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## Technical Advisory

TA 259

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### Subject: New Building Codes – No Pain, No Gain

**Background:** The Three Little Pigs learned a valuable lesson about building construction that we could all benefit from. Yet it seems to be human nature to put off doing the right thing until forced to by circumstances, usually bad circumstances. And when bad circumstances happen on a large scale, government often intervenes and requires compliance with measures that in reality we should have been adhering to all along.

However, improving building codes and similar common sense safety measures can be both costly and disruptive, in the short term. But with the pain of complying with stronger building codes, comes the gain of reduced losses to life and property in the future.

In the aftermath of Hurricanes Katrina and Rita in 2005, there was a concerted effort by a number of interest group, including insurance, to strengthen the Louisiana building code. In December 2005, Gov. Blanco signed Act 12 (SB 44) into law, creating the first uniform, statewide building code. The code became effective statewide on January 1, 2007.

Building code laws have been around for quite a long time. Among the first were those created by Hammurabi, the ruler of Babylonia nearly 3,400 years ago. Hammurabi is well known for codifying the laws of his kingdom, which has served as foundations for modern law (he is depicted on several U.S. government buildings, including the House of Representatives building and the Supreme Court building). It might surprise us in the modern world to know that several of the almost 300 laws etched into the 7-foot stone obelisk dealt with construction. (The engraved stone containing Hammurabi's Code is on display at the Louvre Museum in Paris.) The laws dealing with building codes are brief, clear, and in some cases harsh – compared to the current International Building Code, which runs over 700 pages.

*229. If a builder build a house for some one, and does not construct it properly, and the house which he built falls in and kills its owner, then that builder shall be put to death.*

*230. If it kills the son of the owner, the son of that builder shall be put to death.*

*232. If it ruins goods, he shall make compensation for all that has been ruined, and inasmuch as he did not construct properly this house which he built and it fell, he shall re-erect the house from his own means.*

*233. If a builder build a house for some one, even though he has not yet completed it; if then the walls seem toppling, the builder must make the walls solid from his own means.*

235. *If a shipbuilder build a boat for some one, and do not make it tight, if during that same year that boat is sent away and suffers injury, the shipbuilder shall take the boat apart and put it together tight at his own expense. The tight boat he shall give to the boat owner.*

Major catastrophes throughout history have caused stronger building codes to be put in place. Research shows that some of the most infamous, such as the Great London Fire of 1666, the Great Chicago Fire of 1871, and the 1906 Great San Francisco Earthquake and Fire, were responsible for substantial improvements in building codes and safety measures.

George Washington and Thomas Jefferson were strongly supportive of building regulations that improved public safety. In 1865, New Orleans adopted one of the first laws allowing for the inspection of public buildings. In addition, many industrial accidents that occurred during the growth of the industrial revolution led to many improvements in construction requirements and safety procedures.

In more recent times, the tragic fire in 1942 at the Cocoanut Grove Night Club in Boston had far reaching effects on efforts to improve building safety through stronger codes. Shocked by the nearly 500 deaths, Massachusetts later enacted the first statewide fire code. Due to a large loss of life at a single set of revolving doors at one of the limited exit points, the code required that a building with revolving doors also have a bank of outward-opening doors, and that they be equipped with what have become to be know as “panic bars” to quickly allow for escape. This illustrates that building codes are far more comprehensive than just mandating building materials and techniques. Some deal with entry and exit requirements, what engineers call “ingress and egress” specifications. The new Massachusetts code also mandated sprinkler systems in certain buildings.

The success of the reform efforts in Massachusetts provided a strong impetus for insurers and other interests to work actively in other states to upgrade and strengthen building codes and safety measures.

Hurricanes and their catastrophic damage have been the impetus for major revisions in coastal building codes. Following the four major hurricanes to hit Florida in 2004, it was widely reported in the press that buildings built since the stronger codes were adopted following Hurricane Andrew in 1992 survived the 2004 storms strikingly better than buildings built prior to 1992. Industry studies show that post-Hurricane Andrew construction in Florida had 30% fewer claims than buildings built prior to the stronger codes. In addition, post-Andrew homes saw only 10-20% with claims, vs. over 50% of homes built prior to Andrew. In another study, it was estimated that approximately 60% of property losses during Hurricane Andrew were due to human error in poor design or installation methods.

Louisiana’s laudable action to enact stronger building codes will certainly prove worth the effort and expense, although we hope that proof is a long time coming.

**Main Points:** The enactment of the new statewide Louisiana building code with the Governor’s signature of SB 44 (now Act 12) in December 2005 created two key actions. First, Louisiana moved to adopt the International Building Codes statewide, although some requirements are more stringent in coastal parishes (such as wind resistance of 130-150 mph).

Second, a 19-member Louisiana State Uniform Construction Code Council was created, with the primary task being to educate and certify building officials who will be inspecting and enforcing the new code. In addition, the Council will review the code every three years.

Another provision of Act 12 amends the Louisiana insurance code with the addition of 22:1407(J), which stipulates “Any insurer who makes application to the Louisiana Rating Commission for a rate filing shall provide in their application details as to what discount or reduced rate will be given to insureds who comply with the State Uniform Construction Code.”

The International Building Code (IBC) itself is a recent development, first published in 2000 by the International Codes Council (ICC). The ICC, headquartered in Washington, DC, was formed in 1994 as a nonprofit organization for the purpose of developing a single set of comprehensive and coordinated national model construction codes. It grew out of the efforts to consolidate the three principal regional code organizations: the Building Officials and Code Administrators International (BOCA), the International Conference of Building Officials (ICBO), and the Southern Building Code Congress International (SBCCI).

The International Building Codes (commonly called the I-Codes) are actually comprised of over a dozen specific types of codes, such as the International Residential Code, International Fire Code, International Mechanical Code, etc. The I-Codes are reviewed and published by the ICC every three years. For more information, go to the ICC web site at: [www.iccsafe.org](http://www.iccsafe.org).

### **Building Codes and Insurance**

***In general – Ordinance or Law exclusions.*** Property policies covering dwellings or commercial buildings typically limit or exclude the increased costs of complying with “any ordinance or law,” which would include not only building codes, but also laws such as Americans with Disabilities Act, which includes requirements related to access and accommodation, such as elevators, ramps, etc.

Building code compliance requirements will be an issue for insureds in two basic situations: repairs, additions or renovations to *existing* buildings, and *new* construction. It is not uncommon for the threshold of compliance with current building codes to be set at 50%, so that damage or renovation involving more than 50% of an existing building’s value will trigger compliance.

While stronger building codes unquestionably will provide significant benefit to policyholders in the long run, there is no doubt that meeting the new codes will increase the costs of repair to current buildings, and to new construction as well. This increased cost is compounded by the fact that many insureds believe that under replacement cost provisions of an insurance policy, the policy will pay actual repair or replacement costs, up to the limit of insurance. As indicated above, the ordinance or law exclusions prohibit any increased costs due to the compliance requirements of any law.

However, endorsements are often available to buy back coverage. ISO has promulgated Ordinance & Law endorsements in the Homeowners (and Dwelling) Program, as well as in Commercial Property (direct damage and business income). Availability of the coverage options depends on each individual market.

**Homeowners Policy.** The ISO Homeowners Policy (HO-2000 edition) contains the following exclusion:

#### **SECTION I – EXCLUSIONS**

**A.** *We do not insure for 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. These exclusions apply whether or not the loss event results in widespread damage or affects a substantial area.*

##### **1. Ordinance Or Law**

*Ordinance Or Law means any ordinance or law:*

- a. Requiring or regulating the construction, demolition, remodeling, renovation or repair of property, including removal of any resulting debris. This Exclusion A.1.a. does not apply to the amount of coverage that may be provided for in E.11. Ordinance Or Law under Section I – Property Coverages;
- b. The requirements of which result in a loss in value to property; or
- c. Requiring 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.

*Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.*

*This Exclusion A.1. applies whether or not the property has been physically damaged.*

As referenced in the exclusion above, the Additional Coverages ("E.11" above) contain the following provision related to the ordinance or law exclusion:

## **SECTION I – PROPERTY COVERAGES**

### **E. Additional Coverages**

#### **11. Ordinance Or Law**

- a. You may use up to 10% of the limit of liability that applies to Coverage A for the increased costs you incur due to the enforcement of any ordinance or law which requires or regulates:
  - (1) The construction, demolition, remodeling, renovation or repair of that part of a covered building or other structure damaged by a Peril Insured Against;
  - (2) The demolition and reconstruction of the undamaged part of a covered building or other structure, when that building or other structure must be totally demolished because of damage by a Peril Insured Against to another part of that covered building or other structure; or
  - (3) The remodeling, removal or replacement of the portion of the undamaged part of a covered building or other structure necessary to complete the remodeling, repair or replacement of that part of the covered building or other structure damaged by a Peril Insured Against.
- b. You may use all or part of this ordinance or law coverage to pay for the increased costs you incur to remove debris resulting from the construction, demolition, remodeling, renovation, repair or replacement of property as stated in a. above.
- c. We do not cover:
  - (1) The loss in value to any covered building or other structure due to the requirements of any ordinance or law; or
  - (2) The costs to comply with any ordinance or law which 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 in or on any covered building or other structure.
    - Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.*

*This coverage is additional insurance.*

**Comment:** This Additional Coverage provides up to 10% of the Coverage A limit for the increased costs of complying with an ordinance or law.

**Endorsement:** HO 04 77 – Ordinance or Law Increased Amount of Coverage is used to supplement the amount automatically provided in Additional Coverage #11 – Ordinance or Law. (Refer to ISO manual Rule 303.)

For the Dwelling Program, use endorsement DP 04 71 – Ordinance or Law Increased Amount of Coverage. (Refer to ISO manual Rule 303.) (Louisiana endorsement DWG-E277).

**Commercial Property – Direct Damage.** The ISO Commercial Property Causes of Loss Forms contain the following exclusion:

**B. Exclusions**

1. We 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.

**a. Ordinance Or Law**

*The enforcement of any ordinance or law:*

(1) *Regulating the construction, use or repair of any property; or*

(2) *Requiring the tearing down of any property, including the cost of removing its debris.*

*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.*

**Endorsement:** CP 04 05 – Ordinance or Law Coverage provides three key coverage options, described below. (Refer to ISO Rule 38.D.)

**Coverage A – Coverage for Loss to the Undamaged Portion of the Building.** This coverage option is needed for partial losses, where the undamaged portion of the building must be demolished due to a building ordinance. This coverage option allows the value of the undamaged portion to be covered. When electing this coverage, there is no amount of insurance shown on the schedule portion of the endorsement. A mark in the checkbox for Coverage A activates the coverage, thus the entire limit of insurance is available for the loss. (There is a premium charge for the option.)

**Coverage B – Demolition Cost Coverage.** While the Building and Personal Property Coverage Form includes some Debris Removal expense as an Additional Coverage, it only applies to “*remove debris of Covered Property caused by or resulting from a Covered Cause of Loss.*” Where undamaged parts of the building are required to be demolished due to a building ordinance (which can be covered by electing Coverage A above), the expense of demolishing the building and removing this debris is not covered by the Additional Coverage Debris Removal provision in the Building and Personal Property Coverage Form. The cause of loss to the undamaged portion of the building is the operation of a building ordinance, and not a Covered Cause of Loss. A limit of insurance for Coverage B must be selected in the schedule portion of the endorsement.

**Coverage C – Increased Cost of Construction Coverage.** This option provides coverage for the increased costs to repair, reconstruct or remodel covered building property “*when the increased cost is a consequence of enforcement of building, zoning or land use ordinance or law.*” A limit of insurance for Coverage C must be selected in the schedule portion of the endorsement. ISO Rule 38.D. also allows for Coverages B and C to be combined under a single blanket limit, which is shown as another option on the schedule portion of the endorsement.

**Comment #1:** The need for Coverage A is sometimes questioned in cases involving a partial loss, where a building ordinance requires that the undamaged portion be demolished, and it is thus argued that the entire loss should be considered a “constructive total loss.” While the Commercial Property forms do not include the phrase, the argument is often bolstered by claims under the provisions of a state’s Valued Policy Law. Research of insurance literature finds some court cases that have upheld this argument, although the exclusionary language has changed over the years, and the outcome of these cases might be different under the revised language. However, the intent of the Ordinance of

Law exclusion seems clear, and an insured might well end up in litigation with his insurer over the issue. Securing Coverage A with the CP 04 05 would eliminate this potential problem.

**Comment #2:** Determining the correct amount of insurance for Coverage B and Coverage C is not an easy task. In the case of Coverage B, the amount of money needed to demolish the undamaged portion of the building, and remove the resultant debris, would vary with each loss. As mentioned above, some building ordinances have a threshold for compliance when damage, repair or renovation involves 51% or more of the building's value, which means that the limit of insurance for Coverage B could possibly need to be sufficient to cover demolition and debris removal costs for as much as 49% of the building.

For Coverage C, determining the degree to which a particular building might be "out of code" requires not only an extensive knowledge of all pertinent local, state and federal (such as ADA, etc.) code requirements, but it also requires keeping current on all changes and upgrades to all codes.

One common misconception by insureds is that if they have a brand new building, built in compliance with all applicable codes, there is no need for Coverage C. The error in this line of reasoning is that building codes change. As mentioned above, the I-Codes change every three years, and the Louisiana State Uniform Construction Code will also be reviewed every three years. So a building that is current today won't necessarily be current in the future.

Therefore, arriving at an appropriate amount of insurance for Coverage B and Coverage C requires special training and knowledge. From a practical standpoint, as well as an E&O standpoint, agents should avoid recommending a limit of insurance for these coverage options.

**Comment #3 – 1995 edition vs. 2000 edition.** The ISO changes in the Commercial Property program in 2000 edition impacted two issues related to Ordinance & Law coverage.

First, in the Building and Personal Property Form, a new Additional Coverage was added for Increased Cost of Construction (ICC). It is available only for buildings insured on a Replacement Cost basis. The key provision is as follows:

*(2) In the event of damage by a Covered Cause of Loss to a building that is Covered Property, we will pay the increased costs incurred to comply with enforcement of an ordinance or law in the course of repair, rebuilding or replacement of damaged parts of that property.*

The new Additional Coverage for ICC provides a limit of \$10,000 or 5% of the Limit of Insurance on the building, whichever is less. The new ICC coverage is additional insurance. The amount of coverage under the new ICC Additional Coverage cannot be increased, thus the need remains for the CP 04 05 – Ordinance or Law Coverage.

Second, the 2000 edition of the CP 04 05 – Ordinance or Law Coverage endorsement added provisions for situations in which there was damage by a covered and an uncovered cause of loss. The revised endorsement includes an example of a loss in which there was both wind and flood damage, and as result of the damage, compliance with current building codes is required.

Under a new provision in the endorsement, the amount of payment is based on a “proportional loss payment” formula. The amount of any payment under Coverages A, B or C of the endorsement is based on the proportion of damage to the building done by a Covered Cause of Loss. In the example included in the endorsement, a \$200,000 building sustains \$100,000 in damages – \$30,000 from wind, and \$70,000 from flood. The damage meets the threshold for compliance with current building codes. Since 30% of the damage is caused by wind, the CP 04 07 will pay for 30% of any covered loss under Coverages A, B or C.

While not addressed in the revised endorsement, the wind vs. flood scenario raises another issue. Suppose there was wind-only damage to a building, and the damage was sufficient to trigger a building ordinance which was unrelated to wind construction, such as floodplain management, or ADA, etc. The insuring agreements for Coverages A, B and C are based on damage by a Covered Cause of Loss, and there is no requirement that the ordinance be related solely to the cause of loss, just that the need to comply arise from a covered loss. This rationale seems consistent with the proportionate payment formula discussed above, in that a covered loss sets the provisions of the endorsement in motion.

**Commercial Property – Business Income.** Coverage under the Business Income Coverage Form is triggered by damage to property at the described location, by a Covered Cause of Loss, requiring a necessary suspension of operations during the period of restoration.

Within the Definitions section, there is a limitation for the “period of restoration” that relates to building codes and Ordinance & Law coverage, as follows:

#### **G. DEFINITIONS**

##### **3. "Period of Restoration"**

*"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."*

**Comment:** Where an insured is required to comply with building codes or other ordinances or laws following a covered loss to the building, it seems highly likely that it will take longer to repair the damage than would otherwise be the case. Since this would probably lengthen the time the business operations are suspended, the business income coverage would not continue into this longer period, since the cause is related to compliance with an ordinance or law, which is not covered within the definition of “period of restoration.”

**Endorsement:** Use of endorsement CP 15 31 – Ordinance or Law – Increased Period of Restoration addresses the limitation in the “period of restoration” language in the Business Income Coverage Form. The endorsement provides the following coverage provision:

*"Period of restoration" includes any increased period required to repair or reconstruct the property to comply with the minimum standards of any ordinance or law, in force at the time of loss, that regulates the construction or repair, or requires the tearing*

*down of any property.*

**Flood – NFIP.** For NFIP Flood Policies written on either homes (Dwelling Form) or businesses (General Property Form), there is an automatic limit of \$30,000 for Increased Cost of Compliance (ICC) under Coverage D. This coverage applies to covered structures that are required to comply with state or local floodplain management law or ordinance affecting repair or reconstruction of a structure suffering flood damage. Eligible compliance activities are: elevation, floodproofing, relocation, or demolition (or any combination of these). The limit is additional insurance, subject to the overall maximum available coverage through NFIP.

### **Other Issues**

**E&O.** E&O awareness is a constant companion for all insurance practitioners today. Given the potential magnitude of an uncovered loss arising from a requirement to comply with any ordinances or laws regulating the repair, renovation or construction of a home or commercial building, careful attention should be paid to utilizing proper E&O loss control practices.

As with any other important coverage option, the safest and most reliable procedure for making insureds aware of the coverage, and for documenting their acceptance or rejection of the optional coverage, is with a coverage checklist, which E&O attorneys stress should be used with every account.

In cases where the agent has no market willing to provide the coverage for Ordinance & Law on a specific risk, that fact needs to be noted on the coverage checklist, and in other ways, as appropriate.

In addition, as discussed above, agents should avoid recommending specific limits of insurance for the various coverages available through different Ordinance & Law endorsements.

**Coalition to Insure Louisiana (CIL).** The Coalition to Insure Louisiana (CIL) is a broad-based group of 31 professional and business organizations dedicated to maintaining the availability and affordability of private insurance markets that serve Louisiana residents and businesses. The Independent Insurance Agents & Brokers of Louisiana was a founding member of this important organization, and will strongly support the CIL legislative program in the 2007 session of the Louisiana Legislature.

Two items on the CIL's agenda deal with building code issues. First, the CIL proposes that in order to reduce the hurricane catastrophe risk exposure, strong enforcement of statewide building codes be maintained. This will require adequate government funding and strong enforcement of the new statewide building code.

Second, to improve the availability and affordability of competitive private insurance, the CIL proposes that government provide incentives to encourage the retrofitting of existing buildings to meet the new statewide building code. These incentives would take the form of low-interest loans, grants, and tax incentives.



**Beyond minimum requirements.** While the benefits of stronger building codes are obvious, complying with them is no easy task, in time, or money, or any other measurement. At the same time, it is important to recognize that even the new I-Codes are developed and implemented as *minimum* standards.

For the Three Little Pigs, upgrading their houses built of straw or built of sticks still did not offer the same level of protection and durability (and insurability) of the house built of brick.

This is yet another lesson we could all learn from the lovable fairy tale characters. While there is a lot of attention being given at present to the new statewide building codes in Louisiana (and other states), there is a growing body of research being done into construction materials and methods that are far above minimum standards. The insurance industry, long interested in improved construction methods and materials, is actively supportive of numerous research groups developing innovative and cost-effective materials and procedures for residential and commercial applications.

The Institute for Business and Home Safety, a nonprofit association funded by the insurance industry, has as its mission *“to reduce the social and economic effects of natural disasters and other property losses by conducting research, and advocating improved construction, maintenance and preparation practices.”* It offers a “Fortified For Safety” seal of approval for homes built to their higher standards. ([www.ibhs.org](http://www.ibhs.org))

The International Hurricane Research Center, located at Florida International University in Miami, is currently working on a “Wall of Wind” Research Initiative. The project utilizes a device which can generate a windfield of 140 mph, in order to study the effects of wind and rain on structures. One of the main goals is to develop new technologies, designs and products which will revolutionize building construction and retrofitting practices. ([www.ihc.fiu.edu](http://www.ihc.fiu.edu))

The Institute for Catastrophic Loss Reduction (ICLR) is a research institute established by Canada’s property and casualty insurers in 1998. One project ICLR is working on in cooperation with the University of Western Ontario is called “The Three Little Pigs,” which will subject a full-size mock building to Category-5 winds. The ICLR does extensive research in a wide variety of areas related to understanding and mitigating natural hazards. ([www.iclr.org](http://www.iclr.org))

The FM Global Research Campus in West Gloucester, R.I. is a 1,600 acre facility which studies property loss prevention and product testing in the areas of fire technology, natural hazards, electrical hazards, and hydraulics. From shooting 10-foot 2x4’s at walls to complex engineering studies, the research facility is actively involved in broadening the understanding of construction design and materials. ([www.fmglobal.com/about/campus/campus.asp](http://www.fmglobal.com/about/campus/campus.asp))

From these and other research efforts, lessons big and small are being documented and reported. For example, the International Hurricane Research Center found that a ring-shank nail has twice the holding capacity of an ordinary smooth nail. As a result, use of ring shank nails in roof construction can improve the wind uplifting resistance from a Category 2 to a Category 4. For an average size roof, this adds only around \$100 to the cost.

The 2x4 “cannon” used by FM Global Research Campus vividly demonstrates the increased protection  $\frac{3}{4}$  inch plywood provides, compared to  $\frac{1}{2}$  inch plywood.

The Sherwin-Williams Paint Company is developing a paint-like coating that will block water from penetrating a concrete wall during hurricanes, which will be especially important in preventing subsequent mold damage.

Composite Building Structures Company is developing a high-tech composite material similar to that used on the Stealth bomber, which can be designed for the framing and outer shell of a home. The structural framing material is termite proof, water proof, mold proof, earthquake resistant (certified to have withstood the San Francisco and Kobe earthquakes with a 350% safety margin), and withstands hurricane and tornado force winds in excess of 350 mph.

The Chinese philosopher Lao Tzu's often-quoted line of *"a journey of a thousand miles begins with one step"* seems apropos for the journey being taken with stronger building codes. Each step, especially the initial steps being taken now, will not be easy. Getting a statewide code adopted for the first time, and managing all the myriad details of education, administration, and implementation, will take time, patience, and determination. Down the road, hopefully we will see buildings that can resist 350 mph winds. But for now, the journey has begun, and we are headed in the right direction.

**Necessary Action:** Circulate this Technical Advisory to all appropriate agency staff, and any other interested parties.