

The Metropolitan Corporate Counsel®

National Edition

www.metrocorpcounsel.com

Volume 22, No. 4

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April 2014

When Standard Pollution Insurance Policies Aren't Enough

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Real estate development, construction, mining and energy development share a set of risks ranging from construction accidents, earth movement and collapse to environmental clean-up. While these risks may be anticipated in some measure, the fast-changing regulatory landscape exacerbates them.

Sometimes, these risks may seem to outweigh the potential rewards of doing business at all. But taking a systematic approach to risk transfer and becoming familiar with the full array of risk transfer mechanisms can render them manageable.

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Remediation costs have long been a problem for many companies, in part because of the difficulty in accounting for and transferring the risks of those liabilities. In commercial contracts, one of the challenges that may arise is the financial stability of the counterparty who has agreed to shoulder the risks of environmental remediation. If the party to whom the risk has been transferred does not have the financial ability to pay when called upon, then the risk of that loss was not transferred at all.

Another familiar method of risk transfer is through insurance policies. However, in many instances, exclusions for pollution and other liabilities, as well as limitations on what types of losses are covered, may leave a company without meaningful insurance coverage or other risk transfer options for liabilities that may arise from environmental contamination.

Much has been written about standard Pollution Legal Liability (PLL or EIL) policies. These policies cover a wide range of site-specific exposures, but they are not designed to cover all risks. Below we examine three types of specialty insurance products that address specific coverage gaps: cleanup cost cap, contractor pollution, and environmental lenders insurance policies.

Cleanup Cost Cap Insurance Coverage

A "cleanup cost cap" insurance policy can be an effective way to manage the uncertainties associated with environmental remediation costs. These insurance policies enable a company to transfer the risk that a remediation will exceed the estimated cleanup cost. Typically, these policies are available only where the cost of the remediation is known and has been determined by an independent consultant. In addition, the policy attaches when the cost of remediation is between 10 and 25 percent more than the estimated cost (the buffer layer).

Up until the mid-2000s, this product was offered by most of the leading environmental insurance companies and many policies

were sold. However, large and frequent losses led just about all of the insurance companies to stop offering this product. Recently, two newer insurance companies have stepped up with their version of the policy form.

One of these new entrants provides coverage designed for site owners for cleanup cost overruns and also contingent and vicarious professional liability resulting from the contractors performing the remediation. So, in addition to coverage for remediation expenses in excess of the estimated costs plus the buffer, this program offers coverage for damages and defense costs for third-party claims arising out of wrongful acts by the policyholder's consultants, contractors or remediation design professionals. Coverage is provided for remediation of known conditions and also newly identified contamination discovered during the cleanup.

The other new entrant's policy form is designed around contractors and their approved subcontractors as the policyholder, not the site owners. This program offers risk transfer to those contractors who are offering guaranteed-cost or fixed-cost cleanup programs for the site owners and operators. Coverage for unknown conditions can be offered on this carrier's program but would be managed with a separate sublimit. Lastly, a co-payment requirement ranging from 15 percent to 25 percent will apply with no cap on maximum amount.

A prior version of this product was the Environmental Protection Program (EPP), where the policyholder paid the insurance company the net present value of the full cleanup costs plus the buffer layer, while the insurance company assumed the responsibility for financing and managing the remediation. This arrangement would allow the policyholder to remove this liability from their financial statements. Only time will tell whether this version of the policy form returns to the insurance marketplace.

Unlike the earlier versions of these policies, where \$50 million limits of liability

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and 20-year terms were available, the current maximum limits are \$10 million and policy terms up to 10 years. Another difference is that the current program may require upfront payment of engineering fees ranging up to \$15,000 that are non-refundable but can be credited towards premium if coverage is bound.

Contractor's Pollution Liability Insurance

It is commonplace to require a counterparty to purchase insurance. Typically, contracts require a counterparty to purchase particular types of insurance policies with specified limits for primary and excess insurance coverage.

With contractors, it may be easy to think only of liabilities associated with defective workmanship leading to construction problems. However, "defective workmanship" can also give rise to liabilities related to environmental pollution, hazardous waste, toxic waste, mold and Legionella, and other potentially pollution-related liabilities.

In the past, general liability insurance policies may have insured these risks. Today, however, pollution exclusions found in most general liability insurance policies eliminate much of the insurance coverage that was previously available. In some instances, courts have interpreted pollution exclusions so broadly that the exclusion effectively eviscerates the coverage that would otherwise have been available.

Owners and general contractors should be aware of all of the risks that their project presents and consider requiring subcontractors to purchase pollution liability insurance policies, or including that coverage within an owner-controlled program.

Contractor pollution liability (CPL) policies are typically offered with an "occurrence" as opposed to a "claims-made" coverage trigger. The difference is that an occurrence policy covers any incident that occurred within the policy period, regardless of when the claim is reported. Claims-made policies, in contrast, provide coverage only for claims reported during the policy period or any extended reporting period.

CPL policies afford coverage for a pollution condition resulting from a contractor's operations at a job site. Policies can be offered for a contractor's entire suite of services on an annual or multi-year basis or on a project-specific basis. Completed operations coverage can extend for up to

10 years after the project is done. Clients of a contractor are automatically given additional insured status whenever a contract is signed.

CPL policies include coverage for new pollution conditions or exacerbating existing conditions. For example, they provide coverage if a contractor causes a stockpile of contaminated soil to spill onto an adjacent property or run-off into a waterway or stormwater system during a heavy rain. CPL policies also include liability coverage to protect against third-party claims, including legal expenses to defend these suits.

Environmental Lender's Insurance Policy

Commercial lenders are sometimes willing to offer terms for a loan transaction for land development involving construction, redevelopment, mining, or other activities. Often, however, the potential environmental liabilities to which the borrower may be exposed can be a roadblock.

While a lender may transfer some of the risk of environmental liabilities by conducting due diligence and incorporating loan terms that serve to fund costs associated with environmental liabilities, it may also be possible to use insurance policies to transfer the risk associated with environmental liabilities. Insurance policies specifically geared to insure lender's risks may enable a lender to balance effectively the rewards of entering into a loan transaction against the risks of default, pollution and other liabilities associated with the transaction, including the construction and other development activities that the loan may fund.

These insurance policies, known as Lender's Environmental Liability or Secured Creditor policies, have unique coverage triggers in that they provide protection to the lender in the event a loan default is accompanied by the discovery of a pollution condition and/or a related third-party claim. The policy pays for the lesser of either the clean-up costs or the loan balance. These policies include liability coverage to protect the lender against third-party claims including legal defense costs. They are often used by borrowers in lieu of providing environmental indemnity (i.e., "carve-outs") to the lender and along those lines can be helpful in closing a transaction even on sites that are believed to be "clean."

The information needed to underwrite lender liability policies is a combination of environmental and financial information. Specifically the required information includes the loan amount and term, the loan-to-value ratio and the debt-to-coverage ratio, in addition to the typical environmental information on the current operations, status and history of the property.

More To Learn

We have just scratched the surface of these three types of environmental insurance policies that are specifically structured to help property owners, contractors and lenders transfer risk and reduce their potential liabilities. Without these specialized insurance products, a large number of remediation projects, contracting jobs, and real estate loans would not get done. It is essential to work with professionals who know the markets and the right coverages for risks that are particular to your business or needs.

About Anderson Kill's Environmental Law Group

Anderson Kill wrote the book on obtaining coverage dollars to protect the environment. "Going green," however, means much more than funding cleanups from insurance proceeds. Our Environmental Law Group is uniquely positioned to provide many environmental law services beyond our renowned coverage work. As a full-service law firm, Anderson Kill provides comprehensive environmental legal and risk-management services, including dispute resolution, relating to real estate and corporate transactions.

Our experienced attorneys regularly assist clients with a variety of routine and complex environmental regulatory and compliance and land use matters. The firm has considerable experience in CERCLA, RCRA and with Brownfields as well as with voluntary or risk-based cleanup programs. We also are experienced in implementing institutional controls and other risk-management solutions to address lingering liabilities and avoid complex indemnification obligations. For more information, please visit <http://www.andersonkill.com/environmentallaw/default.asp>.