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January 2013

The Next Green Issue: Considering Property Insurance for the Green Building

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THE NEXT GREEN ISSUE: CONSIDERING PROPERTY INSURANCE FOR THE GREEN BUILDING

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“The best insurance policy for the future of an industry is research, which will help it to foresee future lines of development, to solve its immediate problems, and to improve and cheapen its products.”¹

INTRODUCTION

AS government policies across the country try to encourage more environmentally friendly buildings, the next green issue facing owners of these structures is obtaining the proper insurance coverage to protect their investment. A typical property insurance policy covers the costs to reconstruct or replace property damaged as the result of a casualty based on a valuation of the building or loss.² Valuation is determined by an analysis of the structure and its condition just before the loss took place.³ However, the typical property insurance policy may not include contractual language, which adequately identifies and alleviates the potential risks associated with a green building.⁴

Given that the number of green buildings continues to increase across the country, an emerging market appears to be developing for the insurance companies in this area.⁵ However, these buildings have unique

¹ Sir Harold Hartley, Quote, in *THE FORBES SCRAPBOOK OF THOUGHTS ON THE BUSINESS OF LIFE* 292 (1992).

² 1 JAMES S. TRIESCHMANN, ET AL., *AM. INST. FOR CHARTERED PROP. CAS. UNDERWRITERS, COMMERCIAL PROP. INS. AND RISK MGMT* 132 (4th ed. 1994).

³ *Id.*

⁴ See *infra* Part II. A green building is “a development that stresses the holistic practice of creating structures so as to produce, operate, and maintain a building that bring together respect for the environment, conservation of materials, efficient utilization of resources, and provides positive influences on its occupants while aspiring to sustainability.” See Darren A. Prum, *Green Buildings, High Performance Buildings, and Sustainable Construction: Does it Really Matter What We Call Them?* 21 *VILL. ENVTL L.J.* 1, 33 (2010) [hereinafter Prum, *Green Buildings*].

⁵ Andrea Wells, *It’s Not Easy Being Green; But It’s Profitable*, *INS. J.* (Apr. 21, 2009),

characteristics,⁶ which are relevant to owners and policy underwriters, as well as to other stakeholders like mortgage holders and major tenants. Consequently, these parties can easily end up in contentious situations because the typical property policy may not maintain adequate contractual language to identify and allocate the potential risks, or may provide unexpected coverage issues.⁷

In response to this situation, the Insurance Services Office (ISO) and insurance carriers offer specific green building endorsements in an effort to augment the underlying property policy.⁸ While these might be necessary, they may also offer redundant and excessive coverage if the underlying property policy already covers green buildings.⁹ Therefore, to determine the appropriate level of coverage, it is necessary to have a clear understanding and assessment of a property policy's limits and possible endorsements.

The recent trend towards building green, and the subsequent need to insure the completed structure, has generated legal scholarship. But the scholarly legal literature tends to focus on the statutes, ordinances, and regulations that incentivize or compel private developers to build green structures, or the contractual or tort issues that occur when difficulties arise in construction.¹⁰ While these public policy and contractual obligations are

<http://www.insurancejournal.com/news/national/2009/04/21/99798.htm>.

⁶ See *infra* Part II(b).

⁷ See *infra* Part II(c).

⁸ See INS. SERV. OFF., INCREASED COST OF LOSS AND RELATED EXPENSES FOR GREEN UPGRADES (2009) [hereinafter GREEN BUILDING ENDORSEMENT]; FIREMAN'S FUND INS., PROPERTY-GARD GREEN COVERAGE ENDORSEMENT (2010) [hereinafter FIREMAN'S FUND GREEN ENDORSEMENT]; TRAVELERS GRP., GREEN BLDG. COVERAGE ENHANCEMENT ENDORSEMENT (2008) [hereinafter TRAVELERS GREEN ENDORSEMENT]; LEXINGTON INS., UPGRADE TO GREEN – COMMERCIAL ENDORSEMENT (2008) [hereinafter CHARTIS GREEN ENDORSEMENT]; LIBERTY MUT. GRP OF CO, GREEN SELECT (2008) [hereinafter LIBERTY MUT. GREEN ENDORSEMENT].

⁹ *Id.*

¹⁰ See, e.g., Carl J. Circo, *Using Mandates and Incentives to Promote Sustainable Construction and Green Building Projects in the Private Sector: A Call for More State Land Use Policy Initiatives*, 112 PENN ST. L. REV. 731 (2008) [hereinafter Circo, *Using Mandates*]; Darren A. Prum & Stephen Del Percio, *Green Building Claims: What Theories Will a Plaintiff Pursue, Who Has Exposure, and A Proposal for Risk Mitigation*, 37 REAL EST. L.J. 243 (2009) [hereinafter Prum & Del Percio 1]; Carl J. Circo, *Should Owners and Developers of Low-Performance Buildings Pay Impact or Mitigation Fees to Finance Green Building Incentive Programs and Other Sustainable Development Initiatives?* 34 WM. & MARY ENVTL. L. & POL'Y REV. 55 (2009); Darren A. Prum, *Creating State Incentives for Commercial Green Buildings: Did the Nevada Experience Set an Example or Alter the Approach of Other Jurisdictions?* 34 WM. & MARY ENVTL. L. & POL'Y REV. 171 (2009) [hereinafter Prum, *Creating State Incentives*]; A. Paige Reber, *Taking the "LEED": Determining the Appropriate Amount of Government Regulation in Green Building Projects*, 98 KY. L.J. 573 (2009-

important, the subsequent issues that arise when owning a green building also require proper consideration. With this in mind, this article seeks to address the issues associated with obtaining coverage for green buildings in property insurance policies and their applicable endorsements.

In part I, I consider the modern-day practice of using a property insurance policy as part of a comprehensive strategy to transfer risk. I begin by explaining the types of coverages and approaches taken to value a structure, followed by a description of the common practice by insurance companies of not covering construction costs required by updates to construction ordinances or new laws passed subsequent to a building's completion. I then trace court opinions, beginning in England in 1859, that today's courts use to interpret these exclusions, and explain why these exclusions are often ineffective. Finally, I evaluate the current ISO Building and Personal Property Coverage Form, as well as the ISO's Increased Cost of Loss and Related Expenses for Green Upgrades endorsement.

In part II, I expand on the evolving standards associated with green buildings and analyze the underlying ISO property policy based on this complexity. This starts with an assessment of the different approaches employed by state and local governments to encourage green buildings, and the role played by third-party verification organizations in setting standards. Then I analyze the green building coverage issues associated with the ISO property insurance policy and the endorsement offered as a solution.

In part III, I evaluate the endorsements for green buildings offered by a variety of insurance companies. Many of these endorsements contain similar provisions for coverage, so I begin by describing those similarities and the parallel approaches among the different policies. Then I turn to the supplementary coverages offered by Fireman's Fund, before analyzing how the green building endorsements fit into the broader building and property insurance policy.

Finally, in Part IV, I consider many of the more important issues for

2010); Prum, *Green Buildings*, *supra* note 3, at 26; Sarah B. Schindler, *Following Industry's LEED: Municipal Adoption of Private Green Building Standards*, 62 FLA. L. REV. 285 (2010); Darren A. Prum, *Green Building Liability: Considering the Applicable Standard of Care & Strategies for Establishing a Different Level by Agreement*, 8 HASTINGS BUS. L.J. 33 (2012); Darren A. Prum et al., *In Third Parties We Trust? The Growing Antitrust Impact of Third-Party Green Building Certification Systems for State and Local Governments*, 27 J. ENVTL. L. & LITIG. 191 (Spring 2012). [hereinafter Prum et al., *In Third Parties*]; Darren A. Prum & Robert J. Aalberts, *Our Own Private Sustainable Community: Are Green Covenants, Conditions, And Restrictions A Viable Alternative To A More Environmentally Sustainable Future For Homeowners?* 43 N.M. L. REV. (forthcoming 2013) [hereinafter Prum & Aalberts].

insuring a green building. Since the ordinance or law exclusion, valuation method and amount, and coverage features play an important part in establishing the proper scope of insurance for a green building, I contemplate a proper level of risk transfer through the use of a replacement cost approach as a loss settlement basis.

I. PROPERTY INSURANCE POLICIES

Where owners of green buildings wish to minimize their risk of loss on their investment in the event of a casualty, many turn to a property insurance policy as a solution. At its core, an insurance system attempts to transfer a loss through a contractual relationship whereby an insured conveys a benefit to an insurer in exchange for the obligation to perform at a later point in time.¹¹ The benefits received by an insurer generally make it liable for providing resources to compensate an insured for its loss in an amount sufficient to return the property to a condition reasonably comparable to its condition prior to the casualty.¹²

When using a building and personal property insurance policy as part of a comprehensive risk strategy, an owner of a green building needs to understand the basic coverages and valuation options available. These coverages and valuation options serve as the underlying mechanism to ensure that an owner does not lose the green building investment should a casualty occur. With this in mind, I explore the fundamental elements of a building and personal property policy.

A. Building and Personal Property Coverage

Since the construction of many early buildings involved wood, property insurance policies emanated out of a need for an owner to protect against a fire.¹³ Over time, these policies continued to cover casualties due to fire, but now include many other perils.¹⁴ For each of these perils, the contract provided by an insurance company will contain unique terms, conditions, and

¹¹ ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW, A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES* § 3.1(a) (1988).

¹² Often, the concept that an insurer's obligation requires it to only provide assets to compensate for a partial or complete loss gets called the "principle of indemnity." *Id.*

¹³ See TRIESCHMANN, ET AL., *supra* note 1, at 173.

¹⁴ *Id.* at 174. For example, a typical policy now includes: "Windstorm, Civil Commotion, Smoke, Hail, Aircraft, Vehicles, Explosion, Riot, and riot attending a strike."

exclusions.¹⁵

Modern-day insurance policies also normally specify some method of valuation in order to establish a loss amount in the event of a claim.¹⁶ Among the more common alternatives the insured may elect to value the property loss are actual cash value (ACV), replacement cost, or functional building valuation.¹⁷

In an ACV valuation, the coverage is determined by subtracting the depreciated use from the current cost of replacement.¹⁸ Many of the insurers that use this approach either explicitly or implicitly expect to determine the value of the property when the casualty occurs.¹⁹ While this valuation method deters insureds from destroying their own property because of the reduction in payments, it often fails to provide the covered party with sufficient funds to rebuild after a loss.²⁰

In contrast, a replacement cost approach covers the property without the reduction for depreciation.²¹ This effectively allows a property owner to receive a “new” property for an “old” one at the insurer’s expense.²² Because of this ability to essentially trade up, many insurers in the past hesitated to offer this type of coverage, but over time the underwriting community determined that it could overcome this risk.²³

Finally, a property owner may utilize a functional building valuation method, especially in situations where the replacement cost far surpasses the

¹⁵ PETER S. BRITTELL, GREEN BUILDINGS: LAW, CONTRACT AND REGULATION § 9.02 (2010).

¹⁶ See TRIESCHMANN, ET AL., *supra* note 1, at 132. The authors explain that if this did not occur and the contract did not address this issue then any reasonable valuation method would apply. Consequently, the parties would routinely contest the reasonableness of the applicable valuation method. *Id.* To provide flexibility in a single policy due to the broad types of circumstances, the contractual language normally establishes coverage for a specific property while allowing an insured to choose amongst several different options.

¹⁷ *Id.* at 146. One commentator suggests an additional strategy that calls for a property owner to purchase supplementary insurance that will pay for any excess costs beyond those of the underlying policy equal to an agreed upon maximum amount. See BRITTELL, *supra* note 14, § 9.02.

¹⁸ *Id.* at 132.

¹⁹ See KEETON & WIDISS, *supra* note 10, § 3.9(a). Other times, an insurer may create an “actual value” situation where the language of the policy specifically affixes a value when coverage begins. *Id.*

²⁰ See TRIESCHMANN, ET AL., *supra* note 1, at 146. Often times, this approach does not even return the property to working order because of the reduction. *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.* Since this type of approach can create serious underinsurance issues, a replacement cost coverage usually requires a coinsurance clause to address these concerns. *Id.*

market value.²⁴ Under this approach, the insurer agrees to repair or replace the building with one that is functionally equivalent and less expensive than the one involved in the loss.²⁵ In partial loss situations, the insurer determines its payments for repair or replacement using less expensive materials that retain the architectural style of the building prior to the casualty.²⁶

When using ACV valuation, underinsurance can be an issue for both the property owner and the insurance company because the amount of coverage purchased may fall below the cost of repair or replacement of the building in the event of a loss.²⁷ To resolve this concern, many policies include a coinsurance clause that requires the insured to purchase coverage equal to or greater than a specified percentage of the actual cash value of the covered property.²⁸ As a result, the coinsurance clause effectively creates a proportional reduction in coverage based on the amount the property is underinsured.²⁹ This creates an incentive for an insured to correctly value the property or personally carry the risk for the difference.³⁰

Coinsurance clauses are also used with the replacement cost coverage approach to valuing property.³¹ The clause pertains to the replacement cost instead of the ACV.³² As a result, the insurer indirectly forces an insured to carry higher policy limits in order to avoid a coinsurance penalty for understating a property's value.³³

In a policy using functional building valuation, the coinsurance clause is removed from the policy, since the insurer only needs to repair or replace the

²⁴ *Id.* at 150.

²⁵ *Id.* In a Functional Building Valuation approach, the standard policy language also removes the coinsurance clause. *Id.* This places a greater emphasis on both the insured and insurer to mutually agree upon coverage and cost for replacing the building with its functional equivalent. *Id.*

²⁶ *Id.*

²⁷ *Id.* at 129.

²⁸ *Id.* In practice, insurers generally offer coinsurance at 80, 90, or 100 percent of the actual cash value of the property. *Id.*

²⁹ *Id.* at 131. The coinsurance formula calculates the insurer's payment as follows: " $((\text{Limit of Insurance}/(\text{Value of Covered Property} \times \text{Coinsurance Percentage})) \times \text{Total Amount of Covered Loss}) - \text{Deductible} = \text{Insurer's Payment (Not to Exceed Limit)}$." *Id.* at 129.

³⁰ *See id.* at 131. The authors explain that underinsurance situations are caused by errors in valuation, a failure to maintain with property fluctuations like inflation, or confusion with the insurance requirements. *Id.* at 131.

³¹ *See id.* at 146.

³² *Id.*

³³ *Id.*

building with one that is functionally the same but at a lower cost.³⁴ Accordingly, this approach places a greater onus on the parties to identify the proper price tag for the building's replacement cost as well as the correct amount for the insurance coverage.³⁵

Thus, the underlying valuation methods along with the coinsurance clause set the foundation for a building owner's ability to transfer risk to an insurer and receive compensation should a casualty occur.

B. Ordinance or Law Coverage

Beyond the enumerated limitations specified within the description of the covered perils, a policy will also contain a distinct section with additional exclusions.³⁶ For buildings, many causes-of-loss forms include an ordinance or law exclusion, which excludes costs associated with changes in law or regulation.³⁷ This exclusion is often explained as a result of the diverse laws that apply to each property, although one set of commentators argue this exclusion grows out of the unanticipated costs an insurer may incur based on changes in the ordinances or laws that govern the building code or construction, not because of difficulties associated with providing coverage.³⁸

Of course, a building must meet the relevant codes and regulations when it is constructed in order for its owners to lawfully occupy and use the structure.³⁹ And while governments update building codes as necessary, an existing structure generally does not have to meet new regulations because grandfathering provisions are usually included in new laws.⁴⁰ Should an owner of an existing building that fits within a grandfathering situation suffer a casualty on the covered property, however, the law usually requires the

³⁴ *Id.* at 150.

³⁵ *See id.*

³⁶ *See* TRIESCHMANN, ET AL., *supra* note 1, at 189.

³⁷ *Id.* at 190. A sample of the exclusionary language eliminates coverage for loss caused by the "enforcement of any ordinance or law regulating construction, repair or demolition of a building or other structure, unless endorsed to this policy." BRUNER & O'CONNOR, CONSTR. LAW § 11:238.

³⁸ TRIESCHMANN, ET AL., *supra* note 1, at 190.

³⁹ JUSTIN SWEET & MARC M. SCHNEIER, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING AND THE CONSTRUCTION PROCESS § 8.08 (9th ed. 2009).

⁴⁰ *See* TRIESCHMANN, ET AL., *supra* note 1, at 190. The grandfathering provisions receive support from lawmakers for a variety of reasons. One of the main arguments is founded on the fact that it would be cost prohibitive and burdensome to building owners to retrofit a structure each time the laws changed.

repair or replacement of the structure to adhere to the latest regulations.⁴¹

When this occurs, an insurer of an older building, or one built prior to a significant change in regulations, may take a greater loss than anticipated when fulfilling its obligations.⁴² New regulations may create unexpected cost increases regardless of whether the situation calls for repairing or replacing the building.⁴³ The insured, too, might encounter an unexpected construction bill if the costs associated with constructing a conforming building exceed those of constructing a building identical to the original one.⁴⁴

To assist those seeking coverage for updates to the building codes, the insurer will generally offer an additional endorsement for policies using ACV or replacement cost as the valuation method.⁴⁵ This endorsement typically allows three different options for property owners seeking this type of coverage.⁴⁶ Two of the endorsements available provide coverage for those situations where the loss in one portion of a building renders an undamaged part unusable, while a third offers a comprehensive solution for a casualty situation.⁴⁷

The first version of the endorsement solely provides coverage for the costs associated with demolishing and removing the debris from the undamaged portion of a building.⁴⁸ In the second version, the endorsement extends coverage for the entire building despite a lack of a casualty to a portion of the structure.⁴⁹ Should the policy use the replacement cost approach and the owner choose to rebuild the structure, the insurer pays either the sum the insured spends for construction, the amount of money needed to restore a building comparable to the original one, or the coverage

⁴¹ *Id.*

⁴² *Id.* This may happen when a loss occurs on a portion of a building, but a law prohibits the repair of the damaged structure. *Id.* This essentially renders the useful parts of the building a loss as well, which makes the insurer liable for demolition, debris removal, and construction of the salvageable portions too. *Id.*

⁴³ *Id.* For example, the Americans with Disabilities Act requires improved access for the handicapped and local fire codes may compel additional exits, a less combustible roof, updated electrical or mechanical systems, or even additional coverage by the sprinkler system. *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.* at 208. For those using the functional building valuation approach, the language of its endorsement already incorporate ordinance or law coverage up to the policy limits. *Id.* at 151.

⁴⁶ TRIESCHMANN, ET AL., *supra note 1*, at 208. It is important to recognize that this endorsement excludes coverage for pollutants on the premises. *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

limit, whichever option is the least expensive.⁵⁰

In the third version, the endorsement calls for the repair or replacement of the building as soon as possible, at the same or another location.⁵¹ However, the language of the endorsement only obligates the insurer to pay for the increased construction costs for two years after the loss occurs.⁵² When using this endorsement version, one group of commentators stresses the importance of establishing an accurate cost to replace the insured building under the most current set of building regulations, which also includes estimates for debris removal.⁵³

Thus, although most property insurance policies specifically exclude updates to the building code because they present many different types of problems, an owner seeking to protect against these types of issues may separately purchase an endorsement to gain coverage.

C. Court Opinions

Given the complexity of the types of scenarios a casualty may invoke for a green building, two different precedents provide guidance. Prior to the insertion of the ordinance or law exclusion, the courts developed a doctrine for situations where the government prevented the rebuilding of a structure. Following the change by insurers to include ordinance or law exclusions, the courts began developing a new line of precedent. Since both precedents may apply in a green building context, both require an analysis.

1. *Cases Involving A Casualty But The Law Prevents Rebuilding*

Interestingly, three lines of precedent formed a single default rule when the courts began to interpret situations where a building suffers a casualty covered by a property insurance policy but cannot be repaired due to legal obstacles. The earliest of the three doctrines originated under English common law in 1859.⁵⁴ The Court of Queen's Bench decided the case, which involved the partial destruction of a building.⁵⁵ The insurer failed to make

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.* Depending on the circumstances, an insurer may agree to extend the two-year limit.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁴ *Brown v. Royal Ins.*, 1 Ellis & Ellis 853 (Q.B. 1859).

⁵⁵ *Id.*

repairs in a timely fashion, so the government declared the remnants a hazard and demolished it.⁵⁶

Reviewing the case, the justices applied the law of contracts and debated whether to excuse performance due to impossibility.⁵⁷ But the justices decided to hold the insurance company responsible because the mere fact that costs escalated did not relieve the insurer of its obligations in the underlying contract.⁵⁸ In the United States, the Supreme Courts of Texas,⁵⁹ Minnesota,⁶⁰ and Pennsylvania⁶¹ turned to this precedent for cases in their jurisdictions when a building owner suffered a partial destruction of an insured structure.

Four years after the Queen's Bench decision, the Michigan Supreme Court began the second line of precedent, in a case where the building code changed several times while the insurance policy was renewed, followed by a fire, which completely destroyed the structure.⁶² The Michigan court began by distinguishing between an "actual" and a "proximate" cause of the structure's loss.⁶³ The court found the fire to be the actual cause of the loss, not the adoption of a building code, which did not allow for the building's replacement.⁶⁴ The court also recognized that each renewal of the property policy constituted a new contract and that the insurer took a risk each time it continued with the relationship, which made it responsible to pay for a fully compliant building.⁶⁵

Finally, the Louisiana Supreme Court created the third starting point when it evaluated the property insurance obligations of another building partially destroyed by fire and condemned by government officials.⁶⁶ This time the insurer claimed it did not need to cover the total loss of the structure, since it was already in disrepair prior to the casualty.⁶⁷ The opinion

⁵⁶ *Id.* at 855.

⁵⁷ *Id.* at 858.

⁵⁸ *Id.* at 858-60.

⁵⁹ *See* Hamburg-Bremen Fire Ins. v. Garlington, 18 S.W. 337, 338 (Tex. 1886).

⁶⁰ *See* Larkin v. Glens Falls Ins., 83 N.W. 409, 410 (Minn. 1900).

⁶¹ *See* Pa. Co. for Ins. on Lives and Granting Annuities v. Phila. Contributionship, 51 A. 351 (Pa. 1902).

⁶² Brady v. Nw. Ins., 11 Mich. 425, 444 (Mich. 1863). The Supreme Court of Massachusetts found this case influential, see Hewins v. London Assurance Corp., 68 N.E. 62, 64 (Mass. 1903), in addition to the Texas and Minnesota courts previously mentioned *supra* notes 58-59.

⁶³ Brady 11 Mich. at 444-45.

⁶⁴ *Id.*

⁶⁵ *Id.* at 446-47.

⁶⁶ Monteleone v. Royal Ins. of Liverpool and London, 18 So. 472, 472-73 (La. 1895).

⁶⁷ *Id.* at 472.

quoted and endorsed the lower court's reasoning that "[t]he insurer taking a risk on an old and, in this instance, an insecure building, incurs the obligation to pay for a total loss, if the injuries by the fire, combined with antecedent defects, make repairs impracticable."⁶⁸

Taken together, the three different origination points formed a single rule, which the Minnesota Supreme Court summed up in a case where an insurer only offered to pay for the cost of repairs on a building unable to obtain a permit for reconstruction instead of compensating the owner for a total loss.⁶⁹ The court explained the default rule was that "ordinances are a part of the contract of insurance, and that the insurer is bound thereby."⁷⁰

Also citing the earlier decisions as precedent, the Massachusetts Supreme Court issued a single opinion that evaluated a series of similar disputes with partially destroyed buildings and an insurer refusing to fulfill its obligations.⁷¹ In applying the unified precedent to its jurisdiction, the Massachusetts court accepted the approach of the earlier courts in all situations except for one insurance policy that did not follow the "Massachusetts Standard."⁷² That particular policy included two unique provisions, one of which created a stop loss for the insurer, and another that specifically excluded the building codes.⁷³ When read together, the court held, the provisions mutually strengthened each other and resulted in a valuation calculation that ignored the subsequent change in law.⁷⁴

Over time, many courts adopted the unified approach,⁷⁵ while others found ways to distinguish their case at hand from the general rule based on the insurance policy language or the presented facts.⁷⁶ Hence, the majority of

⁶⁸ *Id.* at 475.

⁶⁹ *Larkin v. Glens Falls Ins.*, 83 N.W. 409, 410 (Minn. 1900).

⁷⁰ *Id.*

⁷¹ *Hewins v. London Assurance Corp.*, 68 N.E. 62, 63 (Mass. 1903).

⁷² *Id.*

⁷³ *Id.* The first provision explains that in the event of a casualty, the loss or damage "shall in no event exceed what it would cost the insured to repair or replace the same with material of like kind and quality." *Id.* The second provision limits the insurers liability to situations "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." *Id.*

⁷⁴ *Id.*

⁷⁵ *See, e.g.*, *Am. Home Fire Assurance Co. v. Mid-West Enter. Co.*, 189 F.2d 528 (10th Cir. 1951); *Rutherford v. Royal Ins.*, 12 F.2d 880 (4th Cir. 1926); *Taylor v. Aetna Cas. & Sur.*, 341 S.W.2d 770 (Ark. 1961); *Fid. & Guar. Ins. v. Mondzelewski*, 115 A.2d 697 (Del. 1955); *Md. Cas. Co. v. Frank*, 452 P.2d 919 (Nev. 1969); *Feinbloom v. Camden Fire Ins.*, 149 A.2d 616 (N.J. Super. Ct. App. Div. 1959).

⁷⁶ *See, e.g.*, *Providence Wash. Ins. v. Bd. of Educ. of Morgantown Sch. Dist.*, 38 S.E. 679,

early cases articulated a general rule that held insurers liable for the additional cost of complying with updated laws, provided the actual cause of the casualty was a covered peril, but also allowed parties to contract for a different result through their actions or contractual language.

2. Cases Involving the Ordinance or Law Exclusion

With the decision by the insurance companies to insert an ordinance or law exclusion into a property policy, a new set of precedent emerged.⁷⁷ This began with a federal court in the Southern District of Indiana that, at least according to that court, presided over the first dispute based on an ordinance or law exclusion.⁷⁸ The court began its inquiry by considering many of the cases mentioned in the previous subsection to provide guidance on its decision.⁷⁹ The court sided with the majority of prior precedent, and held that the extra costs associated with additional compliance measures grew out of a covered casualty rather than governmental regulations.⁸⁰ In a different case, the Idaho Supreme Court explained that “if the loss itself is caused by an ordinance or law, there is no coverage,”⁸¹ which mirrors the same pronouncement by the Michigan Supreme Court in 1863, though the decision does not directly reference the older case.⁸²

Many courts follow this longstanding precedent in forming their opinions.⁸³ An appellate court in the State of Washington placed this rule

681-90 (W. Va. 1901); *Gouin v. Nw. Nat'l Ins.*, 259 P. 387, 389-90 (Wash. 1927); *Midwood Sanatorium v. Fireman's Fund Ins.*, 185 N.E. 674 (N.Y. 1933); *Weinstein v. Commerce, Ins.*, 82 S.E.2d 477, 477-80 (Va. 1954).

⁷⁷ In reviewing the many decisions that interpreted the ordinance or law exclusion, the subject matter did not always cover commercial buildings and are not included in this legal survey of precedent. Some of the omitted cases covered homes. *See e.g.*, *Fire Ins. Exch. v. Super. Ct. of Los Angeles*, 10 Cal. Rptr. 3d 617, 621 (Cal. Ct. App. 2004); *Dupre v. Allstate Ins.*, 62 P.3d 1024, 1026 (Colo. App. 2003).

⁷⁸ *Daniels v. Aetna Life & Cas. Ins.*, No. IP 81-1413-C, 1983 U.S. Dist. LEXIS 15851, at *6 (S.D. Ind. June 29, 1983).

⁷⁹ *Id.*

⁸⁰ *Id.* at *6-7.

⁸¹ *Garnett v. Transamerica Ins. Serv.*, 800 P.2d 656, 666 (Idaho 1990).

⁸² *Compare id. with* *Brady v. Nw. Ins.*, 11 Mich. 425 (Mich. 1863).

⁸³ *See, e.g.*, *Regents of Mercersburg Coll. V. Republic Franklin Ins.*, 458 F.3d 159 (3d Cir. 2006); *Davidson Hotel Co. v. St. Paul Fire & Marine Ins.*, 136 F. Supp. 2d 901, 905-06 (W.D. Tenn. 2001); *Commonwealth Ins. v. Benihana of Tokyo, Inc.*, No. 3:96-CV-0826-R, 1997 U.S. Dist. LEXIS 17448, at *8-12 (N.D. Tex. June 19, 1997); *Daniels v. Aetna Life & Cas. Ins.*, No. IP 81-1413-C, 1983 U.S. Dist. LEXIS 15851, at *7 (S.D. Ind. June 29, 1983); *Royal Cloud Nine, LLC v. Lafayette Ins.*, 987 So. 2d 355, 359 (La. Ct. App.

within the general rules of interpreting insurance policies, which were that “[a] policy is to be given a fair, reasonable, and sensible construction that comports with how it would be viewed by an average purchaser of insurance.”⁸⁴ For exclusionary clauses in particular, the Washington courts have explained:

There are certain general rules with regard to interpretation of insurance policies: (1) Exclusionary clauses are to be strictly construed against the insurer and in favor of the insured; (2) If a clause can be construed in two ways, one favorable to the insured and the other favorable to the insurer, the construction favoring the insured must be adopted; (3) The language of insurance policies is to be interpreted as it would be understood by the average man.”⁸⁵

Using these tools of interpretation, the court reasoned that the added cost to repair a building stemmed from the loss connected to the casualty rather than out of the enforcement of the ordinance or law.⁸⁶

Following the traditional beginning of property insurance policies, the largest number of the cases had a damaging fire as the underlying claim for the loss, which made it the actual cause. Most of these situations dealt with the legal impediments for reconstructing the structure;⁸⁷ however, two cases evaluated the applicability of building upgrades to meet the Americans with Disabilities Act and the Pennsylvania Handicapped Act.⁸⁸ Several other cases sorted out the coverage for removing hazardous materials such as asbestos or contaminated debris with PCBs even though the insurer argued the policy

2008); *Haas v. Audobon Indem. Co.*, 722 So. 2d 1022, 1028-29 (La. Ct. App. 1998); *Farmers Union Mut. Ins. v. Oakland*, 825 P.2d 554, 556-57 (Mont. 1992); *DEB Assoc. v. Greater N.Y. Mut. Ins.*, 970 A.2d 1074, 1077-83 (N.J. Super. Ct. App. Div. 2009); *Starzewski v. Unigard Ins. Grp.*, 810 P.2d 58, 62 (Wash. Ct. App. 1991).

⁸⁴ *Starzewski*, 810 P.2d at 62 (quoting *Odessa Sch. Dist. 105 v. Ins. of Am.*, 791 P.2d 237, 239 (Wash. Ct. App. 1990)).

⁸⁵ *McDonald Indus., Inc. v. Rollins Leasing Corp.*, 613 P.2d 800, 802-03 (Wash. Ct. App. 1980).

⁸⁶ *Id.*

⁸⁷ *See Transamerica Ins. Dist. v. RLI Ins.*, 873 P.2d 1292 (Alaska 1994); *Commonwealth Ins. v. Benihana of Tokyo, Inc.*, No. 3:96-CV-0826-R, 1997 U.S. Dist. LEXIS 17448; *Garnett v. Transamerica Ins. Serv.*, 800 P.2d 656; *Bering Strait Sch. Dist. v. RLI Ins.*, 873 P.2d 1292 (Alaska 1994); *Starzewski v. Unigard Ins., Grp.*, 810 P.2d at 62.

⁸⁸ *See Regents of Mercersburg Coll. v. Republic Franklin Ins.*, 458 F.3d 159; *DEB Assoc. v. Greater N.Y. Mut. Ins.*, 970 A.2d 1074.

excluded such a requirement.⁸⁹ In other decisions, the courts needed to resolve issues surrounding water damage and floods that occurred as a result of vandalism⁹⁰ or a fire sprinkler malfunction,⁹¹ the replacement of roof on a historic building after Hurricane Katrina destroyed it,⁹² and the partial collapse of a parking garage followed by a government order demolishing the undamaged portion as well.⁹³ As such, the courts in each of these scenarios decided that the ordinance or law exclusion did not apply and supported the property owner's contention that coverage existed.

In the decisions supporting the insurance companies' ordinance or law exclusion, three federal district court holdings⁹⁴ and two state appellate opinions⁹⁵ found the casualty was the proximate cause of the loss. The courts in Pennsylvania and Tennessee dealt with situations where the property owner sought reimbursement for costs attributed to undamaged portions of the building that were tenuously connected to the underlying casualty;⁹⁶ whereas another Pennsylvania court attributed the loss that was not included in the policy.⁹⁷ Similarly, an appellate court in Illinois refused to require coverage for a repair occasioned by asbestos because the discovery was the result of a governmental directive, not a casualty.⁹⁸ In New York, a court disallowed the government-required secondary testing of a building's plumbing and gas systems in response to a similar loss in another part of the

⁸⁹ See *Daniels v. Aetna Life and Cas. Ins.*, No. IP 81-1413-C, 1983 U.S. Dist. LEXIS 15851, at *6 (S.D. Ind. June 29, 1983); *Farmers Union Mut. Ins. v. Oakland*, 825 P.2d 554 (Mont. 1992).

⁹⁰ See *Haas v. Audobon Indem. Co.*, 722 So.2d 1022 (La. Ct. App. 1998).

⁹¹ See *Davidson Hotel Co. v. St. Paul Fire & Marine Ins.*, 136 F. Supp. 2d 901 (W.D. Tenn. 2001).

⁹² See *Royal Cloud Nine, LLC v. Lafayette Ins.*, 987 So. 2d 355 (La. Ct. App. 2008).

⁹³ See *Seward Park Housing Corp. v. Greater N.Y. Mut. Ins.*, 836 N.Y.S.2d 99 (N.Y. App. Div. 2007).

⁹⁴ See *Chattanooga Bank Assoc. v. Fid. & Deposit Co. of Md.*, 301 F. Supp. 2d 774 (E.D. Tenn. 2004); *St. Paul Fire & Marine Ins. v. Darlak Motor Inns, Inc.*, No. 3:97-cv-1559, 1999 U.S. Dist. LEXIS 23283 (M.D. Pa. 1999); *Carlson v. State Farm Fire & Cas. Co.*, No. 91-cv-3323, 1992 U.S. Dist. LEXIS 1488 (E.D. Pa. 1992).

⁹⁵ See *Park City Estates Tenants Corp. v. Gulf Ins.*, 33 A.D.3d 484 (N.Y. App. Div. 2006); *Bd. of Educ. of Me. Township High Sch. Dist. No. 207 v. Int'l Ins.*, 799 N.E.2d 817 (Ill. App. Ct. 2003).

⁹⁶ *St. Paul Fire & Marine Ins. v. Darlak Motor Inns, Inc.*, 1999 U.S. Dist. LEXIS 23283 (M.D. Pa. 1999); *Chattanooga Bank Assoc. v. Fid. & Deposit Co. of Md.*, 301 F. Supp. 2d 774 (E.D. Tenn. 2004).

⁹⁷ *Carlson*, 1992 U.S. Dist. LEXIS 1488.

⁹⁸ *Bd. of Educ. of Me. Township High Sch. Dist. No. 207 v. Int'l Ins. Co.*, 344 Ill. App. 3d 106 (Ill. App. Ct. 2003)..

structure.⁹⁹

In spite of the addition of an ordinance or law exclusion to the property policies, courts tend to rely on longstanding precedent and inquire as to whether the actual cause of the casualty emanated from a covered peril to compel an insurer pay for the total loss of the building.

D. ISO Building and Personal Property Coverage Form

Perhaps in response to the adverse court decisions, the latest Insurance Services Office policy for building and personal property also demonstrates a new approach to changes in building regulations by creating a defined coverage instead of an outright exclusion.¹⁰⁰ Nonetheless, the policy follows the traditional approach in that it uses ACV with a coinsurance requirement as the default valuation method.¹⁰¹

Should a building owner wish to change the valuation method to the replacement cost approach, the policy contains language for this option as well.¹⁰² The applicable section of the ISO Building and Personal Property Coverage Form explains that the replacement cost approach will supplant ACV in the Valuation Loss Condition and lists some non-building-related coverages where the method will not apply;¹⁰³ it also allows the insured to revert back to the ACV method voluntarily when making a claim for a casualty.¹⁰⁴

The final two subsections of the ISO coverage form also create an interesting limitation on the total loss an insurer will incur. The first clause limits the insurer's loss to the smallest amount of either: the policy's limits, the cost to replace the building with equivalent materials and quality, or the

⁹⁹ Park City Estates Tenants Corp. v. Gulf Ins. Co., 33 A.D. 3d 484 (N.Y. App. Div. 2006).

¹⁰⁰ INS. SERV. ORG., COM. PROP. CP 00 10 06 07, BLDG. AND PERSONAL PROP. COVERAGE FORM (2007) [Hereinafter referred to as ISO BUILDING POLICY].

¹⁰¹ *Id.* at §§ E(7), F(1). The policy explains the same mathematical formula mentioned in footnote 19. *Id.* at § F(1).

¹⁰² *Id.* at § G(3). In order to trigger this approach, the policy language states that the Replacement Cost alternative must be "show as applicable in the Declarations." *Id.* at § G.

¹⁰³ *Id.* §§ G(3)(a)-(b). The policy excludes the Replacement Cost method from applying to: (1) personal property of others; (2) contents of a residence; (3) works of art, antiques or rare articles, including etchings, pictures, statuary marbles, bronzes, percelains and bric-a-brac; or (4) "stock", unless the included "stock" option is shown in the Declarations. *Id.* §§ G(3)(a)-(b). Under the terms of this Replacement Cost Optional Coverage, tenants' improvements and betterments are not considered to be the personal property of others.

¹⁰⁴ *Id.* § G(3)(c).

cost to restore or rebuild the property.¹⁰⁵ This limitation works in conjunction with a second clause that specifically excludes “the increased cost attributable to enforcement of any ordinance or law regulating the construction.”¹⁰⁶

Although the provision that allows the replacement cost approach appears to maintain the ordinance or law exclusion, the policy also includes an “Increased in Costs of Construction” subsection which specifically states, “[t]his Additional Coverage applies only to buildings to which the Replacement Cost Optional Coverage applies.”¹⁰⁷ The subsection further explains that the insurer agrees to pay for any cost escalations necessary to comply with any ordinance or law emanating out of a claim that results in repairing, reconstructing, or replacing the building¹⁰⁸ provided that the governmental requirement is in force at the time of the casualty.¹⁰⁹

Moreover, this subsection also incorporates the previously discussed Replacement Cost exclusion.¹¹⁰ Effectively, the language creates a system that calls for the insurer to value the property at the time of the casualty without reference to any additional costs associated with changes in the building code, but then allows the “Increased Cost Of Construction” subsection to establish a second coverage within the policy for these types of requirements with a cap at the lesser of \$10,000 or 5 percent of the policy’s limits.¹¹¹ The subsection of the policy also excludes coverage “due to the contamination by ‘pollutants’ or due to the presence, growth, proliferation, spread or any activity of ‘fungus’, wet or dry rot or bacteria.”¹¹²

Furthermore, the form addresses the issue of “Debris Removal” as a separate subsection within the “Additional Coverages” part of the policy.¹¹³

¹⁰⁵ *Id.* § G(3)(e). The cost-to-replace option also requires that the new building be used for the same purpose. *Id.*

¹⁰⁶ *Id.* § G(3)(f).

¹⁰⁷ ISO BUILDING POLICY, *supra* note 99, § A(4)(e)(1).

¹⁰⁸ *Id.* § A(4)(e)(2).

¹⁰⁹ *Id.* § A(4)(e)(3).

¹¹⁰ *Id.* § A(4)(e)(9).

¹¹¹ *Id.* § A(4)(e)(6). Of course, a property owner may always pay for increase coverage as per the policy. *Id.*

¹¹² *Id.* § A(4)(e)(5)(a). The form addresses the definitions of “pollutants” and “fungus” elsewhere. “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. *Id.* § H(2). “Fungus” means any type or form of fungus, including mold or mildew, and any mycotoxins, spores, scents or by-products produced or released by fungi. *Id.* § H(1).

¹¹³ ISO BUILDING POLICY, *supra* note 99, §§ A(4)(a) and (e).

Similar to the “Increased Costs of Construction” approach, the “Debris Removal” subsection also creates a supplementary coverage.¹¹⁴ In this coverage, the policy articulates a detailed formula that caps an insurer’s exposure to 25% of the costs associated with the sum of the deductible and casualty or policy limits plus an additional \$10,000.¹¹⁵ The coverage also excludes the extraction of “pollutants” from the land or water as well as their removal, restoration, or replacement.¹¹⁶

Thus, the latest version of the ISO’s Building and Commercial Property Coverage Form offers a new approach where an insured receives limited additional coverage for increases in the cost of construction due to governmental regulation and debris removal, instead of an outright exclusion.

E. ISO’s Increased Cost of Loss and Related Expenses For Green Upgrades

Interestingly, the ISO’s Building and Commercial Property Coverage Form remains silent on how it will treat the unique properties of a green building outside of the two supplemental coverages.¹¹⁷ However, the ISO began offering its Increased Cost of Loss and Related Expenses For Green Upgrades endorsement to the Building and Commercial Property Coverage Form in 2009.¹¹⁸ This endorsement amends the optional replacement cost coverage of the underlying property policy in an effort to address the unique characteristics of a green building.¹¹⁹

Should a covered building sustain a loss, this endorsement binds the insurer to repair or replace the structure with materials and products recognized by a third-party verification organization or governmental entity that sets a standard related to green products and practices.¹²⁰ The endorsement amends the discretionary replacement cost coverage to include the “reasonable additional costs to repair or replace lost or damaged parts . . .

¹¹⁴ *Id.* § A(4)(a).

¹¹⁵ *Id.* §§ A(4)(a)(3) and (4). For greater detail on how this formula exactly functions, the policy provides two examples. *Id.* § A(4)(a)(5).

¹¹⁶ *Id.* § A(4)(a)(2).

¹¹⁷ *But see id.*

¹¹⁸ See GREEN BUILDING ENDORSEMENT, *supra* note 7.

¹¹⁹ *Id.* at A(4).

¹²⁰ *Id.* The endorsement allows for a broad definition of a third-party verification organization or governmental entity as long as it “produces and maintains guidelines related to Green products and practices.” *Id.* at A(2). The subsection specifically accepts the USGBC’s LEED, the GBI’s Green Globes, and the EPA’s Energy Star programs. *Id.*

with materials and products that are recognized by a Green Standards-setter as Green.”¹²¹ For a partial loss, the endorsement provides coverage for the replacement of those building components or systems with an equivalent “Green” one.¹²²

Moreover, this endorsement extends coverage to include the additional expenses that may arise out of the direct loss related to the unique characteristics connected to green buildings.¹²³ To this end, the insurer agrees to provide payments for waste reduction and recycling, for building aeration and tests associated with air quality, for design and professional services, and third-party certification fees and related equipment testing.¹²⁴

Under the waste reduction and recycling coverage, the endorsement provides payments from the insurer when an insured reuses or salvages building materials and contents as well as when removing and hauling recyclable construction waste for proper disposal.¹²⁵ The language providing these payments also creates a limitation that disallows an insured to profit from the program, so any generated revenue will offset the amount of loss taken by the insurer.¹²⁶

Likewise, the endorsement requires that an insurer pay for the costs associated with the building’s indoor air quality when construction is completed.¹²⁷ This coverage includes aerating the affected parts of the building as well as any necessary tests to evaluate the air quality in conformance with a third-party certification organization’s requirements.¹²⁸

To return the green building back to its original state, the endorsement

¹²¹ *Id.* at A(4). Within the endorsement, “Green means enhanced energy efficiency or use of environmentally-preferable, sustainable materials, products or methods in design, construction, manufacture or operation, as recognized by a Green Standards-setter.” *Id.* at A(3).

¹²² *Id.* at A(5). While making sure to not offer coverage for any unaffected building components or systems, the language of the endorsement allows for payments in the event the repair or replacement of the direct loss requires damage or destruction to other parts of the structure. *Id.*

¹²³ *Id.* at B. Depending on the third-party certification system applied, most of the standards assess a green building on a variety of different levels like design, construction, and operation, which includes influences upon the environment, resource utilization, and occupant’s health and well being. See CHARLES K. KIBERT, SUSTAINABLE CONSTRUCTION: GREEN BUILDING DESIGN AND DELIVERY 55 (2d ed. 2008).

¹²⁴ GREEN BUILDING ENDORSEMENT, *supra* note 7, at B.

¹²⁵ *Id.* at B(1).

¹²⁶ *Id.*

¹²⁷ *Id.* at B(4).

¹²⁸ *Id.*

supplies two additional coverages that address this issue.¹²⁹ First, an insurer agrees to pay for essential architectural and engineering services used to repair or replace the affected areas of the building.¹³⁰ Second, the endorsement requires the insurer to pay the fees charged by a third-party certification organization so that the building can attain either certification or recertification.¹³¹ This includes any and all testing required by the organization, but it limits the insurer's responsibility to deliver certification or a specific level within a program.¹³²

However, the endorsement also contains limitations to what it will cover in the event of a casualty that also applies to the unique characteristics of a green building. The endorsement explicitly limits the insurer's responsibility to pay additional costs that emanate out of a change in the building code.¹³³ While not completely disallowing the disbursement of funds in such cases where the green building standard changes due to an enhancement in the law, the language also attempts to curtail payments in an effort to place the Ordinance or Law Coverage or Increased Cost of Construction Coverage ahead of this endorsement.¹³⁴ In effect, this limitation forces the owner of a green building to obtain multiple endorsements in order to obtain full coverage instead of providing a single solution for a complex structure.

Accordingly, the limitations asserted by this provision and how it interacts with the actual coverage supplied by the endorsement compared to its name falls short of what it purports to deliver in the event of a total loss of a green building absent an insured purchasing additional limits with respect to ordinance or law and increased cost of coverage policies. To this end, the ISO appears to follow an à la carte approach that manages risk by broadening

¹²⁹ *Id.* at B(2)-(3).

¹³⁰ GREEN BUILDING ENDORSEMENT, *supra* note 7, at B(2). The allowance of only "an accredited architect or engineer" creates an interesting issue; since many of the third-party certification organizations require that individuals meet their own standard and are not always members of the underlying profession.

¹³¹ *Id.* at B(3).

¹³² *Id.*

¹³³ *Id.* at A(6).

¹³⁴ *Id.* This language used by the ISO in these provisions make it seem as if the policy drafters wanted to have it both ways with respect to coverage. As explained later, sometimes the government remains silent, offers incentives, or mandates green building standards. *See infra* Part III, but this language appears to only offer coverage for replacing the exact same building that existed at the time of its completion. At the same time, the provision seems to make relevant any new iteration in the green building standard to the Ordinance or Law Coverage or Increased Cost of Construction Coverage instead of providing the supplemental coverage that its name implies.

the underlying property policy to guarantee payments for many of the types of casualties a green building may sustain, while simultaneously invoking the need for endorsements elsewhere as a tool for minimizing losses because of the unwavering precedent set by the courts to determine the actual cause of the harm as it relates to the entire injury.

II. GREEN BUILDINGS

With respect to green buildings, the evolving nature of the construction standards and certification continues to mature as the practice becomes more commonplace. However, an owner must look to insure the building once it is completed or else risk absorbing a loss in the event of a casualty. Several areas, such as how state and local governments choose to allow green building projects and the influence of third-party certification programs, may shape the coverage and endorsement needs associated with a property insurance policy. Accordingly, this section considers different approaches taken by state and local governments to regulating green buildings and the role and involvement of a third-party certification program followed by an analysis of the coverage issues related to the ISO's Building and Personal Property Coverage Form.

A. State and Local Governments' Approaches: Incentives or Mandates

Recognizing that the built environment plays an extensive role in a variety of macro and micro issues such as climate change, air quality, energy, and transportation, a number of governmental jurisdictions¹³⁵ and private developers¹³⁶ turned their efforts to regulating the construction of buildings. The initial measures from the state and local governments that imposed green building standards on a project only affected publicly financed or municipal buildings.¹³⁷ However, many of these governments recognized the need to

¹³⁵ See Prum et al., *In Third Parties*, *supra* note 9.

¹³⁶ See Prum & Aalberts, *supra* note 9. Because the property insurance policies take no position with regard to coverage emanating from private land regulations like restrictive covenants and equitable servitudes, this section will focus on the ordinances and laws originating from the government.

¹³⁷ See, e.g., 2005 59th Wash. Sess. Laws ch. 12; 2005 Nev. Stat. 68, 69; Res. 00608-43, Austin City Council (Tex. Jan. 8, 2000); Res. 30121, Seattle City Council (Wash. Feb. 22, 2000); Res. 35956, Portland City Council (Or. Jan. 10, 2001); CMR 02-060, San Diego City Council (Cal. Apr. 16, 2002); Res. 03-0365, Dallas City Council (Tex. Jan. 22, 2003); Res. 041222, Kansas City Council (Mo. Nov. 18, 2004); Art. 37, Boston Zoning Code (Mass.

incentivize private developers and their projects¹³⁸ since limiting these requirements to the construction of public buildings only affected a limited portion of the market.

In casting a wider net, the different governments have employed a variety of approaches to gain acceptance by developers of commercial buildings to embrace a green outcome.¹³⁹ Sometimes the government uses financial and nonfinancial incentives to encourage environmentally friendly structures within its jurisdiction; other times, it uses mandates by adopting and enforcing codes that require the building meet specific green standards.¹⁴⁰

In those jurisdictions taking the incentives approach, the government determines a standard for compliance and then offers some type of perceived benefit to the private developer of the project for furthering the established green building goals.¹⁴¹ In some jurisdictions, a third-party organization's certification is necessary to obtain the incentive,¹⁴² while in others a developer only needs to intend to obtain recognition, and need not necessarily complete their green building obligations.¹⁴³

Of course, a developer retains discretion as to whether or not participation in the program coincides with the project's best interests.¹⁴⁴ This means that the jurisdiction's ordinances or laws do not incorporate any of the added requirements associated with achieving the incentivized sustainable standard as part of the building code. Consequently, only the adopted building code will apply to the completed structure notwithstanding the many green features that may be present or even certified by a third-party verification organization. This approach, endorsed by the U.S. Green Building Council (USGBC), is a market-driven strategy which aims to convince developers that third-party certification will ultimately be in their best interest.¹⁴⁵

Jan. 10, 2007). One commentator interpreted this approach as a situation where the local governments thought that by setting a superior example other participants in the construction industry would also participate. See Schindler, *supra* note 9, at 312.

¹³⁸ See generally Prum, *Creating State Incentives*, *supra* note 9.

¹³⁹ See generally Reber, *supra* note 9.

¹⁴⁰ See Prum et al., *In Third Parties*, *supra* note 9, at 209-19; Prum, *Creating State Incentives*, *supra* note 9, at 177-99; Reber, *supra* note 9, at 585.

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ See Reber, *supra* note 9, at 585.

¹⁴⁵ See KIBERT, *supra* note 123, at 47-49; Reber, *supra* note 9, at 585. In fact, Dr. Kibert explains that a predecessor program to LEED failed due to the decision to create a system based on the standards structure of the ASTM. *Id.* at 56, 77.

In contrast to an incentive based system, some jurisdictions have turned to a more authoritative approach by adopting green building codes.¹⁴⁶ Not without controversy, this alternative approach alters the paradigm set forth by the USGBC and others that look to bring a market driven strategy to building green by convincing developers that the third party certification will ultimately be in their best interest; yet others foresee increased adoptions of such codes as a public policy tool to promote sustainable construction projects.¹⁴⁷

In early 2007, Governor Schwarzenegger directed the California Building Standards Commission to draft regulations for the 2010 code adoption process with respect to residential, commercial, and public green building construction.¹⁴⁸ This directive led to California drafting and adopting the nation's first statewide and comprehensive green building standard, called CALGreen, for implementation on January 1, 2011, which set minimal construction requirements for the entire jurisdiction with respect to sustainability.¹⁴⁹

Similarly, the International Code Council (ICC) developed its own standard "to meet new market needs through model code regulations that promote safe and sustainable construction in an integrated fashion with the ICC Family of Codes."¹⁵⁰ After several years of development and public comment, the ICC released public code version 2.0 of the International Green Construction Code (IgCC) in March 2012.¹⁵¹ The IgCC is a model code aimed at local and state jurisdictions.¹⁵²

¹⁴⁶ See *infra* notes 147-57; Reber, *supra* note 9, at 579-80. There are many motivations for a legislature or agency to take this approach such as a response to natural disasters like hurricanes and earthquakes, the need for a comprehensive uniform standard within a jurisdiction, or as part of a more broadly defined measure that encompasses green building aspects like energy conservation.

¹⁴⁷ See Circo, *Using Mandates*, *supra* note 9; Douglas Feichtner & Andy Kwiatkowski, *An Elevated Standard of Care: Will Green Codes LEED to Litigation?*, 54 FOR THE DEFENSE 61 (Apr. 2012).

¹⁴⁸ CAL. BLDG. STANDARDS. COMM'N, CALGREEN: THE 2010 CALIFORNIA GREEN BUILDING STANDARDS CODE, ARE YOU READY? 3 (2010), available at <http://www.documents.dgs.ca.gov/bsc/CALGreen/The-CALGreen-Story.pdf>.

¹⁴⁹ *Id.* at 1, 3.

¹⁵⁰ History of the IgCC: IgCC Code Development, INT'L CODE COUNCIL, <http://www.iccsafe.org/cs/IGCC/Pages/history.aspx> (last visited Feb. 19, 2013). Established as a nonprofit organization in 1994, the ICC develops and offers a single set of comprehensive and coordinated model national building codes for adoption by communities and governments. About ICC, INT'L CODE COUNCIL, <http://www.iccsafe.org/AboutICC/Pages/default.aspx> (last visited Feb. 19, 2013).

¹⁵¹ History of the IgCC: IgCC Code Development, INT'L CODE COUNCIL, *supra* note 151.

¹⁵² *Id.*

Demonstrating early enthusiasm for such an option, Rhode Island became the first state to adopt a preliminary version of the IgCC when Governor Carcieri signed the Green Buildings Act into law on November 9, 2009.¹⁵³ Following Rhode Island, the North Carolina Building Code Council adopted the Rainwater Collection and Distribution Systems section of the IgCC,¹⁵⁴ Florida passed legislation allowing the IgCC as an option for the retrofitting and new construction of all state-owned facilities,¹⁵⁵ Oregon based its alternate building code, the Commercial Reach Code, on the IgCC,¹⁵⁶ and Maryland allowed its Department of Housing and Community Development to adopt the IgCC by regulation.¹⁵⁷ Both CALGreen and the IgCC create a minimal green building benchmark for those jurisdictions adopting them as part of their applicable construction standard.

Prior to the introduction of CALGreen and IgCC, several other governments attempted to adopt more environmentally friendly building codes to address sustainability in specific areas, which achieved mixed results when tested in the courts. An early decision by a federal court in New Mexico rejected the City of Albuquerque's green building code when the court concluded that federal legislation preempted the Albuquerque code's provisions relating to energy efficiency of equipment and products used in a structure.¹⁵⁸ However, the Ninth Circuit Court of Appeals distinguished the State of Washington's Building Code from the Albuquerque ordinance to find that preemption did not occur.¹⁵⁹ Given these decisions, future litigation will

¹⁵³ Green Buildings Act, 2009 R.I. Pub. Laws §1 (codified at R.I. GEN. LAWS § 37-24-1-37-24-6). Note the Rhode Island Act applies only to public agencies.

¹⁵⁴ *Minutes of N.C. Bldg. Code Council for Dec. 14, 2010, New Petitions for Rulemaking, Item B-10*, N.C. Building Code Council (2010) (request by Ralph Euchner, representing the Plumbing Ad-Hoc Committee to adopt the Rainwater Collection and Distribution Systems code language).

¹⁵⁵ Act of June 24, 2011 ch. 2011-222.

¹⁵⁶ OR. ADMIN. R. 918-465-0010, 918-465-0020, 918-465-0030, 918-465-0040, 918-465-0070 (2011).

¹⁵⁷ Act of May 10, 2011, 2011 Md. Laws ch. 369.

¹⁵⁸ *See* Air Conditioning, Heating & Refrigeration Inst. v. Albuquerque, No. 08-633, 2008 WL 5586316, at *7, *12 (D.N.M. Oct. 3, 2008), *aff'd*, 683 F. Supp. 2d 1133 (D.N.M. 2010). The court found that the Albuquerque ordinance forced a builder to install additional products in situations where the project already met federal standards. *Id.* at *9. Under The Energy Policy and Conservation Policy Act of 1992, federal law establishes the applicable energy conservation standard for products and disallows a state building code to exceed it. *Id.* at *1.

¹⁵⁹ *See* Bldg. Indus. Ass'n of Wash. v. Wash. State Bldg. Code Council, 683 F.3d 1144 (9th Cir. 2012). Recognizing the prior decision in New Mexico, the Ninth Circuit agreed with its lower court that the Washington Building Code and the Albuquerque ordinance

ultimately determine whether CALGreen and the IgCC will more permanently supplant existing building codes.

Thus, the differences between a governmental mandate and an incentive program will serve as the basis for a meaningful distinction when it comes to coverages and exclusions contained in the property insurance policy, which will certainly affect all parties involved in the risk transferring contract.

B. Third-Party Certifications

A better name for a “green building” may be a “high performance” building, because the standards used to measure a project’s contribution to sustainability receive incremental upgrades and adjustments over time.¹⁶⁰ In that case, the third-party programs that determine the certification requirements need consideration as well. Currently, the main third-party participants in verifying and certifying commercial buildings nationally are the USGBC’s Leadership in Energy and Environmental Design (LEED) program and The Green Building Initiative’s (GBI) Green Globes rating system.¹⁶¹ While LEED and Green Globes attempt to measure and quantify the sustainability features of a building differently, they both view the process iteratively and make periodic updates to their programs.¹⁶²

LEED originated in a long development process, between 1994 and 1998, when those individuals creating the program decided on a market-driven approach that allowed building owners to accept or reject the rating method instead of one that compelled compliance through regulations.¹⁶³ The beta Version 1.0 emerged in 1998.¹⁶⁴

Two years later, the USGBC revamped the program and released Version 2.0.¹⁶⁵ Following this release, the USGBC added the New Construction (NC) for commercial buildings as well as other market segments to the program in

contained major differences. *Id.* at 1152. The court determined that the Washington Building Code did not burden builders with additional costs or require the use of higher efficiency products, so it did not conflict with the federal statutes. *Id.*

¹⁶⁰ See Prum, *Green Buildings*, *supra* note 3.

¹⁶¹ See KIBERT, *supra* note 123, at 56. While LEED and Green Globes dominate the national market, other certification systems such as Austin Energy’s Green Building program offer rating systems based on their local requirements.

¹⁶² See KIBERT, *supra* note 123, at 55-65.

¹⁶³ *Id.* at 56.

¹⁶⁴ *Id.* at 57. The USGBC used this version to certify 20 buildings. *Id.*

¹⁶⁵ *Id.* The USGBC significantly overhauled the program and certified 153 buildings with this version. *Id.* at 58.

order to offer a collection of rating systems, and issued LEED-NC Version 2.1 in 2002 followed by 2.2 in 2005.¹⁶⁶ Subsequently, the USGBC launched “the next major evolution of the existing LEED rating systems for commercial buildings” called LEED 2009.¹⁶⁷ Most recently, the USGBC renamed Version 2012 to v4 and announced a delay in the release of the latest iteration to sometime in 2013.¹⁶⁸ This history of repeated revisions appears to have moved the applicable green building benchmarks forward.

Taking a similar approach but with a different pedigree, the Green Globes protocol offers an assessment system that supports a developer’s desires to satisfy market demands for environmentally friendly buildings.¹⁶⁹ The Green Globes assessment tool embodies more than nine years of research and fine-tuning by authorities in the field in conjunction with well-known international organizations.¹⁷⁰

Since its beginnings as a tool designed in the United Kingdom’s Building Research Establishment’s Environmental Assessment Method (BREEAM), later adapted for use in Canada, Green Globes has evolved into a sophisticated online assessment program capable of evaluating multiple types of sustainable construction settings.¹⁷¹ Following these transformative years of 1999 to 2002 in Canada, in 2004 the GBI acquired the rights for the

¹⁶⁶ *Id.* at 57-58. LEED-NC Version 2.1 practically mirrors Version 2.0 but streamlined the required documentation, while Version 2.2 changed the process for submitting a project for certification to an online website. *Id.* at 57.

¹⁶⁷ Press Release, U.S. Green Bldg. Council, LEED 2009 PASSES MEMBER BALLOT: New Rating System Resets the Bar for Green Bldg. Performance (Nov. 18, 2008), *available at* http://www.usgbc.org/Docs/News/Press%20Release_LEED%202009.pdf. The USGBC explained that Version 2009 will include a series of major technical advancements focused on improving energy efficiency, reducing carbon emissions, and addressing other environmental and human health outcomes. LEED 2009 will also incorporate highly anticipated regional credits, extra points that have been identified as priorities within a project’s given environmental zone. LEED has also undergone a scientifically grounded re-weighting of credits, changing allocation of points among LEED credits to reflect climate change and energy efficiency as urgent priorities. This will be one of the most significant changes to the rating system, and will increase the importance of green building as a means of contributing immediate and measurable solutions toward energy independence, climate change mitigation, and other global priorities. *Id.*

¹⁶⁸ Press Release, U.S. Green Bldg. Council, U.S. Green Bldg. Council Announces Changes to LEED 2012 (June 4, 2012), *available at* <http://www.usgbc.org/News/PressReleaseDetails.aspx?ID=4815>.

¹⁶⁹ See KIBERT, *supra* note 123, at 63.

¹⁷⁰ *Green Building Programs: History of the Green Globes System*, GREEN BLDG. INITIATIVE, <http://www.thegbi.org/products/green-globes/history.shtml> (last visited Sept. 8, 2012).

¹⁷¹ *Id.*

United States and agreed to continually improve the system to make sure that it reflects contemporary opinions and continual progress in research and technology.¹⁷²

The GBI received accreditation from the American National Standards Institute (ANSI) to develop standards for green buildings.¹⁷³ When establishing Green Globes as an official ANSI standard, the GBI stated, “[a]ll standards shall be reaffirmed, revised, or withdrawn within 5 years from the original standard approval date, and every five years thereafter.”¹⁷⁴ This affirmation shows the Green Globes rating system is an evolving standard as well.

Besides setting minimum standards, both of these programs allow for additional recognition of buildings that incorporate more sustainable features as part of the structure. The LEED program bestows Silver, Gold, and Platinum recognition for those projects that the USGBC deems to have demonstrated greater sustainability characteristics than required for basic certification.¹⁷⁵ Likewise, the Green Globes system awards a single “green globe” for a minimally compliant building but awards up to four globes for those projects incorporating more sustainable features.¹⁷⁶

Hence, the third-party verification organizations provide a building owner and insurance company tangible proof of a green building’s characteristics and will play a vital role in determining the proper type of coverage as well as setting the valuation and cost for such policies.

C. Issues with the ISO Building and Personal Property Coverage Form

Those parties that choose to use the ISO property policy as a means for transferring risk must consider many unique issues associated with a green building. For instance, many of the systems, materials and products used in the construction of the structure offer cutting-edge solutions, which, because of the risk associated with using untested materials, makes the task of determining replacement value more difficult.¹⁷⁷ As with most emerging

¹⁷² *Id.*

¹⁷³ *Id.* The GBI was the first green building organization allowed to set an ANSI standard.
Id.

¹⁷⁴ THE GREEN BLDG. INITIATIVE, THE GREEN BUILDING INITIATIVE (GBI) PROCEDURES FOR THE DEVELOPMENT AND MAINTENANCE OF GREEN BUILDING STANDARDS § 1.3 (2012).

¹⁷⁵ See KIBERT, *supra* note 123, at 58.

¹⁷⁶ See *Id.* at 62.

¹⁷⁷ See MARSH, GREEN BUILDING: ASSESSING THE RISKS FEEDBACK FROM THE

technologies, their lifecycle and longevity remains unknown.¹⁷⁸ This creates an unpredictable situation where the prices for the replacement products or parts may drop as they become more mainstream, or follow an opposite course due to a lack of supply if they get discontinued.

In other situations, the existing policy language will provide an ample exclusion of coverage. For instance, a vegetative roof may resolve many issues on a project while offering a sustainable solution at the same time, but this design element may raise water intrusion potential and ultimately increase mold exposure. In this case, the ISO policy already provides for claims that may arise from this type of exposure with a very specific exclusion.¹⁷⁹

Given these risks, the valuation will also pose a difficult question; since a green building creates a new and formidable set of challenges to the appraisal community.¹⁸⁰ In fact, one practitioner explained that “there is currently a lack of comprehensive educational material and practical guidance on the integration of sustainability aspects into the educational programs for North American appraisers.”¹⁸¹ To remedy this issue, the parties need to determine a mutually agreeable valuation for the building and continually update it as the governing professional standards evolve. Otherwise, assigning a uniform value to a green building in the event of a total loss will likely become a point of contention.

Moreover, the cost of certification from one of the third-party organizations may create additional and unanticipated costs because it is not part of a change to the building code. Since the organizations that set the standards tend to make incremental changes as research and technology progress,¹⁸² the party bearing the risk will most likely see the cost of achieving equivalent certification rise significantly over time.

To address these issues and those posed by the need for further architectural or engineering services, the ISO offers the previously discussed Increased Cost of Loss and Related Expenses for Green Upgrades endorsement.¹⁸³ While this endorsement presents a solution, it may not be necessary in many cases because the building codes of the jurisdiction in

CONSTRUCTION INDUSTRY 9 (Al Modugno ed. 2009).

¹⁷⁸ *See id.*

¹⁷⁹ *See* ISO BUILDING POLICY, *supra* note 102 and accompanying text.

¹⁸⁰ Timothy P. Runde & Stacey Thoyre, *Integrating Sustainability and Green Building into the Appraisal Process*, 2 J. SUSTAINABLE REAL EST. 221, 222 (2010).

¹⁸¹ Grant W. Austin, *Sustainability and Income-Producing Property Valuation: North American Status and Recommended Procedures*, 4 J. SUSTAINABLE REAL EST. 78, 79 (2012).

¹⁸² *See supra* Part II(b).

¹⁸³ *See supra* Part I(e).

which the property is located may be determinative. Therefore this subsection analyzes the underlying property policy's coverage and makes recommendations for building owners and insurers.

1. Recommendations when the Government Offers Incentives or There is no Public Policy

In a jurisdiction with an incentive scheme, or one with no public policy toward green buildings at all, determining the proper insurance coverage is a nontrivial matter. The ISO form for building and personal property coverage applies the general building code of the jurisdiction at the time of construction.¹⁸⁴ Accordingly, an insurer may inadvertently cover many of the additional requirements used to obtain the green incentives and certification without an insured purchasing the green upgrades, the increased cost of construction, or the debris-removal coverages.

Moreover, the combination of the ISO's underlying building policy and the availability of an endorsement for green upgrades poses another obstacle to determining coverage. Since the underlying building policy does not specifically exclude the unique characteristics associated with a green building,¹⁸⁵ an insurance company would seem to be contractually obligated to provide coverage. However, the availability of the green upgrades endorsement shows that the insurance company recognized the risks associated with such a building and required the purchaser of the underlying policy to satisfy certain conditions in order to obtain this coverage. This predicament will most likely turn on the fact that the insurer bound coverage for the green building based on the established valuation, since the ISO could have excluded green buildings from the underlying policy but chose to remain silent on the subject.

Because of the passive language contained in the ISO policy, the loss settlement basis and the valuation of the building will now play a more critical role in determining if and how much exposure a party bears. Should the owner of the building purchase a replacement cost policy, then the risk would most likely fall on the insurer to meet the new standard for equivalent certification put forward by the third-party verification organization; but the policy limits or valuation established may be too low to cover the construction of a new structure. In this situation, an insurer would be allowed to pay out the policy limit in lieu of the more costly option of

¹⁸⁴ See ISO BUILDING POLICY, *supra* note 100.

¹⁸⁵ *But see id.*

replacing the green building and obtaining appropriate third-party certification, with all of its associated costs.¹⁸⁶

Therefore, both parties face possible exposure and uncertainty to the elevated risks associated with green buildings constructed under a public policy with no standards or uses incentives. This is because the language adopted by the ISO in its Building and Personal Property Coverage Form lacks specifics and may allow for additional coverage by its silence.

2. Recommendations when the Government Mandates Green Buildings

Green building codes, widely adopted across the nation,¹⁸⁷ present different coverage issues when mandated by law. In situations where a jurisdiction applies a green building code to a structure, the standard ISO policy will reflect the environmentally-friendly standard. Consequently, owners and insurers still need to evaluate their actual and acceptable risk tolerances for a particular building when government mandates occur.

With a green building code in place, the increased-cost-of-construction and debris-removal provisions in a policy may become more effective when a total loss occurs if the IgCC has been customized to incorporate existing third-party rating systems.¹⁸⁸ In such cases, the costs associated with reconstructing and certifying the new building to a revised standard and building code will most likely fall under the increased-cost-of-construction and debris-removal limitations contained in the property policy. In these cases, the building owner will need to purchase additional coverage or accept the risk when a casualty occurs.

In the alternative, a government could adopt a green building standard but remain silent on requiring third-party certification. In this situation, the third-party certification requirements will depend on the policy limits and valuation method discussed previously.¹⁸⁹ A replacement-cost approach will most likely force the insurer to obtain similar certification under the new standard unless the valuation of the structure or the policy limits do not cover the cost of constructing a new building. In such a case, the insurer of a green building will likely choose to disburse the policy limits rather than

¹⁸⁶ *Id.* § G(3)(e).

¹⁸⁷ *See supra* notes 141-45 and accompanying text.

¹⁸⁸ Press Release, Int'l Code Council, A Green Code That Was Worth the Wait (Mar. 4, 2010), available at <http://www.iccsafe.org/newsroom/News%20Releases/NR03410-GreenCode.pdf>.

¹⁸⁹ *See supra* Part II(c).

reconstructing and recertifying a new structure with all of the expected cost increases due to the third-party standards associated with a newer version.¹⁹⁰

Consequently, a government's adoption of a green building code brings with it a mixed bag of results for the parties. In some respects, it streamlines the existing property insurance policy and forces a building owner to purchase additional coverage; in other situations, the loss settlement basis and the valuation amount may leave either party with some unexpected costs.

3. Recommendations to Reduce the Uncertainty

The insurer and building owner face the aforementioned exposure because of the policy language adopted by the ISO in its Building and Personal Property Coverage Form. To add some clarity to the situation, an insurer could change the language contained within the policy or look to an underwriting and pricing solution.

Most simply, the ISO could alter the policy language to add a provision that explicitly excludes the green features and third-party certification incorporated into a building from its basic coverage. This would force the insured to purchase the Increased Cost of Loss and Related Expenses for Green Upgrades endorsement in order to remain covered for the sustainable features of the building, or accept the risk.

In the alternative, a pricing solution could allow an insurer that uses the ISO's policies to avoid exposure to the cost of green buildings. The insurer could develop different pricing models for buildings containing sustainable features and buildings without them. These different rates could take into account the added risk associated with a green building without changing the underlying policy language.

Hence, the ISO or an insurer may alter its approach in order to provide all parties involved in a property insurance policy a more stable and predictable outcome in the event of a casualty given the unique characteristics of a green building and the steps taken by the government to promote sustainability in the built environment.

III. INSURANCE INDUSTRY SOLUTIONS

Taking a leadership position in the industry, Fireman's Fund offered the

¹⁹⁰ See *supra* ISO BUILDING POLICY, *supra* note 100 § G(3)(e).

first policy to address green building property issues in 2006.¹⁹¹ At the time, the insurer believed that a green building presented fewer risks than comparable structures that did not incorporate sustainability features.¹⁹² Data collected subsequently by the carrier validated this belief because the company's loss experience showed very few claims that posed few difficulties to settle.¹⁹³ As a result, other insurance companies began offering their own green building endorsements too.¹⁹⁴

Notwithstanding each insurance company's underlying property policy and coverages, most of the green building endorsements offer similar features. In reviewing the common coverages offered by the different insurance companies, each endorsement provides compensation for the recertification of a building in the event of a casualty.¹⁹⁵ This generally includes the costs associated with: debris removal that comports with sustainable practices,¹⁹⁶ the fees for hiring the appropriate design professionals to gain certification,¹⁹⁷ the need for testing and balancing of the systems within the structure,¹⁹⁸ and the commissioning of the building.¹⁹⁹

¹⁹¹ Wells, *supra* note 4. According to a representative from Fireman's Fund, the company collected \$5 million worth of premiums in 2006. *Id.* In 2007, it received \$20 million and expected to complete 2008 at the \$100 million level. *Id.* By 2010, the company reported writing \$150 million in premiums with approximately 1,500 endorsements in force. Fireman's Fund Green Insurance Fact Sheet FIREMAN'S FUND INS. (Jan 26, 2011), available at http://www.firemansfund.com/Documents/Green_Press_Kit.pdf. See also Press Release, Fireman's Fund Ins., Fireman's Fund Insurance Company Introduces New Green Insurance Endorsements to Broaden Coverage for Policyholders (June 23, 2010).

¹⁹² Wells, *supra* note 4.

¹⁹³ *Id.*

¹⁹⁴ See, e.g., TRAVELERS GREEN ENDORSEMENT, *supra* note 7; CHARTIS GREEN ENDORSEMENT, *supra* note 7; LIBERTY MUT. GREEN ENDORSEMENT, *supra* note 7.

¹⁹⁵ See FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, § V(E); TRAVELERS GREEN ENDORSEMENT, *supra* note 7, § 5; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 3(B); LIBERTY MUT. GREEN ENDORSEMENT, *supra* note 7, § 1(A)(5). Both Travelers and Chartis limit their liability in this area to \$25,000. TRAVELERS GREEN ENDORSEMENT, *supra* note 7, § 5; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 3(B).

¹⁹⁶ FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, § V(F); TRAVELERS GREEN ENDORSEMENT, *supra* note 7, § 5; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 4(A); LIBERTY MUT. GREEN ENDORSEMENT, *supra* note 7, § 1(C). Chartis limits its liability in this area to \$25,000. CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 4(A).

¹⁹⁷ FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, § V(C); TRAVELERS GREEN ENDORSEMENT, *supra* note 7, § 5; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 4(C); LIBERTY MUT. GREEN ENDORSEMENT, *supra* note 7, § 1(A)(1). Travelers limits its liability in this area to \$25,000, while Chartis limits its liability to \$50,000. TRAVELERS GREEN ENDORSEMENT, *supra* note 7, § 5; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 4(C).

¹⁹⁸ FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, § V(G); TRAVELERS GREEN ENDORSEMENT, *supra* note 7, § 5; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 4(B);

Each endorsement also eliminates many of the exclusions contained in the underlying property policy for a vegetative roof and makes individually unique coverages for this feature available.²⁰⁰ Some insurers include provisions for the steps taken to reduce the heat island effect of a building, while Fireman's Fund even extends its coverage to incorporate vegetative swales as well.²⁰¹

All of the endorsements also determine which third-party certification organizations' ratings qualify for compensation. The endorsements universally identify the LEED program as acceptable, while Green Globes is used by endorsements from all of the insurance companies except Chartis.

Beyond these common coverages, Fireman's Fund also offers to replace any green-certified building that has suffered a total loss with a new one that conforms to the current requirements imposed by the green-rating authority, even if this is a level higher than that which the old building had to meet to be certified; or, if the old building was not green-certified prior to the casualty, Fireman's Fund will pay the increased cost to update the replacement building to the minimum requirements of green-certification.²⁰² Liberty Mutual offers a similar policy for buildings with a green building certification, while Chartis offers it only for buildings without such distinction.²⁰³

LIBERTY MUT. GREEN ENDORSEMENT, *supra* note 7, § 1(A)(2). Both Travelers and Chartis limit their liability in this area to \$25,000. TRAVELERS GREEN ENDORSEMENT, *supra* note 7, § 5; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 4(B).

¹⁹⁹ FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, § V(D); TRAVELERS GREEN ENDORSEMENT, *supra* note 7, § 5; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 4(D); LIBERTY MUT. GREEN ENDORSEMENT, *supra* note 7, § 1(A). Both Travelers and Chartis limit their liability in this area to \$25,000. TRAVELERS GREEN ENDORSEMENT, *supra* note 7, § 5; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 4(D).

²⁰⁰ FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, § V(B); TRAVELERS GREEN ENDORSEMENT, *supra* note 7, §§ 1, 2; CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 3(A)(2); LIBERTY MUT. GREEN ENDORSEMENT, *supra* note 7, § 1(D). Vegetative roofs provide an interesting dichotomy of provisions since each insurance company supplies its own definitions for coverages and exclusions.

²⁰¹ FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, § V(B); CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 3(A)(2). Chartis also includes only the heat island effect coverage but limits its liability in this area to \$25,000. CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 3(A)(1). Fireman's Fund's endorsement defines a vegetated swale as:

[T]rees, plants and shrubs that are apart of a broad, shallow channel incorporated in the landscaping system that includes a dense stand of vegetation covering the side slopes and bottom of the channel. Swales can be natural or manmade, and are designed to trap particular pollutants, promote infiltration of water, and reduce the flow velocity of storm water runoff.

FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, § XI(L).

²⁰² FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, §§ III(B)-(C), II(B).

²⁰³ LIBERTY MUT. GREEN ENDORSEMENT, *supra* note 7, § 1(A); CHARTIS GREEN

The endorsement offered by Fireman's Fund surpasses those of other insurance companies in other ways as well. It provides its policy holders with coverage for all real and personal property that is intended to improve energy or water consumption efficiency, enhance human health, or reduce the environmental footprint of the structure as well as porous paving that facilitates drainage into the ground in order to manage water flow.²⁰⁴ Because many green buildings receive financial incentives from the government and utilities for furthering important public policies, the Fireman's Fund endorsement also provides coverage in the event a property owner loses such benefits.²⁰⁵

Essentially, all of the endorsements offered by the insurance industry seem to deliver the same basic coverages for a green building with the caveat that the endorsement from Fireman's Fund offers quite a bit more than those of the other insurers. The insurers all appear to recognize many of the unique aspects and characteristics of a green building by the types of coverages they make available.

Unfortunately, it is hard to tell whether these endorsements are more of a defensive approach by the insurance companies or an attempt to address the green building issues in an altruistic manner. As discussed previously with the ISO policy language and endorsements, the underlying building coverage will play an important role in determining whether an insurance company will be obligated to pay for the additional certifications and features associated with a green building.²⁰⁶ But these endorsements all provide for compensation to deliver the same or better recognition from the third-party verification organizations.

Therefore, it is reasonable to foresee a scenario where one of the carriers requiring a green building endorsement will deny an insured with replacement coverage compensation for recertifying with a third-party organization for a structure suffering a total loss, solely because the insured did not purchase the additional policy and pay for the extra risk. In such a case, the fact that the insurance company offered such an endorsement could relieve it of its green building obligations, but with the current lack of sympathy by courts toward

ENDORSEMENT, *supra* note 7, § 2(B)(5). The Chartis endorsement offers LEED silver certification. CHARTIS GREEN ENDORSEMENT, *supra* note 7, § 2(B)(5).

²⁰⁴ FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7, §§ II(C), V(I). Note the policy only covers such property but where there is no equivalent material or product acceptable under the provisions of Section II(B). *Id.*

²⁰⁵ *Id.* § V(H).

²⁰⁶ See *supra* Part III(c)(i).

insurers, it is highly unlikely this argument will prevail.

In addition, none of the documents included language similar to the ISO strategy described earlier to redirect the risk associated with changes due to an ordinance or law onto another endorsement.²⁰⁷ Absent a complete analysis of each insurance company's underlying property insurance policy, this approach remains an issue that will require attention. As seen earlier, courts appear to deny these provisions in property insurance policies in favor of ascertaining whether the actual cause of the casualty originated from a covered peril in order to force an insurer to cover the total loss of a building.²⁰⁸

Consequently, it appears from these green building endorsements that the insurance companies appear to see a need for these types of coverages and are trying to satisfy the demand of the market in a straightforward manner without developing a sophisticated model for transferring the risk.

IV. CONSIDERATIONS FOR INSURING A GREEN BUILDING

The stakeholders involved in transferring the risk associated with a green building must evaluate their situation carefully to determine a proper course of action. The unique characteristics of a green building, along with the shifting governmental landscape with respect to the public policy, creates numerous issues for this type of property insurance coverage. As discussed throughout this article, a building owner and the owner's insurance company need to consider the application of the ordinance or law exclusion, the valuation method and amount, and the coverages features as applied to the green building being insured.

In evaluating the ordinance or law exclusion, both parties need to consider the current and future attitudes of the jurisdiction where the property is located with respect to green buildings. If the jurisdiction has already adopted a green building code like IgCC or CALGreen, then the building owner most likely needs to obtain a separate ordinance or law endorsement with significant coverage, because the chances of a change in the code in the future is very high.

In contrast, for those jurisdictions that have not adopted a more environmentally-friendly building code, then the ordinance or law exclusion

²⁰⁷ See FIREMAN'S FUND GREEN ENDORSEMENT, *supra* note 7; TRAVELERS GREEN ENDORSEMENT, *supra* note 7; CHARTIS GREEN ENDORSEMENT, *supra* note 7; LIBERTY MUT. GREEN ENDORSEMENT, *supra* note 7.

²⁰⁸ See *supra* Part I(d).

may not pose as large a risk for a green building as for a normal structure, because many of the green requirements already surpass standard practice, and are therefore likely to be compliant with the law even in the event the applicable law or regulations are updated. Additionally, a property owner may rationally forgo the purchase of an ordinance or law endorsement because the case law appears to regard such exclusions in an adverse manner.²⁰⁹ Regardless of the decision to opt out of having coverage in those jurisdictions that do not maintain a green building code, the building owner ultimately chooses to accept the risk in the event a casualty occurs and will later have to prove that it was transferred to the insurer should that be the point of contention.

When taking into account the valuation issues, the building owner and insurer will find the best solution with replacement coverage because of the unique features associated with a green building and its high performance characteristics. For a property owner looking to transfer the risk of a loss, the materials and lifecycle of the products used to construct the building remains questionable; so the risks of issues with obtaining suitable replacements in the future shifts to the insurer and its experience and tolerance for identifying the possibility of a casualty. To this end, Fireman's Fund took the position that green buildings presented a better risk than comparable non-green ones, which the company subsequently validated in its loss experience.²¹⁰

Furthermore, an appraiser will face obstacles in determining the proper value for a green building in the event of a total loss. Because of the relative novelty of green buildings and a lack of historical experience quantifying their intangible features, the process of determining a value appears to be evolving as appraisers continue to fine-tune their methods.²¹¹ A lack of consensus for determining a loss value means that both the building owner and insurer need to proceed with caution as they determine the policy limits, given that the valuation could cause an over- or under-insurance problem. All of these issues cut both ways, so the replacement coverage approach as a loss settlement basis provides the best balance to the risks associated with green buildings provided that everyone involved can settle on a fair and reasonable value.

Finally, coverage issues surrounding a green building require special attention from both the building owner and the insurer. While many of the

²⁰⁹ See generally *supra* Part I(c) (providing a summary of relevant court opinions on the matter).

²¹⁰ See Wells, *supra* note 4.

²¹¹ See Runde & Thoyre, *supra* note 180, at 222-26.

systems are designed to meet sustainable policy objectives and can be easily replaced with more efficient models during a products evolutionary cycle, other aspects of a green building may present difficulties. For example, many green buildings contain unique architectural and other types of features in order to gain additional credit toward third-party certification. In these situations, the insurer needs to identify and remediate such risks in a similar manner to that which they already do with vegetative roofs where the underlying property policy contains an exclusion but the endorsement recognizes and covers this type of feature.

On the other hand, the property owner needs to verify whether the underlying property policy language excludes the documentation associated with delivering and recertifying the building up to a third-party verification-organization's standards. Should the underlying policy fail to exclude such documentation, then a building owner could reasonably expect that a replacement-coverage approach will include such documentation should the valuation reflect the significance of this certification, which may come as a surprise to an insurer.

Moreover and aside from the coverage issues presented, a situation where the insurance policy fails to reconstruct the green building after a total loss may trigger the termination of government incentives. In some states like Nevada and Virginia, the government chose to induce developers to construct green buildings by offering property tax abatements after they satisfy specific requirements.²¹² With the exception of the Fireman's Fund endorsement, neither the ISO nor the other insurance companies offer coverage for a situation where the building owner loses their tax incentives after a total loss.

Thus, a property owner and insurer can determine the correct amount of coverage using the existing documents. To simplify the coverage issues, an insurer can take the foregoing steps to strengthen the language in its policy or look to an underwriting solution by asking a property owner at the beginning whether the building is green and requiring premiums according to a separate rate-structure.

V. CONCLUSION

With more green building owners seeking to insure their property, the insurance industry is trying to meet the challenges associated with identifying

²¹² See Assemb. B. 621, 74th Gen. Assemb., (Nov. 2007); VA. CODE ANN. § 58.1-3221.2 (2009).

the appropriate risk for these structures through endorsements. Many insurers already feel comfortable with the risks presented, but few have sufficient experience with the features and requirements associated with the green building movement. As a result, a property insurance policy may inadvertently provide sufficient coverage for a green building even without the purchase of an applicable endorsement.

To solve this problem, a property insurance policy for a green building needs to reflect how the regulatory requirements, the valuation method and amount, and the coverage features correlate with potential losses in order to provide a more precise instrument to shift the risk. Therefore, the insurance industry needs to continue to refine its product based on these evolving factors while further developing this growing market; since many of the features linked to a green building of today will become the standard of tomorrow.