Courthouse.<sup>153</sup> The county’s repair proposal included code upgrades to six nonconforming conditions of the courthouse: egress, accessibility, fire alarm, fire protections, ventilation, and seismic systems.<sup>154</sup> Commonwealth’s repair proposal, however, did not include any upgrades. The City of Montesano building official decided to condition the construction permit on the implementation of the six code upgrades.<sup>155</sup>

A dispute developed with respect to the scope of coverage afforded under the code upgrade coverage provision in the policy. Commonwealth argued that the building official lacked legal authority to require the upgrades and, thus, that coverage should be measured by what the building code legally requires.<sup>156</sup> The county, on the other hand, argued that coverage should be measured by what the building official reasonably believed the code entailed.<sup>157</sup> The court, however, rejected both arguments and held that “the test is what a reasonable lay insurance purchaser would believe the code allows the city to enforce.”<sup>158</sup> The court then examined the city building code and held “that a reasonable lay purchaser of this insurance would conclude that even though the nonconforming uses existed before the earthquake, the County’s need to obtain a permit to repair the damage gave the building official authority to require safety upgrades.”<sup>159</sup> The court then held that Commonwealth’s policy covered the safety upgrades if the county could show that the building official enforced the code upgrades because of the earthquake damage.<sup>160</sup>

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149. *Id.*

150. *Id.* The court also added that even if the test was not what codes the county believed applied, “the Court finds Wayne County’s interpretation of its laws reasonable and persuasive.” *Id.*

151. 84 P.3d 304 (Wash. Ct. App. 2004).

152. *Id.* at 307.

153. *Id.* at 305.

154. *Id.*

155. *Id.*

156. *Id.* at 306.

157. *Id.* at 307.

158. *Id.*

159. *Id.* at 308.

160. *Id.*

Because Commonwealth's language was unambiguous as to the requirement that the earthquake damage must cause enforcement of the building code, the court said that there was no coverage if the building official enforced the code because the scope of the county's proposal also included alterations unrelated to the earthquake damage.<sup>161</sup> Because it was not clear whether the building official required the code upgrades solely because of the earthquake or because of the expanded scope of the county's proposal, the court remanded the matter to the trial court for that determination.<sup>162</sup>

*Mesaba Holdings* and *Commonwealth* are the only cases that have addressed the question of the code upgrades for which the insurer is liable. Both cases suggest that the insurer is liable for the cost of complying with all building code upgrades actually required by the building officials. Although the *Commonwealth* court purportedly rejected that argument, it effectively did the same thing. Indeed, in the vast majority of cases, the test adopted by the *Commonwealth* court—that is, liability is measured by “what a reasonable lay insurance purchaser would believe the code allow[ed] the city to enforce”—will result in a finding that the insurer is liable for the cost of all building code upgrades actually required by the building officials. The only possible exceptions would be those rare cases in which the building official ordered compliance with codes that very clearly did not apply.

### C. Liability for Post-Loss Enacted Codes

In some cases, an insured's repair of a damaged building is governed by laws or ordinances that took effect after the date of loss. This often occurs after a large-scale natural disaster like an earthquake or hurricane.<sup>163</sup>

Whether there is coverage for the cost of complying with post-loss code upgrades likely will turn on the policy language. Some policy forms, including the ISO forms, specifically limit the insurer's liability to those increased costs necessitated by laws and ordinances “in force at the time of loss.”<sup>164</sup> If the policy includes this type of limiting language, that limitation

161. *Id.* at 309.

162. *Id.*

163. See, e.g., *B A Props., Inc. v. Aetna Cas. & Sur. Co.*, 221 F. Supp. 2d 592 (D.V.I. 2002), vacated, 273 F. Supp. 2d 673, 677 (D.V.I. 2003) (court rejected insured's argument that coverage included cost to comply with building code requirements adopted after Hurricane Marilyn); Hugo Martin, *Officials May Toughen Codes Before Formal Upgrades*, L.A. TIMES, July 7, 1994, at B4 (discussing new code requirements enacted after the 1994 Northridge earthquake).

164. The ISO endorsement states thus: “B. Application of Coverage[:] The Coverage(s) provided by this endorsement apply only if both B.1 and B.2 are satisfied and are then subject to qualification set forth in B.3. 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.” ISO ORDINANCE OR LAW COVERAGE CP 04 05 04 20 at 1; see also ISO ORDINANCE OR LAW—INCREASED PERIOD OF RESTORATION CP 15 31 04 02.

should be upheld because courts will enforce policy language that is plain and unambiguous as written.<sup>165</sup> Indeed, the plain and ordinary dictionary definition of *in force* is “valid, operative, binding.”<sup>166</sup>

A more difficult question arises in cases where the *in force* type of language is not present. On the one hand, insurers could reasonably argue that there is no coverage under the endorsement for the increased cost of construction due to building laws and ordinances that took effect after the date of loss. Specifically, insurers could reasonably argue that the loss did not cause the enforcement of any post-loss law or ordinance because those laws and ordinances were not in effect at the time of the loss. This argument is supported by the general insurance law principle that the amount of the loss is fixed as of the date of the loss.<sup>167</sup> This interpretation also is consistent with the insurer’s intent. Indeed, most underwriters believe that the liability of the insurer cannot be increased by post-loss events.

Two public policy arguments also support the position that there is no coverage for the cost of complying with post-loss laws and ordinances. First, a construction that extends coverage to post-loss building laws and ordinances eliminates any underwriting certainty and allows post-loss legislation to act as an *ex post facto* law for the insurance company’s obligations. Second, this construction encourages an open-ended adjustment period. In other words, an insurer could literally be paying for the cost to comply with laws and ordinances enacted many months or even years after a loss.

On the other hand, insureds may argue that there is coverage for the costs of complying with post-loss enacted laws and ordinances in the absence of any explicit language limiting the coverage to only those laws and ordinances in effect at the time of loss. Furthermore, insureds may argue that they reasonably expected the policy to provide code upgrade coverage for post-loss laws and ordinances. Specifically, code upgrade coverage

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165. See, e.g., *New Castle County v. Hartford Accident & Indem. Co.*, 970 F.2d 1267, 1270 (3d Cir. 1992) (applying Delaware law); *Jakobson Shipyard, Inc. v. Aetna Cas. & Sur. Co.*, 961 F.2d 387, 389 (2d Cir. 1992) (applying New York law); *Damar, Inc. v. U.S. Fire Ins. Co.*, 856 F. Supp. 679, 681 (N.D. Ga. 1993); *Hermitage Ins. Co. v. Dahms*, 842 F. Supp. 319, 323 (N.D. Ill. 1994); *AIU Ins. Co. v. Superior Court*, 799 P.2d 1253, 1264 (Cal. 1990); *Kane v. Royal Ins. Co. of Am.*, 768 P.2d 678, 680 (Colo. 1989); *Levier v. Koppenheffer*, 879 P.2d 40, 44–45 (Kan. Ct. App. 1994); *Hoffman Constr. Co. v. Fred S. James & Co.*, 836 P.2d 703, 706 (Or. 1992).

166. WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 887 (2002).

167. See, e.g., *Ash v. Safeco Ins. Co. of Am.*, 652 F. Supp. 148, 152 (C.D. Cal. 1986) (“The amount of Ash’s loss became fixed immediately after the occurrence of the landslide and submission of the claim in 1984.”), *vacated*, 117 F.R.D. 433 (C.D. Cal. 1987); see also *Hughes v. Potomac Ins. Co.*, 18 Cal. Rptr. 650, 655–56 (Ct. App. 1962) (endorsing concept that the amount of a loss is fixed immediately after the insured occurrence in holding that third party’s repair of damage did not relieve property insurer of its liability under the policy), *disapproved on another point* in *Sabella v. Wisler* 377 P.2d 889, 897 (Cal. 1963).

endorsements are designed to protect insureds from exposure to a risk of loss from the operation of federal, state, and local building laws and ordinances.<sup>168</sup> Where replacement cost coverage is provided, insureds may argue that it is reasonable to expect coverage under the endorsement for the increased cost of construction necessitated by both building laws in force at the time of loss and building laws that become effective after the date of loss, unless the policy explicitly stated otherwise.

At least one federal district court has rejected similar arguments and held that an insurer was not liable for the cost of complying with post-loss enacted building codes. In *B A Properties, Inc. v. Aetna Casualty & Surety Co.*,<sup>169</sup> the insured owned a hotel in the U.S. Virgin Islands that was severely damaged by Hurricane Marilyn. The insured sought coverage for the cost to comply with building code upgrades that were adopted after the hurricane.<sup>170</sup> Although the policy included no *in force* type of limiting language, the insurers argued that they were liable only for the cost of complying with the code as it existed at the time of the loss and not as it was modified after the loss.<sup>171</sup> In rejecting the insured's argument, the court relied on the policy language that the policy covered "replacement cost new . . . at time and place of loss . . . whether or not building is actually rebuilt or replaced including the increased cost occasioned by the enforcement of any ordinance."<sup>172</sup> The court reasoned that this language was "plain and unambiguous with regard to when the replacement cost is to be measured; it is to be measured at the time of loss, not the time of replacement."<sup>173</sup> The court further reasoned that "[t]o include the costs associated with the enforcement of ordinances enacted after Hurricane Marilyn would be to interpret the Policy as determining the replacement cost at the time of replacement, rather than at the time of loss."<sup>174</sup>

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168. See ROBINSON & GIBSON, *supra* note 1, at VI.F.2–VI.F.4.

169. 221 F. Supp. 2d 592 (D.V.I. 2002), *vacated*, 273 F. Supp. 2d 673 (D.V.I. 2003).

170. *Id.* at 676.

171. *Id.* The specific language read thus: "In case of loss, the basis of adjustment shall be as follows: A. Buildings, structures, improvements, and betterments owned by the Insured at replacement cost new (plus custom duties, taxes, or assessments if incurred) without deduction for depreciation at time and place of loss, which in no event will exceed the cost for rebuilding, repairing or replacing on the original site whether or not building is actually rebuilt or replaced including the increased cost occasioned by the enforcement of any ordinance, and including the value of the undamaged part of facility." *B A Props.*, 221 F. Supp. 2d at 598–99, *vacated*, 273 F. Supp. 2d 673.

172. 273 F. Supp. 2d at 677.

173. *Id.*

174. *Id.* The court vacated an earlier ruling by a different judge who had found coverage for the post-loss enacted ordinances. Citing the absence of any limiting language, the prior judge had found coverage: "The plain language of the policy provision stated above mandates coverage for costs resulting from code upgrades that are enforced against a property under construction following an insured loss. This language does not distinguish between

The presence of explicit language limiting the coverage to only those laws and ordinances in effect at the time of loss should preclude coverage for the cost of complying with any post-loss enacted building codes. But as *B A Properties* illustrates, the result may be the same even in the absence of that explicit language. Indeed, if the policy provides that replacement cost is measured at the time of loss, not the time of replacement, then there should be no coverage for the cost of complying with any post-loss enacted building codes.

#### D. *Change in Building Size or Configuration*

Some building laws may require a new building to be constructed in a size or configuration that is different from the prior building. For example, a five-story office building may have to be rebuilt as a six-story building in order to comply with current building codes.

Some policies include language that limits the insurer's exposure in these types of cases. For instance, some policies specifically limit the replacement cost coverage to those costs actually expended in rebuilding or replacing with like height, floor area, and style. Other policies provide for replacement cost but state that the rebuilt structure is not to exceed the size and operating capacity that existed on the date of loss. To the extent that the insured's claim is for a larger building with a different configuration, these costs are not covered under such policies.

Courts also may rely upon a policy's *equivalent construction* or *like kind and quality* language to preclude coverage for a larger-size building or a building of different construction. The *McCorkle*<sup>175</sup> case supports this position. In *McCorkle*, the court declined an insured's claim for the cost to replace a wooden garage floor with a concrete floor after the structure burned down, despite the fact that local codes required a concrete floor and the insured had replacement cost coverage.<sup>176</sup> The policy's replacement cost coverage provided "[f]or equivalent construction and use on the same premises."<sup>177</sup> The court held that a concrete floor was not equivalent to a wooden floor and denied the additional cost.<sup>178</sup> The court reasoned that such an upgrade

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increase[d] building costs due to enforcement of a pre-existing or a newly enacted ordinance. Thus, if during the course of rebuilding an insured property following a covered loss, such as occurred here, the Legislature modifies the Virgin Islands Building Code by imposing higher standards that are immediately enforceable against properties still under construction, the insured is entitled to any increased cost occasioned by enforcing the upgraded code provisions. This is what is meant by the policy term, 'at replacement cost new.'" *B A Props.*, 221 F. Supp. 2d at 599, *vacated*, 273 F. Supp. 2d 673.

175. 270 Cal. Rptr. 492 (Ct. App. 1990).

176. *Id.* at 495.

177. *Id.* at 494.

178. *Id.* at 495.

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was contrary to the requirement to replace the property with “equivalent construction and use on the same premises.”<sup>179</sup>

Although an insurer covers many types of code upgrade costs, it limits the extent of those costs by requiring that the new building be of like height, floor area, and style. Because these code upgrade costs for the insured’s buildings are for adding more floor space and more rooms, this additional cost is not covered. But the insurer’s argument will be weaker where policies do not specifically limit costs to a rebuilt building with like height, floor area, and style.

#### E. Coverage for the Cost to Correct Preexisting Code Violations

Another issue that can arise is whether an insured can get coverage after a loss for the cost of remedying preexisting code violations. Here, it is important to distinguish the situation where the insured building was grandfathered into compliance with codes existing at the time of the loss. In such a case, the owner had no pre-loss obligation to comply with building codes because of the grandfathered status.<sup>180</sup> But a coverage issue does arise where an insured building does not comply with current codes and then, after a loss, the insured is required to bring all or part of the building up to code. Some policies include specific language to preclude coverage in these instances while others do not.

##### 1. Specific Policy Limitation for Preexisting Code Violations

Many policies include specific language that precludes coverage for the costs of complying with preexisting code violations.<sup>181</sup> For example, ISO’s law and ordinance endorsement provides thus: “G. Under this endorsement we will not pay for loss due to any ordinance or law that: (1) You were required to comply with before the loss, even if the building was undamaged; and (2) You failed to comply with.”<sup>182</sup>

In *Celebrate Windsor, Inc. v. Harleysville Worcester Insurance Co.*,<sup>183</sup> the court construed this ISO language. There, a substantial portion of the canopy covering the insured’s unique tent-like performing arts center developed tears and collapsed under the weight of accumulated ice and snow.<sup>184</sup> The insured, known as Summer Wind Performing Arts Center, sought to re-

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179. *Id.*

180. *Mesaba Holdings, Inc. v. Fed. Ins. Co.*, No. Civ. 02-660RHKJGL, 2002 WL 31856384, at \*5 (D. Minn. Dec. 19, 2002).

181. *See, e.g., id.* at \*2 (construing policy that provided code upgrade coverage “except we will not include any costs: a. for ordinance or law that you were required to, but failed to, comply with before the loss”).

182. ISO ORDINANCE OR LAW COVERAGE CP 04 05 04 02, at 4.

183. No. 3:05CV282, 2006 WL 1169816 (D. Conn. May 2, 2006).

184. *Id.* at \*1.

cover the cost of an improved and upgraded facility. As the insurer argued, the proposed replacement was “designed, engineered and constructed to correct design defects in the [original] structure that led to the collapse of the canopy” as well as to bring the structure into compliance with existing building codes.<sup>185</sup> Although the Harleysville policy included code upgrade coverage, that coverage was subject to the following limitation: “[Harleysville] will not pay any costs due to an ordinance or law that: (a) You were required to comply with before the loss even when the building was undamaged; and (b) You failed to comply with.”<sup>186</sup>

In ruling in favor of Harleysville, the court found that this language “could not be clearer” and that it precluded coverage for the increased costs attributable to complying with the preexisting code violations.<sup>187</sup>

## 2. No Specific Policy Limitation for Preexisting Code Violations

Several federal district courts have examined whether there is coverage for preexisting code violations in the absence of specific policy language precluding coverage for such costs. As seen below, the courts are divided.

*a. Courts Finding Coverage*—Two federal district courts have found coverage for the cost to comply with preexisting building code violations that were discovered after a loss.

In *Commonwealth Insurance Co. v. Benihana of Tokyo, Inc.*,<sup>188</sup> for example, a fire damaged part of Benihana’s restaurant.<sup>189</sup> The fire damaged four ventilation hoods, but the city fire department required that Benihana also repair sixteen undamaged ventilation hoods because they did not comply with the existing fire code.<sup>190</sup> Commonwealth, whose policy provided code upgrade coverage, paid for the cost to repair the four damaged ventilation hoods in compliance with the current code, but it refused to pay for the cost to repair the sixteen undamaged ones.<sup>191</sup> The court rejected Com-

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185. *Id.* at \*15–16.

186. *Id.* at \*4.

187. *Id.* at \*18.

188. No. 3:96-CV-0826-R, 1997 WL 361617 (N.D. Tex. June 19, 1997).

189. *Id.* at \*1.

190. *Id.* at \*2.

191. *Id.* at \*1. The code upgrade provision stated: “Subject to the terms, conditions, and limitations of this Policy including endorsements thereon, in the event of loss or damage by a peril insured under this Policy that causes the enforcement of any law or ordinance regulating the construction or repair of damaged facilities, this Company shall be liable for: . . . (c) the increased cost of repair or reconstruction of the damaged and undamaged portion of the facility on the same or another site but limited to the minimum requirements of such law or ordinance regulating the repair or reconstruction of the damaged property on the same site. However, the Company shall not be liable for any increased cost of construction loss unless the damaged facility is actually rebuilt or replaced. (d) any increase in the business interruption, extra expense and rental value loss arising out of the additional time required to comply with said law or ordinance.” *Id.* at \*2.

monwealth's argument that the ventilation hoods were in violation of an existing law at the time of the fire and, thus, that the fire did not cause the law's enforcement:

While it is true that the fire department may have conducted an inspection at any time, the fact is that the inspection was triggered by the occurrence of the fire. Moreover, the fact that the code may have been applicable before the fire is irrelevant since the bylaw [code upgrade endorsement] does not specify that the regulation being enforced be newly applicable or that the fire hazard not have previously existed. Instead, the language simply requires the enforcement of *any* law or ordinance, regardless of whether the hazard or violation was preexisting.<sup>192</sup>

The court also suggested that if Commonwealth did not want to provide coverage for this risk, it could have used different policy language:

[T]he language is broad and encompasses the enforcement of any law after a covered peril occurs. The peril does not have to cause the noncompliance; rather, the enforcement of the code must have been caused by the peril. If the company wanted to limit coverage, as it attempts to do *ex post facto* through its motion, then it should have made the desired limitations explicit in its policy language.<sup>193</sup>

The court in *Davidson Hotel Co. v. St. Paul Fire & Marine Insurance Co.*<sup>194</sup> reached the same conclusion without citing *Benihana*. There, the insured's hotel sustained water damage after an inadvertent activation of the building's sprinkler system.<sup>195</sup> Davidson sought recovery of the costs incurred when city building inspectors inspected the hotel and required compliance with numerous preexisting building code violations.<sup>196</sup> St. Paul argued that there was no coverage for these costs under the code upgrade provision.<sup>197</sup> The court, however, disagreed and found coverage. First, the court found that the policy language was clear and that it applied to the "enforcement of any law or ordinance in effect at the time of covered loss."<sup>198</sup> The court

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192. *Id.* at \*3 (footnote omitted).

193. *Id.* at \*3 n.20.

194. 136 F. Supp. 2d 901 (W.D. Tenn. 2001).

195. *Id.* at 904.

196. *Id.* at 910.

197. *Id.* at 911. The St. Paul policy included the following provision: "J. Demolition and Increased Cost of Construction[;] In the event of loss or damage under this policy that causes the enforcement of any law or ordinance in effect at the time of covered loss, regulating the construction, repair or use of property, this Company shall be liable for: . . . 3. increased cost of repair or reconstruction of the damaged and undamaged property on the same or another site intended for the same occupancy, and limited to the costs that would have incurred in order to comply with the minimum requirements of such law or ordinance regulating the repair or reconstruction of the damaged property on the same site." *Id.* at 910–11.

198. *Id.* at 911.

reasoned that the “breadth of the provision is not diminished by any limiting language regarding the ‘grandfathered’ status of code violations.”<sup>199</sup> Second, the *Davidson Hotel* court found that the insurer’s liability extended to the cost of upgrading code violations discovered during an inspection following the sprinkler discharge incident because “in the first place, the inspection occurred only because of the incident giving rise to liability and, secondly, the thoroughness of the inspection was also a result of the incident.”<sup>200</sup> The court dismissed St. Paul’s argument that a finding of liability would be contrary to public policy by suggesting that it was not realistic to think that an insured would forgo compliance with building and fire codes to wait for the occurrence of an insured event, particularly in light of the potential tort liability for one who makes an economic decision that jeopardizes safety.<sup>201</sup>

*b. Courts Finding No Coverage*—In contrast to *Benihana* and *Davidson Hotel*, three federal district courts have reached the opposite conclusion, holding that there was no coverage for the cost of complying with preexisting code violations.

In *St. Paul Fire & Marine Insurance Co. v. Darlak Motor Inns, Inc.*,<sup>202</sup> for example, the court reviewed coverage under the identical policy provision that was at issue in *Davidson Hotel*.<sup>203</sup> There, an HVAC unit in a room at the Darlak Motor Inn malfunctioned and caused a fire. The fire damage was limited to six rooms.<sup>204</sup> City building officials inspected the Darlak Motor Inn and discovered numerous preexisting building code violations.<sup>205</sup> The building official advised that the city would close Darlak Motor Inn unless the code upgrades were made.<sup>206</sup>

In finding no coverage for the cost of complying with the preexisting code violations, the *Darlak* court first looked at the policy’s grant of coverage, which provided that the policy insured against risk of direct physical loss or damage to property, and applied that coverage grant to limit other relevant policy provisions.<sup>207</sup> The court reasoned that the claimed code upgrade costs did not fit within the policy’s grant of coverage because “[n]one of the code violations found by [the inspector] were the result of damage done by the fire.”<sup>208</sup> Second, the court reasoned that “the fire loss and related damage did not ‘cause’ the enforcement of any laws or

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199. *Id.*

200. *Id.*

201. *Id.*

202. No. 3:97-CV-1559, 1999 WL 33755848 (M.D. Pa. Mar. 9, 1999).

203. *See id.* at \*2.

204. *Id.* at \*1.

205. The code violations related to elevators, emergency lighting, smoke detectors, electrical systems, air handlers, panic devices, and emergency generators. *Id.* at \*1 n.1.

206. *Id.*

207. *Id.* at \*2.

208. *Id.* at \*4.

ordinances.<sup>209</sup> Although acknowledging that the code violations may not have been discovered absent the fire, the court concluded that “the fire did not cause the enforcement of the code provisions because the violations . . . existed independent of the fire damage.”<sup>210</sup> In other words, and as the court noted, “the fire did not cause the conditions that rendered the Darlak Motor Inn to be out of compliance with the code.”<sup>211</sup> Finally, the *Darlak* court also examined the *Benibana* decision and found it to be “unpersuasive,” noting that “[w]hile the fire may have triggered the discovery of the violations, the cause of the enforcement of the violations was the code violations that existed independent of the fire.”<sup>212</sup>

The court in *61 Jane Street Tenants Corp. v. Great American Insurance Co.*<sup>213</sup> reached the same conclusion. There, the accidental ignition of escaped natural gas caused a fire in the stove of an apartment. In containing the fire, gas service for the entire building was turned off. Under New York City building regulations, gas service could not be restored until the building’s gas distribution system was tested for leaks.<sup>214</sup> To pass the test, numerous old valves had to be replaced and numerous preexisting leaks had to be repaired.<sup>215</sup> The insured sought to recover these additional costs under its property insurance policy. The policy expressly provided that the insurer will not pay for any loss or damage resulting from the enforcement of any “ordinance or law regulating construction, use or repair” of the property, specifically including “the cost associated with the enforcement of any ordinance or law which requires [the insured] to test plumbing, gas or other building systems for integrity or condition.”<sup>216</sup>

Among other reasons, the court found no coverage for the costs associated with the new valves and repaired leaks because they did not cause the fire:

An all-risk policy is intended to cover casualty losses from events such as fires. But it is undisputed that the stove fire here did not damage the gas system or cause the system to fail the test. Rather, the weaknesses in the system predated the fire; the fire was simply the occasion for their discovery. . . .

. . . [P]laintiff contends that the system was working well despite these defects, and that, had it not been for the fire and the Fire Department’s turning off the gas, neither testing nor repair would have been required. But this does not make the fire the proximate cause of the testing and repairs. Had firefighters

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209. *Id.*

210. *Id.*

211. *Id.*

212. *Id.* at \*5.

213. No. 00 Civ. 1049 (GEL), 2001 WL 40774 (S.D.N.Y. Jan. 17, 2001).

214. *Id.* at \*1 (citing N.Y.C. CODE § 27-922(d)).

215. *Id.*

216. *Id.* (quoting policy language).

damaged the gas system in the course of putting out the blaze, that damage would clearly have been covered, as surely as damage caused by flames or smoke. On the other hand, had the firefighters, in the course of responding to the fire, noticed pre-existing fire or building code violations, and ordered them corrected, the “ordinance or law” exclusion would apply; the fact that the violations would have gone undetected but for the fire would not turn the cost of complying with the code into a fire loss.<sup>217</sup>

More recently, the court in *Chattanooga Bank Associates v. Fidelity & Deposit Co. of Maryland*<sup>218</sup> examined the decisions in *Benihana*, *Davidson Hotel*, and *Darlak* and found that there was no coverage for the cost of remedying preexisting code violations to nondamaged portions of a building. There, two fires occurred on the second floor of a bank building. After the fires, city building officials inspected the building and found it to be in violation of several building codes.<sup>219</sup> A local judge issued an order requiring the owner to immediately correct the violations.<sup>220</sup> Chattanooga Bank argued that its insurer, Fidelity, was liable for the cost of remedying all code violations discovered during the postfire inspections, regardless of their relationship to the fire.<sup>221</sup>

The court concluded that Fidelity was not liable for the cost of remedying code violations discovered in areas unaffected by the fires.<sup>222</sup> It also concluded that liability under the policy was not created based on the fact that the inspection that uncovered the violations would not have taken place absent the fires.<sup>223</sup> The court reasoned that the policy could not be read as intending coverage for the discovery of code violations that did not result from the fires.<sup>224</sup> Also, the court reasoned 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.”<sup>225</sup>

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217. *Id.* at \*5 (internal citations omitted).

218. 301 F. Supp. 2d 774 (E.D. Tenn. 2004).

219. *Id.* at 776. Violations “included damaged and non-code electrical wiring and fixtures, inoperable and non-code fire alarm system, non-code elevator emergency system, damaged and non-code stairway lighting and emergency signage, [and] defective standpipe valves,” among others. *Id.* (internal quotation marks omitted).

220. *Id.*

221. *Id.* at 777. The Fidelity policy included the following code upgrade coverage provision: “*Demolition and Increased Cost of Construction*[:] In the event of loss or damage under this coverage part that causes the enforcement of any law or ordinance regulating the construction or repair of damaged facilities, the company shall be liable for: . . . C. Increased cost of repair or reconstruction of the damaged and undamaged facility on the same or another site and limited to the minimum requirements of such law or ordinance regulating the repair or reconstruction of the damaged property on the same site.” *Id.* at 776–77.

222. *Id.* at 779.

223. *Id.*

224. *Id.*

225. *Id.* at 779–80.

In reaching this conclusion, the *Chattanooga Bank* court expressly rejected the holdings in *Benihana* and *Davidson Hotel* and instead joined in the reasoning of the *Darлак* court. The court reached its conclusion through examination of the contract language, including, in particular, the demolition and increased cost of construction (DICC) language read in conjunction with the policy's coverage grant: "7. *Perils Insured Against*[:] This coverage part insures against all risk of *direct physical loss of or damage* to property described herein including general average, salvage, and all other charges on shipments covered hereunder, except as hereinafter excluded."<sup>226</sup> The court concluded that this language acted to limit the insurer's liability "to only those cases where the loss or damage results from the peril."<sup>227</sup> Next, the court looked to the DICC provision, which provided that the clause applied "[i]n the event of loss or damage under this coverage part that *causes* the enforcement of any law or ordinance regulating the construction or repair of damaged facilities."<sup>228</sup> The court rejected the insured's argument that the fire was the cause of the enforcement of the building code because the building inspection was triggered by the fire and resulted in the enforcement of the building code.<sup>229</sup> Instead, the court found that "[a]lthough the violations might have remained undiscovered if not for the fire, the violations in question existed independent of the fire and the fire cannot be said to have 'caused' the enforcement of a building code, which was at all times subject to enforcement."<sup>230</sup> Additionally, the court found that the DICC provision referring to the "increased cost of repair or reconstruction of the damaged and undamaged facility" limits liability for undamaged portions of a facility to repair or reconstruction.<sup>231</sup> The court said that "[u]pgrades to undamaged portions of a building simply do not amount to repair or reconstruction."<sup>232</sup>

The courts' analyses in *Darлак*, *61 Jane Street*, and *Chattanooga Bank* are sound. Indeed, the general concept is that the insurance policy covers only

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226. *Id.* at 780.

227. *Id.*

228. *Id.*

229. *Id.*

230. *Id.*

231. *Id.* at 780–81.

232. *Id.* at 781. The court said that this provision applied in a different situation: "Such a clause would more likely apply to a situation where the damage occurred to a degree that required total or partial replacement of an insured building with a new building or part of a building. Such new construction, and any modification to the undamaged structure to allow compatibility between the new and old, would necessar[il]ly be required to comply with current building codes. Therefore the 'repair or reconstruction' language can be interpreted consistently with the limitations evident in clause seven and the other portions of clause fourteen." *Id.* (footnote omitted). The court found a genuine issue of fact regarding whether each building code violation was in the area of the building that suffered fire damage. *Id.*

losses caused by a covered peril.<sup>233</sup> As the courts in *Chattanooga Bank and 61 Jane Street* observed, the noncompliance with the codes predated the loss, and the loss was simply the occasion for the discovery of the preexisting code violations. So, there should be no coverage for the cost to make undamaged portions of the building code compliant. Indeed, the loss did not cause the insured to upgrade the building; rather the code required the upgrade regardless of whether the loss occurred.

Public policy considerations also weigh against finding coverage for the cost of correcting preexisting code violations. To be sure, the law should encourage insureds to comply with building codes whenever they apply. This is particularly true for codes that require immediate compliance or retrofitting because the proper authorities have determined that such immediate compliance is essential to protect the public both from personal injury and property damage. If insureds are permitted to remain in non-compliance with building codes and then, after a loss, pass the cost of compliance onto their property insurers, they may be encouraged to postpone code compliance until such a loss occurs. Indeed, interpreting policy in this manner could dissuade insureds from complying with the law until such time as the building suffered damage and the insured could recover the cost of code compliance from its insurer. An insured that flagrantly violated the law for years by not upgrading its building should not be rewarded by obtaining an additional insurance recovery.

#### VIII. CONCLUSION

Building owners are often required to rebuild damaged or destroyed buildings in compliance with various building codes or laws. These costs, of course, can be substantial, and building owners often seek coverage for these costs from their property insurer. Most courts have enforced clear and unambiguous code upgrade exclusions. But even where the policy excludes coverage for code upgrades, some courts have ignored the policy language and found coverage for building code upgrades. Thus, the enforceability of code upgrade exclusions may depend on the specific policy language and jurisdiction.

Many policies now provide specific code upgrade coverage. Even so, coverage issues do arise. These issues include, among others, whether there is coverage for the costs of complying with preexisting code violations. Here, again, the resolution of coverage issues may depend on the specific policy language and jurisdiction.

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233. See, e.g., *Garvey v. State Farm Fire & Cas. Co.*, 770 P.2d 704, 710 (Cal. 1989); *Graham v. Pub. Employees Mut. Ins. Co.*, 656 P.2d 1077, 1081 (Wash. 1983).