

WHAT IS TERRORISM INSURANCE? (AND AM I COVERED?)

Commercial property owners confront insurance requirements at every turn. Good business practices (and lenders) mandate that owners and operators maintain property and casualty, commercial general liability, automobile liability, business interruption, and boiler and machinery policies. Workers' compensation and employer's liability insurance are generally mandatory for the protection of both employers and employees. For a price, coverage can be obtained to protect against most environmental risks and construction risks, as well as sink holes, floods and earthquakes. While the scope of each policy and the interrelationship of the various coverages may not be fully understood (even by the insurers), a commercial property owner is typically at the center of a complex web of insurance policies.

In recent years, lenders providing financing to commercial properties, as well as many landlords, have begun to mandate an additional type of coverage: insurance against terrorist acts. Some owners and operators, when confronted with this requirement, have expressed surprise that they were not already covered under existing policies. Others have debated the necessity for the coverage. This article will review circumstances in the insurance industry that have led to such coverage requirements and the current availability of insurance to address the risk of terrorist acts.

The Impact of September 11

The demand for, and creation of, specific terrorism insurance coverage is obviously a direct outgrowth of the September 11, 2001 terrorist attacks. It is estimated that those attacks resulted in over \$31.6 billion in insured losses. The attacks and their consequences posed a challenge to U.S. business and the insurance industry unlike any prior catastrophe. The likelihood and extent of property and liability claims (under normal circumstances) can be estimated and reserved against based upon historical experience and statistical analysis. Even the risk of most weather-related catastrophes can be calculated with reasonable accuracy based upon historical records and projected trends.

Worker's compensation, builder's risk, and almost all other insurance coverages are amenable to statistical modeling in the evaluation of risk.

The risks associated with terrorism fit none of these criteria. By its nature, terrorism is unpredictable in frequency, location and impact. A terrorist attack is presumably conceived to cause the maximum possible property damage and societal effect. These factors of unpredictability make the underwriting of terrorism risk particularly difficult. Prior to the September 11 attacks, standard commercial insurance policies included terrorism coverage without the imposition of an additional premium. That is no longer the case. While terrorism coverage must, as a matter of law, be offered by private insurers to the owners of commercial properties, that coverage must be specifically purchased. In most cases, there is an additional premium imposed with regard to such coverage.



Terrorism Risk Insurance Act

Terrorism insurance is provided through private insurers, which share the risk of claims with the U.S. Government. This public/private risk sharing program was put into place pursuant to the Terrorism Risk Insurance Act of 2002 (TRIA) signed into law on November 26, 2002. That program was intended to ensure that adequate resources would be available to businesses that are impacted by a terrorist attack. According to a June 2004 report by insurance broker Marsh, Inc., within two years following the September 11th terrorist attacks, 32.7% of U.S. businesses had purchased such coverage. The level had risen to 44.2% by the first quarter of 2004. By 2006, 59% of Marsh clients surveyed had purchased the coverage. The highest 2006 coverage rates were in the Northeast and Midwest, but every region had a coverage rate greater than 50%. Approximately 90% of Marsh clients purchasing the coverage did so through their

WHAT IS TERRORISM INSURANCE? - continued from page 1

property and casualty policies, rather than under a stand-alone policy.

On December 26, 2007, the TRIA program was modified and extended under the Terrorism Risk Insurance Program Reauthorization Act of 2007. The program will remain in effect through December 31, 2014. The 2007 Act included a number of important revisions to the program that had been established in 2002:

- The aggregate amount of property and casualty insurance losses required to trigger the program following a particular incident was increased from five million dollars to one hundred million dollars.
- The law includes coverage for domestic terrorism (the prior law had required that a terrorist be acting on behalf of a foreign person or foreign interest).
- The insurer deductibles are fixed at 20% of the insurer's direct earned premium. For losses above the insurer's deductible amount, the federal government will cover 90%, while the insurer contributes 10%.
- The cap on losses covered by the TRIA program remains one hundred billion dollars per year. The U.S. Treasury is to promulgate regulations to determine pro rata shares of insurance losses under the program when insured losses exceed one hundred billion dollars.

A significant gap in the available terrorism coverage still exists. No casualty coverage is currently available for nuclear, chemical, biological or radioactive ("NCBR") events. Under the 2007 Act, the government authorized a continuing study of the NCBR risks, but the potentially massive effect of any such events has made insurance underwriting of those risks not yet feasible.

Decisions, Decisions

A commercial property owner or operator unsure as to whether it has terrorism coverage, or the extent of the coverage, should review the coverages with its insurance agent or company. Other matters of inquiry beyond the existence of coverage might include: (i) the deductible amounts; (ii) the policy limits; and (iii) whether the policy includes business interruption coverage. Some policies will provide business interruption coverage even if the insured premises have not been damaged, assuming that a terrorist act has precluded or restricted access to the facility. Other policies exclude business interruption coverage altogether.

Whether a property owner deems terrorism insurance to be an appropriate expenditure is ultimately a business judgment. The risk of a terrorist attack in rural Iowa is markedly different than in an urban center in the eastern United States. The risk associated with a warehouse or distribution center is presumably far less than the risk to a shopping center, high-rise office building, or government facility. These factors may impact both the decision to purchase terrorism insurance and the premium to be paid. Fortunately, due to the U.S. Government's high level of participation in the assumption of the insured risk, the premiums associated with terrorism insurance are generally quite affordable. Whether that remains the case in the future is as unpredictable as were the September 11th attacks, but the TRIA program represents a serious effort by the government and the insurance industry to create some certainty in an uncertain world.

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GREENER THAN THOU

Shining through the gloom of housing market forecasts is a rapidly growing interest in green building.

The National Association of Home Builders (NAHB) estimates that this year half of its members will be incorporating aspects of green building into the construction of new homes.

In May, McGraw-Hill Construction, in its market research study co-sponsored by the NAHB, predicted that the green building market will be worth between \$12 billion and \$20 billion nationwide this year—or between six to ten percent of the U.S. new housing market. It predicts that green building will grow to between \$40 billion and \$70 billion by 2012, or between 12 to 20 percent of the U.S. new housing market.

The interest in green building has even taken on a competitive air. The New York Times recently reported on a four bedroom certified green home in Venice, CA. which recently sold for \$2.5 million and attracted the attention of a number of Hollywood stars. High end certified green homes entitle the proud owner to certain bragging rights—a “greener than thou” pride—and the story highlighted the interest both in green building and in the green certification process.

Builders and developers are already advertising “green” or “eco-friendly” homes and communities. But what exactly do these terms mean? The NAHB is working with the International Code Council (ICC) in the development of a set of standards which, when complete, is expected to bear the approval of the American National Standards Institute (ANSI) for green residential construction and remodeling and serve as a national standard. But the terms “green,” and “eco-friendly”, while widely used, express only a concept—not an accepted standard.

Minnesota GreenStar, a Minnesota non-profit corporation formed with the support of the BATC, the Green Institute and National Association of the Remodeling Industry (NARI), is a green certifying organization that has developed green building standards for both new and remodeled homes in Minnesota. Minnesota GreenStar offers escalating levels of certification, beginning with bronze and ending with gold—the highest level of certification. The U.S. Green Building Council, through its LEED program for homes, also offers green certification.



These third party certifying organizations provide both builder and consumer with standards against which to measure and verify a specified level of green building. These programs are voluntary and, by offering different levels of certification, they provide the consumer and builder with options in managing the cost of building green.

The development of green building standards should not discourage builders and remodelers from incorporating aspects of green building techniques. Certainly, each step up in green building has its rewards. But each step also carries its own set of risks.

Advertising or promoting a home as “green” or “eco-friendly” puts the builder or remodeler at an increased risk of liability to the consumer. For example, if you advertise a home as “green,” does that mean the home will achieve a level of energy savings above that of a home built to code? Are you liable if it does not and, if so, how is that liability measured?

If you promote your green or eco friendly building techniques and yet fall short of an established standard set by, for example, Minnesota GreenStar, are you liable to the consumer and, if so, for what?

The answers to these questions and others will come with time and experience with green building. But any type of “green” or “eco friendly” advertising or marketing needs to be carefully reviewed. Federal law prohibits general or unsubstantiated claims of environmental benefits and Minnesota law imposes liability for misrepresenting a product or service, even when the misrepresentation was not intentional. For example, a person who makes a material misrepresentation without knowing whether it is true or false, may be liable for misrepresentation. While we all refer to “green” building, the term is dangerously vague when used in consumer advertising and marketing,

A review of your consumer contract is also in order anytime you plan to build green. For example, if you intend to obtain third party certification, your

contract should be specific about the certifying organization, the level of certification, the time table and the cost. You may want to also address what happens if there is a delay in obtaining certification, e.g., is this a delay which justifies a delay in or postponement of the closing date or substantial completion date? If you are incorporating green products into the construction, you will want to pass on to the customer the warranties which come with these products and disclaim any other warranties, other than the state statutory warranties.

You may also want to consider specific disclaimers as, for example, a disclaimer that green certification will contribute to a higher re-sale value. A higher re-sale value may be a benefit of building to a specified green standard, but the re-sale value of a home can be affected by many factors (as the current market has made so painfully clear).

Consider too whether green building and design will run afoul of private covenants. For example, private covenants may require a specific roof pitch or exterior cladding which is incompatible with a green design.

When it comes to green building, consumer expectations are likely to be high. The decision to build green reflects, at least in part, a bit of altruism. A consumer may want the tangible benefit of increased energy savings and the intangible benefit of taking a positive step towards reducing the impact new construction has on the environment. It is important to manage a consumer's expectations so that you can meet those expectations and avoid liability caused by using poorly defined terms or general references to green building. Certainly, obtaining third party certification is an important step in reducing these risks.



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NEW STATUTE REQUIRES CERTIFICATION FOR CONSTRUCTION INDEPENDENT CONTRACTORS

Beginning January 1, 2009, all individual independent contractors in the construction industry will be required to have an "Independent Contractor Exemption Certificate," or they will be classified, by default, as employees. This new mandate was passed by the 2007 Minnesota Legislature in response to the Legislative Auditor's "conservative estimate" that 14 percent of Minnesota employers misclassified at least one worker as an independent contractor in 2005.

Who is Covered?

The new law, Minn. Stat. § 181.723, only applies to natural persons, so partnerships, corporations, LLCs, and other entities do not need a certificate. Also, the certificate is only required when the individual is performing services in the course of the hiring person's trade, business, profession, or occupation. Consequently, when an individual is working for a licensed residential remodeling company, he or she must have an exemption certificate to maintain his or her independent contractor status, but if the individual contracts directly with a homeowner, a certificate is not required. This applies even to an individual having a residential building contractor license as the residential building contractor license only represents the individual has passed the tests to prove his or her skill and ability, but the Independent Contractor Exemption Certificate represents status as an independent contractor as opposed to the status of being an employee.

What Does It Mean?

The onus for compliance falls on both the general contractor and the subcontractor. The Commissioner of Labor and Industry has been empowered to levy fines of up to \$5,000 for noncompliance. However, general contractors will likely face additional consequences for hiring an "independent contractor" without an exemption certificate because the "independent contractor" will be classified as an employee, and the general contractor will be responsible for all of the usual obligations of an employer, such as workers' compensation, unemployment compensation, OSHA, labor standards, and child labor laws. Even with a certificate, an individual will only be

considered an independent contractor if he or she is performing the services listed on his or her exemption certificate, so someone who has an exemption certificate for masonry will become an employee on a given day if he or she does roofing work on that day.

Furthermore, notwithstanding having a current Exemption Certificate, the individual must also actually operate as an independent contractor by meeting nine specific conditions listed in the statute:



1. Maintain a separate business with the individual's own office, equipment, materials, and other facilities;
2. Hold or has applied for a federal employer identification number or have filed business or self-employment income tax returns with the IRS if the person performed services in the previous year for which the individual is seeking an independent contractor exemption certificate;
3. Operate under a contract for specific services for a specified fee and under which the individual controls the means of performing the services;
4. Incur the main expenses related to the services the individual is performing for the person under the contract;
5. Be responsible for the satisfactory completion of the services the individual has contracted to perform and be liable for a failure to complete the services;
6. Receive compensation for the services performed under the contract on a commission or per-job or competitive bid basis and not on any other basis;
7. Be exposed to realize a profit or suffer a loss under the contract to perform services for the person;
8. Have continuing or recurring business liabilities or obligations; and
9. Have the success or failure of the individual's business depend on the relationship of business receipts to expenditures.

NEW STATUTE - continued from page 5

If any of the above criteria are not met, the worker will be classified as an employee, and the employer will be liable for all employment taxes.

How do I Apply?

An application form for an Independent Contractor Exemption Certificate may be obtained from the Department of Labor and Industry's website: <http://www.doli.state.mn.us>. In addition to filling in the form, the applicant must provide documents listed in the application form to evidence satisfaction of the statutory conditions listed above. There is an application fee of \$150, and the Department will process an application within 30 days. Exemption Certificates issued before March 1, 2009 are effective until March 1, 2011 while Certificates issued after then are effective for two years. The Department of Labor and Industry will maintain a web page listing of individuals

having, and the services covered by, an Exemption Certificate. For more information, visit the Department of Labor and Industry's website.



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With thanks to summer law clerk Daniel Cragg for his contributions to this article.

Pat Brinkman has been asked by the Department of Labor and Industry to serve on an advisory committee to establish guidelines and criteria for course subjects appropriate for continuing education credit for builder licensees.

Real Estate Report

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