Additions and Extensions of Property Coverage: Not an Alternative to Exposure Identification

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"So long as I know it not, it hurteth mee not."
~in Petit Palace by G. Pettie (1576)

"Ignorance is a voluntary misfortune."
~Unknown author

"Ignorance is bliss."
~Thomas Gray (1716–1771)

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Most property insurance policies contain sections titled something like "Additional Coverages" and "Coverage Extensions." While the words "additions" and "extensions" suggest that the policy is broadened, it does not necessarily mean that the coverage and/or limit satisfies the insured organization's coverage needs based on actual loss exposures. If one plays devil's advocate, then any reference to a coverage addition or extension in a property insurance policy should be seen first as a possible coverage limitation until the loss exposure is reviewed and understood. Said differently, some coverage in an insurance policy is just that—"some coverage"—it does not mean the coverage provided is what the insured organization needs. Relying on standard policy additions and extensions of coverage without an understanding of loss exposure may result in an underinsured loss to the insured organization and thereby create a scenario for a possible malpractice claim against the insurance agent or broker. Ignorance is not bliss, and misfortune suffered by one party can become expensive misfortune to all parties involved in an insurance policy.

Coverage disputes between risk manager and insurer, agent, or broker are not always about ambiguity of policy language. Many disputes stem from a lack of understanding of coverage detail and unsatisfied coverage expectations. The devil is in the details; one must understand coverage limitations prior to loss. While one insurance policy may be better written than another is, the best insurance policy is the one that covers the loss as expected by the insured organization.

Risk treatment for any loss exposure (i.e., first party or third party) must begin with exposure identification, no matter if insurance or other technique(s) will be used (i.e., contractual risk transfer, pre/post-loss control, segregation of exposure, etc.). The identification process should rely on many different tools including use of exposure surveys/questionnaires, insurance applications, walking around the insured organization asking "what if" questions. Even reading an insurance policy (property, builders risk, crime, general liability, etc.) is a way to understand what risks of loss may occur to the insured organization and where coverage issues may exist for an uninsured or underinsured event.

Many property insurers follow policies filed by Insurance Services Office, Inc. (ISO), in their entirety or closely but may file their own form with significant deviations. These independently filed policies may be broader than ISO's in certain areas, and significant coverage differences may be found when comparing one insurer's policy form to that of another insurer's policy form; one policy may be superior to that used by another insurer in its ability to cover a specific property loss exposure. What does this mean to the risk management professional? While several different property insurers may be seen as equal in terms of financial stability, quality of service, and cost, the coverage each provides may be unequal in the way one policy addresses a given loss exposure: one may provide sufficient coverage, while the other may not, even though both may be thought of as having broad coverage terms.

Particularly Troublesome Additions and Extensions

To discuss "additions" and "extensions" of coverage issues, we will use ISO building and personal property coverage form CP 00 10 06 07 to set our baseline. While the ISO form has many "additions" and "extensions," we address only those that seem to pose a truly catastrophic loss exposure.

Debris Removal

Coverage is for expense to remove debris of covered property damaged or destroyed by covered cause of loss from insured premises. The limit is 25 percent of the sum of the deductible plus the amount of direct damage loss paid plus a possible additional $10,000 if the 25 percent limit is not sufficient. Debris removal must be within 180 days of the loss.

In addition to physical damage caused by an insured peril, there may be significant costs incurred to remove debris. Debris removal will likely increase in proportion to the size of the loss. Hazardous material debris (i.e., asbestos) will further increase the overall expense related to debris removal. The organization may be liable for land and water pollution as a result of hazardous materials released by the loss event (i.e., fire). There is no guideline or touchstone available that a risk manager can use to estimate the debris removal exposure.

ISO policies consider debris removal expense to be insured to the extent that (1) the debris is of covered property, (2) it is caused by an insured peril, and (3) the expense is not for extraction of pollutants from land or water or to remove, restore, or replace polluted land or water. (These expenses are addressed by the pollutant cleanup and removal additional coverage, discussed below.) The coverage limit for debris removal is part of and not in addition to the overall limit for covered property. In an ISO policy, the coverage is subject to a sublimit of 25 percent of the sum of the deductible plus the amount paid by the insurer for direct physical loss. ISO provides an additional $10,000 for debris removal expense should the coverage limit be insufficient due to the overall property damage limit or the 25 percent sublimit. ISO endorsement "Debris Removal Additional Insurance" CP 04 15 10 00 provides a means for an insurer to increase the $10,000 limit to another amount.

Non-ISO policies treat debris removal in a manner similar to ISO in that the coverage is part of the property limit but may allow a greater sublimit within the overall direct damage limit such as "... the greater of 25% of the amount of physical damage payable ... or $5,000,000."

A catastrophic loss may use a substantial portion or the entire direct damage limit, leaving an insufficient amount for debris removal expense. It is important to consider the cost of debris removal when establishing a direct damage limit at any one location. Debris removal cost drivers include but are not limited to age of the building, proximity to other buildings (i.e., maneuverability of equipment), type of structure (wood frame or steel frame; steel will be more expensive to cut, clear, and remove), and existence and type of hazardous materials.

There is no benchmark that can be used to estimate the pre-loss cost of debris removal. A risk manager could request a cost estimate from a local demolition/debris removal contractor based on an assumption of a total loss. This cost can be trended each year much like trended replacement cost values. An increase in coverage sublimit and overall location limit can be requested as deemed appropriate by the risk management professional.

Pollutant Cleanup and Removal

What is pollution in a property policy? ISO defines "pollutants" in its policy form as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals, and waste ... (materials to be recycled, reconditioned or reclaimed)." This definition is a key to understanding direct damage and business interruption coverage that may be provided, albeit limited, in the ISO property policy form.

Are there any coverage restrictions since direct damage has resulted in release of pollutants? Coverage is excluded unless the discharge, dispersal, migration, release, or escape is from a "specified cause of loss." This means that the Causes of Loss-Special Form will have limitations, as "specified cause of loss" is defined to mean the following named perils: fire; lightning; explosion; windstorm or hail; smoke; aircraft or vehicles; riot or civil commotion; vandalism; leakage from fire-extinguishing equipment; sinkhole collapse; volcanic action; falling objects; weight of snow, ice, or sleet; and water damage. What perils are not "specified" and therefore not covered? Uninsured perils include events such as accidental spills from manufacturing error or seepage from a corroded pipe.

ISO-filed policies provide a limit of $10,000 for expenses to extract pollutants from land or water at the scheduled location if the release of pollutants is from a specified covered peril as defined above, such as fire and windstorm. The catastrophic nature of pollutants may result in land and water extraction costs far greater than those insured in an ISO property policy. An increased pollutant extraction limit should be considered based on exposure, although it is uncertain as to what limits an insurer may provide. It is always better to request an increased limit from the insurer than to assume that none is available. Stand-alone direct damage and business interruption pollution coverage may be available from specialty pollution insurers.

Increased Cost of Construction

Enforcement of building laws after a property loss event may result in perils and costs not otherwise insured by the direct damage portion of a property insurance policy. Such laws may require the condemnation and demolition of the remaining physical structure. Unless properly endorsed, the condemnation and demolition exposures are not insured in the ISO policy form or in many independently filed policies. These exposures must be separately insured by endorsement such as ISO endorsement CP 04 05 04 02.

But the basic ISO property policy, CP 00 10 06 07, provides some coverage for increased costs of construction ("ICC") as long as the building coverage is on a replacement cost basis. Coverage applies to increased costs required by enforcement of ordinance or law to meet current building codes. The limit for the ICC in the base form is the lesser of $10,000 or 5 percent of the direct damage insurance that applies to the damaged building. This limit is likely not sufficient if the building is large, old, and in need of mandatory upgrades in electric service, plumbing, and ingress and egress.

It is important that the ICC exposure is reviewed along with the exposures for condemnation (coverage for the remaining structure that is not damaged by insured peril) and demolition (cost to demolish the condemned structure). Most insured organizations will need coverage as provided by ISO endorsement CP 04 05 04 02 or its equivalent and should not rely on the low limit of coverage provided for ICC in policy form CP 00 10 0607. Relying strictly on the limited ICC coverage provided in this policy form may leave the insured organization vastly underinsured for significant costs related to condemnation and demolition.

Newly Acquired or Constructed Property and Property Off-Premises

Property insurance is typically provided on a scheduled location basis either through a schedule included in the policy form or by reference and reliance on a statement of values provided by the insured organization to the insurer. There may be occasions in which property exposures arise that are not shown as locations on a policy schedule or submitted statement of property values. The risk management professional must understand the limitations of coverage when the location and covered property are not listed in a schedule or currently included in the statement of property values.

Organizations expand to new locations and add personal property as part of their natural evolution. Additions in building exposures can occur by purchase of an existing structure or construction of a new one. Personal property may increase at a location scheduled in the policy, at a newly constructed location, or at a location where the personal property purchase is made pending shipment to a location scheduled in the policy.

In the ISO policy, the newly acquired/constructed coverage is temporary as it exists for a finite period no greater than policy expiration or 30 days. Coverage during this temporary period is limited to $250,000 per newly acquired or constructed building and $100,000 for personal property at each of these same covered buildings. The risk manager must have a process to ensure proper internal reporting of all newly acquired or constructed property (buildings or personal property) to him or her. Proper identification of all property exposures is necessary to make proper changes to scheduled insured locations, update the statement of value for reporting to the insurer, and track values in relation to policy limits—sublimits or otherwise.

It is important to understand how coverage applies to personal property that is at a location that is not scheduled or insured under the newly acquired/constructed property coverage. What events may lead to personal property being at other than a scheduled location? There are several reasons: property left offsite for repair, work on goods in process in the custody of a manufacturing subcontractor, or property in a public warehouse.

The ISO property off-premises extension of coverage is limited in many ways.

1. The location cannot be a scheduled location in the policy, nor covered under "newly acquired/constructed" coverage grant.
2. Coverage is subject to a limit of $10,000 per occurrence.
3. The temporary location must not be owned, leased, or operated by the insured organization, except that coverage does apply to property at a leased storage location if the lease was executed after the beginning of the current policy term.
4. Personal property is covered while at a fair, trade show, or exhibition, but no coverage applies to property in or on a vehicle.
5. No coverage applies to property in the custody of salespersons unless the property is at a fair, trade show, or exhibition.

Risk management due diligence is necessary for all personal property, especially that which may be off premises at an unscheduled location. It is essential that all ongoing locations are known to the risk manager so the policy form and statement of values can be amended correctly to address the exposure created by each location, scheduled or not, and at a limit sufficient for the expected exposure.

Conclusion

The risk management professional must understand the direct damage loss exposures contemplated by *additions and extensions* of a property insurance policy to determine whether the coverage is reasonable for expected loss. Adequacy of insurance coverage can only be achieved if both exposure to loss and policy coverage are compared and understood and revisions are sought as needed. The quality of any insurance policy is measured at time of loss settlement.

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