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Insurance Planning for 2016: Top Ten Real Estate Liability Concerns

Real estate professionals, owners, managers, investors and lenders, as well as anyone else involved in today's real estate market, face a variety of risks of loss. Here are ten ways insurance can help mitigate potential liabilities.[1]

1. **Additional Insured Coverages**. Real estate transactions are complex, with multiple parties with diverse roles and durations of involvement. This means multiple policies of insurance. So, when liability occurs, think "outside the box" and look to *all* potential sources of insurance, rather than only to your own policies. Other sources of insurance might include policies issued to developers, property owners, property managers, lenders, tenants or contractors (and subcontractors). And, when you qualify as an additional insured, coverage may be available even where the third-party policyholder is not itself a liability target.

2. **Cyber Liabilities**. Cyber crime, hacks, data loss and corruption frequently top the headlines. The real estate industry is not immune from this exposure and, in some respects, it is at heightened vulnerability. This is particularly so with financing and tenant relations. In the past, cyber-related liabilities were covered under traditional general liability insurance policies. However, with exposure from cyber risk increasing, insurers have worked to limit coverage under traditional or "legacy" liability policies. Businesses engaged in the real estate market, particularly mortgage lenders and property managers, should consider some form of cyber-risk protection in their insurance portfolio.

3. **Pollution Liability Policies (for lenders)**. Unknown environmental problems can impose liabilities that far exceed those caused by fire, vandalism, theft or title risks. This is particularly significant for lenders, who are removed from day-to-day activity at the property, yet rely heavily on property value to protect their financial investment. When collateral property is contaminated, value falls, increasing risk. Even where the lender assumes ownership of the property through foreclosure or otherwise, the lender may still not recoup the loan balance due to the cost of cleanup and the resulting diminution in value. Lender liability insurance can help mitigate this risk. The insurance can be bought by the lender or the borrower as a condition to the loan.

[1] This information is not intended to create an attorney-client or similar relationship. This paper is only a general overview and is not legal advice; if you have specific questions about your insurance coverage, and how these situations may affect it, please contact the authors at the contact information below.

4. **Mergers and Acquisitions**. Real property transfer is often a significant part of corporate mergers, acquisitions and consolidations. Insurance may not be viewed as a high-priority item in the transaction, or it may be overlooked altogether. Those involved should take care that existing insurance is not forfeited when new legal entities are formed or when existing entities are dissolved. The insurance contracts themselves should always be reviewed for provisions governing assignment of the contract, notice to the carrier or other terms that could affect the viability of the insurance after the transaction is complete.

5. **Reps and Warranties**. Inaccuracies in transaction-related representations and warranties made by a seller or the target company can lead to costly liabilities. Buyers can be left without the ability to cover costs or recover expenditures or losses, while sellers may be forced to give back a portion of the purchase proceeds. Reps and Warranties insurance helps to protect buyers and sellers involved in commercial transactions from financial loss that occurs when inaccuracies in the representations or warranties arise. Although not a new product, it had not been attainable for all transactions. However, increases in policy availability and associated decreases in policy premiums have made such coverages attainable for even small- and medium-size transactions.

6. **"Tail" Coverage**. In addition to the growth in use of Reps and Warranties coverages, commercial real estate deals have a host of other issues that can lead to future claims. It is important, therefore, that companies give sufficient consideration to their own insurance and that of the target company before consummating the transaction. Particular consideration should be given to any pre-transaction D&O insurance to determine whether that coverage will be limited to liability from acts that precede the transaction. Deal participants can avoid this limitation by purchasing extended "tail" coverage, under which the seller's D&O carrier agrees to maintain its policy in effect for an additional period of time — typically six years.

7. **Flood & Storm Damage**. Power outages, roof collapses, landslides and road closures, among other things, are all likely consequences of flood. Damage to occupied properties may give rise to claims against property owners, landlords, building managers and condo/property-owners' associations, while damage to properties under construction or renovation may have a significant impact on contractors, property owners and developers. Different businesses are affected differently by the same storm or event, and even the same physical damage. Having the right insurance for your business is critical. Among other things, therefore, you should confirm that your insurance is adequately equipped to respond to the most common weather-related perils, including:

   - ***Physical Loss or Damage to Insured Property***: The cost to repair, replace or rebuild property that suffers physical loss or damage is typically a covered cost. Covered locations are usually scheduled in the policy and may include not only buildings but also equipment and business personal property such as furniture, machinery and stock.

   - ***Flood***: Commercial property policies often include coverage for loss caused by flood. But this coverage is often subject to a sublimit or sublimits that offer different levels of coverage based on the flood zone(s) in which the affected property is located.

   - ***Wind v. Flood***: Virtually all property policies cover wind damage. Many property policies contain substantially reduced sublimits, or exclusions, for flood damage. It is important to examine the "cause" of any loss, and evaluate whether there are multiple causes, before submitting a claim.

   - ***Collapse***: Some property policies will cover damage caused by collapse. Others may not, while still others may do so at a reduced sublimit.

   - ***Building Association Liabilities***: Condo- and building-owners associations may face storm-related claims concerning alleged failures to properly maintain the building envelope (roofs, doors, windows and walls) in a manner that could weather the storm. These claims can implicate coverages under associations' errors and omissions policies and directors and officers liability policies, as well as property policies maintained for common building elements.

- ***Landlord Liability***: Landlords also are subject to tenant claims for bodily injuries, damage to personal property and loss of use and related losses of rent. Third-party claims by anyone injured on leased or managed properties also are possible. These claims may be covered under landlord liability policies and/or general liability policies.

- ***Builders' Risk Losses***: Contractors, building owners and developers may sustain losses potentially covered under builders' risk insurance. These losses may arise from damage to buildings under construction or renovation, damage to staged construction materials, contamination caused by hazardous materials on the job site, or general soft-cost losses caused by construction delays attributable to weather conditions or storm damage.

- ***Expenses Incurred in Attempting to Mitigate or Stop the Damage***: Property policies typically cover expenses incurred in taking preventative measures to avoid loss. Indeed, many policies contain an affirmative requirement that the insured take steps to safeguard the property and prevent further damage. Those steps should be reimbursed under the insurance policy.

8. **Time Element Coverages**. In addition to insuring physical property, commercial property insurance also typically covers certain pecuniary losses, such as lost business income or additional expenses caused by damage to property. Such coverage may be available even when the damage occurs to property *other than* the insured property. These coverages include:

   - ***Business Interruption Coverage***: Covers lost income or profits caused by the interruptions, including slowdowns, of business activities, due to physical damage to the insured's property.

   - ***Extra Expense Coverage***: Covers the increased cost of operating the business during the time when the business is affected by the physical loss.

   - ***Contingent Business Interruption Coverage***: Covers loss of business income caused by damage to the property of others, such as suppliers, customers or other business partners.

   - ***Orders of Civil Authority***: Covers lost income and expenses caused by governmental directives that prevent or restrict access to covered property.

   - ***Ingress/Egress Coverage***: Covers lost income and expenses when ingress to or egress from a covered property is prevented or hindered by the event. This coverage often comes into play in the event of road closures, the closing of mass transportation and other transportation problems.

   - ***Service and Utility Interruptions***: Covers lost income and expenses caused by power, water, telecom and other service or utility outages.

9. **Notice of Circumstances**. ''Claims-made'' policies cover claims made against the policyholder and reported to the insurer during the policy period. Some policies, however, afford coverage for a claim made against the policyholder *after* the policy's expiration as long as the policyholder notifies the insurer of specific facts and circumstances that are reasonably expected to lead to the claim. Timely notice of the circumstances is critical and a failure to comply could vitiate coverage.

10. **Selection of Defense Counsel**. When an insurer reserves its right to later deny coverage, the policyholder typically is permitted to select its own defense counsel as a consequence of the

potential conflict of interest between the insurer and policyholder. Likewise, the policyholder may be permitted to select its own defense counsel when the potential liability against it will exceed the limits of available coverage. Despite these potential conflicts, insurers still may attempt to limit what the policyholder may spend on its defense. Policyholders should be mindful, therefore, that it is their right alone to select counsel of their choosing.

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