

The Metropolitan Corporate Counsel

www.metrocorp-counsel.com

Volume 17, No. 12

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December 2009

New Jersey Appellate Division Broadly Construes “Ordinance Or Law” Endorsement Of An ISO Property Insurance Policy In Favor Of Coverage

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In a ruling sure to be of interest to both corporate and individual policyholders, on October 6, 2009 the New Jersey Supreme Court denied certification of an insurer's petition to appeal a decision by the New Jersey Appellate Division. In a case of first impression in New Jersey, the Appellate Division broadly interpreted the “Ordinance or Law” (“O/L”) provision of an ISO property insurance policy in favor of coverage. *DEB Associates v. Greater New York Mutual Insurance Co.* (“DEB”)¹

ISO property policies generally cover only the replacement cost of rebuilding the exact same structure that was damaged in a fire, storm or flood. The O/L endorsement extends coverage to the extra costs of reconstructing or repairing a building when the policyholder is required to comply with the current Construction Code from which the structure

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was previously exempt.² Typically, a building need comply only with the Construction Code in effect at the time a permit was issued for its construction. However, if a building sustains a loss requiring substantial reconstruction of the structure, the building may be required to comply with the current Construction Code. It is the increased cost of complying with the current code that is covered by the O/L endorsement.

In *DEB*, the New Jersey Appellate Division found Greater New York Mutual Insurance Co. (“GNY”) liable to the owner of an eight-story office building in Cherry Hill, NJ, for the costs of securing the building's walls to the floors pursuant to the current New Jersey Construction Code. The office building had been constructed in the early 1970s prior to New Jersey's adoption of a state-wide Construction Code.³ The building was erected with concrete block exterior walls attached to slab floors solely by mortar. Subsequently, New Jersey adopted a Construction Code which required the block walls to be mechanically attached to the slab floors, but the building was “grandfathered” from complying with the new code.

On December 11, 2003, a windstorm ripped off the exterior concrete wall of one side of the seventh floor of the building, and sent it crashing onto the parking lot and adjacent highway below.⁴ An



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inspection immediately performed by the Cherry Hill Building Inspector found that the remaining walls of the building, which did not appear to have suffered any damage in the windstorm, visibly deflected (i.e., moved) when pushed by hand. The Building Inspector declared that the building was an “unsafe structure” within the meaning of the Construction Code. He ordered that the building be closed until the remaining walls were attached to the floor in accordance with the current code. The repair ultimately involved opening the interior of the walls throughout the building and installing steel fasteners every three feet mechanically attaching the walls to the floor.

The wall collapse resulting from the windstorm was a covered loss under the policy for which GNY paid the cost of reconstructing the missing wall. The insurer further agreed to pay under the O/L endorsement for the attachment upgrade for the damaged wall required by the current Construction Code. The insurer, however, balked at paying for the cost of bringing the non-damaged walls throughout the building into compliance with the attachment requirements of the current code.

The carrier argued that the windstorm had not caused the current Construction Code to be applied to the undamaged walls because these walls had not been damaged in the windstorm. GNY further argued that if the building inspector had examined the walls pre-collapse and found them to be deflecting, he would have declared them unsafe and ordered the building to comply with the current

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code regardless of the windstorm. Indeed, when DEB performed unrelated wall repair several years earlier, it had been required to comply with the current code for that portion of the wall that had been repaired. Relying on various out of state cases supporting its position, GNY argued that the loss did not cause the undamaged walls to be required to comply with the current code. GNY contended that the collapse merely caused the inspector to discover an existing unsafe condition, which was outside the scope of the O/L coverage.

DEB, represented by Sills Cummis & Gross of Newark, New Jersey, argued that the literal language of the policy mandated coverage in this situation. The O/L endorsement promised payment for “the increased cost to ... reconstruct or remodel undamaged portions” of a building which suffers a covered cause of loss, as long as that cost “is a consequence of enforcement of building, zoning or land-use ordinance or law.”⁵ DEB argued that although the deficient condition may have existed for years, coverage under the O/L endorsement was not defeated because the endorsement only required the occurrence of a covered cause of loss (here, windstorm), and that extra cost thereafter be incurred as a consequence of enforcement of a Construction Code from which the building was previously exempt. Prior to the loss, the building had not been required to conform to the current Construction Code and therefore had not been legally required to undergo the wall-securing construction. Thus, the enforcement of the current Construction Code was clearly a consequence of the windstorm.

No reported New Jersey decision had previously addressed the scope of the O/L endorsement or the causative link needed between the loss and the implementation of the current Construction Code. The Court began by viewing the policy “through the eyes of the reasonable insured...”⁶ The Appellate Division found a “clear causal connection between the collapse of the seventh floor wall and the code official’s mandate that [DEB] bring the remaining floors into compliance”⁷ While declining to elaborate on the outer reach of the causal relationship required, the Court applied a broad proximate cause test for determining coverage stating: “[w]here a peril

specifically insured against sets other causes in motion which, in an unbroken sequence and connection between the act and final loss, produced the result for which recovery is sought, the insured peril is regarded as the proximate cause of the entire loss.”⁸ Stated otherwise, “but for wind damage to the seventh floor of its building ... plaintiff would not have been required to bring the wall-to-floor connections in the rest of the building up to current code standards.”⁹

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Relying on a series of out of state cases finding a carrier not liable for code violations that pre-dated a loss, the insurer argued that the faulty walls were a deficient construction condition that existed prior to the loss and should not be covered by its policy. The Court rejected this noting that “a building that did not conform to the current code might be deemed acceptable before a disaster, but be deemed unsafe after the disaster occurs.”¹⁰ The Court further observed that the O/L endorsement in the policy only excluded the cost of code compliance where the building had violated an applicable code prior to the loss. In this case, it was undisputed the building had not been cited for code violations and did not have to comply with the current code until after the collapse. Indeed, there was no evidence that any building code had been in effect in the early 1970s when the building was constructed. With regard to the insurer’s contention that pre-existing deficient construction conditions should not be covered by the policy, the court

ruled that had GNY intended to restrict coverage for construction deficiencies that were grandfathered, it could have done so, but did not.¹¹ The Court refused to imply an exclusion that the carrier failed to put in the policy.

The DEB case is a major victory for policyholders in New Jersey in a case of first impression in the State. Because it interpreted a common policy form issued by the Insurance Services Organization and used by many insurers, the case has broad application to many other policyholders with the same form. The Court rejected the insurer’s contention that code upgrades resulting from an inspection by a code official after a loss, were not caused by the loss. The Court employed a broad proximate cause test for determining when compliance with a current code is caused by a loss. Further, pre-existing construction deficiencies will not serve to bar coverage unless the building was in violation of applicable codes prior to the loss. O/L coverage extends to both parts of the building damaged during an insured event, and parts of the building which escaped damage. Policyholders facing a steep bill to bring their building into compliance with the current Construction Code after a substantial loss caused by an event insured under their property policy, should look to their insurers for coverage under the O/L Endorsement.

¹ 407 N.J. Super. 287 (App. Div. 2009).

² Most O/L endorsements offer coverage for the costs of complying with construction, zoning, and land-use laws; building codes are prominent among these and were at issue in this case.

³ Since 2003, New Jersey has adopted the International Construction Code. N.J.A.C. 5.23-3.14(a)(1).

⁴ Incredibly, no one was injured by the wall collapse.

⁵ Id. at 290.

⁶ Id. at 296.

⁷ Id. at 300.

⁸ Id.

⁹ Id. at 289.

¹⁰ Id. at 296.

¹¹ Id. at 301.