Environmental Insurance:

A Useful Risk Management Tool When Environmental Conditions Threaten a Project

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Agenda

1. **Brownfield Redevelopment**: Identifying and Overcoming the Hurdles

2. **Environmental Insurance**: A Potentially Useful Tool and "Tips & Tricks" for the Municipal Lawyer

3. **Bonus Issue**: Environmental Risk Transfers

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Where we used to be . . .

Historically:

- Environmental issues seen as insurmountable obstacles to redevelopment
- Environmental issues raised at 11th hour leading to a need for "damage control" versus preemptive risk management
- No (or very few) state or federal incentives for redeveloping contaminated properties



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Where we are . . .

Increasingly:

- Brownfield properties are seen as opportunities (despite more rigorous environmental laws)
- Environmental issues seen as public policy *AND* business issues
- More incentives, liability protections and creative risk management strategies
- Public and private push (e.g., through PPPs) to put dormant/abandoned sites back into productive reuse and on town tax rolls



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A Not So Hypothetical "Hypothetical"

- Former industrial/manufacturing site in town
- Known/suspected to be contaminated (e.g., with PCBs)
- An eye sore
- Vacant for many years
- Delinquent on taxes
- Town takes ownership, e.g., through tax foreclosure

Now what? Get it cleaned up and redeveloped!

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Hurdles to Brownfield Redevelopment

Liabilities and Uncertainties:

- Cleanup obligations
  - Known pre-existing conditions
  - Discovery of unknown pollution conditions
  - Regulatory "re-opener" of closed issues
- Other
  - It's just too darn risky
  - It's too complicated
  - Not enough information
  - Developer can't get financing
- Third Party Claims
  - "Toxic tort" claims for bodily injury/property damage
  - Diminution in value
  - Natural resource damages

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Approaches to Risk Management

In the context of brownfield redevelopment:

- Avoid/Ignore
  - Perpetuates the problem; no one is satisfied
- Price adjustment
  - significant under/over estimation of risk
- Escrow accounts/trusts
  - difficult to structure; requires ongoing administration
- Contractual indemnifications
- ***Environmental insurance***

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Environmental Insurance



- Overcome impediments by boxing-in environmental risks/liabilities
- Implement thorough, long-term and cost-effective solutions
- Backstop/replace indemnification or other contractual agreements
- Types of Programs:
  - Pollution Legal Liability (PLL)
  - Cleanup Cost Cap (CCC)
  - Contractor's Pollution Policy
  - Secured Creditor/Lender Environmental Protection
  - Risk Transfer/Liability Buy-Out

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Environmental Insurance

Brief History:

- Prior to 1970s – no environmental exclusions
- 1973 – US EPA established by Nixon Administration
- Mid 1970s – Sudden and Accidental
- 1986 on – "absolute" pollution exclusion - most general liability insurance policies exclude coverage for environmental claims
- Modern version of environmental insurance policies became popular in the late 1990s
- Sustained interest in the redevelopment of contaminated properties led insurers to develop a new range of environmental insurance products

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Key Elements of Environmental Insurance

Manuscripting:

- Policy and endorsements tailored to sites(s) and/or the deal/allocation of risks and liabilities between parties involved, e.g., seller/buyer or municipality/developer

Policy Term and Limits:

- Specific to each underwriter and type of coverage

Claims Made Policy:

- Claims must be made during policy term

Insureds:

- Owner, former owners, operators, buyer, seller, investors, lenders, and/or mortgagees

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Pollution Legal Liability – Scope of Coverage

Available Coverages:

- 1st party or governmental remediation claims for:
  - On-site and off-site unknown pre-existing conditions
  - On-site and off-site new conditions
- On-site and off-site 3rd party claims for bodily injury and property damage
  - Associated with known and unknown pre-existing conditions
- Changes in cleanup standards (i.e., regulatory “re-openers”)
- Legal defense costs (within the policy limits)
- Natural resource damages

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Pollution Legal Liability – Scope of Coverage

Common Exclusions:

- Pre-existing conditions known to the insured but not disclosed
- Material change in use
- Known underground storage tanks (unless scheduled)
- Only excess over tank fund or other insurance
- Contamination identified during voluntary site investigation/capital improvements
- Noncompliance with institutional or engineering controls
- Punitive damages; fines/penalties

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Pollution Legal Liability – Scope of Coverage

Key Enhancements - through endorsement or <u>through manuscripting</u>:

- Re-opener coverage
- Inclusion of Environmental Professional (LEP in CT, LSRP in NJ, LSP in MA) in definition of "Environmental Laws" or "Governmental Mandate"
- Cleanup coverage for unintentionally disturbed asbestos or lead
- Give back for 3rd party bodily injury and property damage claims for <u>known</u> conditions (i.e., limits exclusion to cleanup only)
- Enhanced definition of "cleanup costs" to include costs associated with institutional and engineered controls (legal and technical)

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Pollution Legal Liability – Program Structure

Policy Term and Coverage Limits:

- Typically 5 or 10 year term (possibly up to 15 years)
- Limits generally range from $1M to $100M per incident and in the aggregate (subject to “stacking” and “follow form”)

Deductible/Self Insured Retention:

- Amount will impact policy pricing/premium
- Aggregating deductible

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Environmental Insurance Incentives

- Massachusetts – Brownfield Redevelopment Access to Capital (BRAC)
- Wisconsin – Brownfield Insurance Program
- Ohio – VAP Environmental Insurance Incentive
- New York – Environmental Insurance Tax Credits (sunset in 2015)
- Federal/USEPA Grants

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PLL Example

Public-Private Brownfield Redevelopment





- Municipality in upstate NY foreclosed on property and obtained EPA grant to investigate and remediate
- Private developer partially funded cleanup
- Site entered into the New York State Department of Environmental Conservation (NYSDEC) Brownfield Cleanup Program
- Certificate of Completion received from NYSDEC
- Lease negotiated with shopping center tenant
- Negotiated 10-year pollution legal liability policy with a $7MM limit of liability, insuring owner and tenant, and including coverage for reopeners under NYSDEC's Brownfield Cleanup Program

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Cleanup Cost Cap (CCC) –Key Elements

- Addresses known cleanup obligations
- Covers cost overruns associated with implementation of Remedial Action Plan (RAP), including:
  - Discovery of additional contamination (more of the same or different types)
  - Unexpected site conditions
  - Failure of cleanup method/technology
  - Changes in regulatory requirements
- Approved RAP required (or preferred)
- Claim process
  - Periodic updates to carrier about status of remediation work and costs
  - Application of costs against SIR
  - Payment by carrier once SIR surpassed



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CCC – Program Structure

Program Structure:

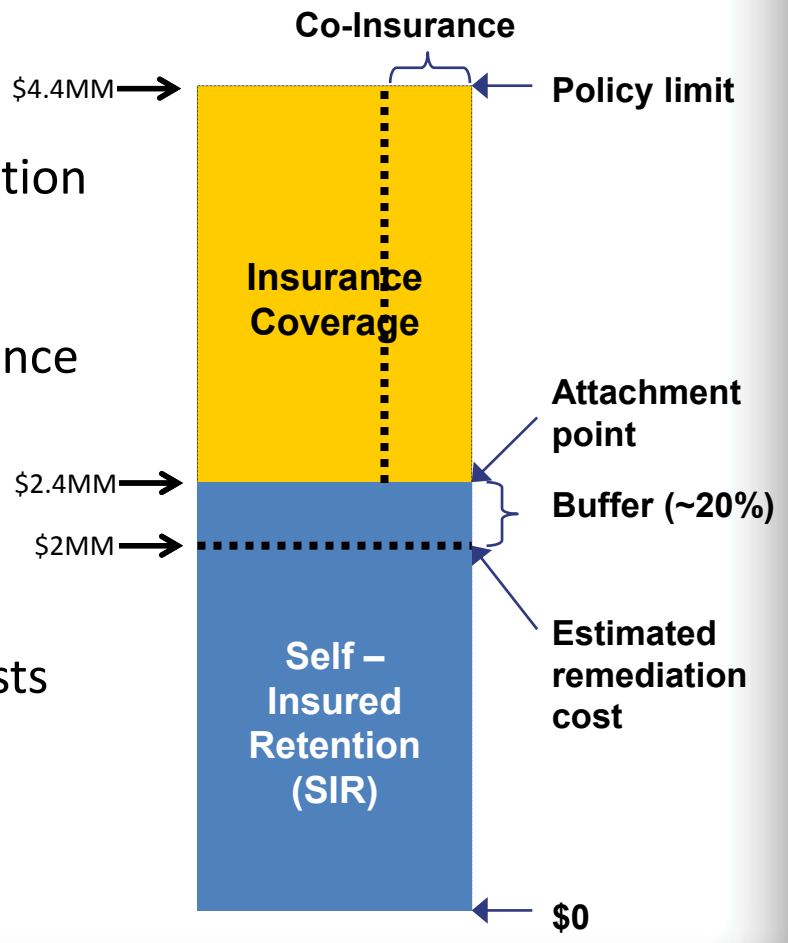
- Coverage “attaches” above SIR
- Buffer of ~20% or more of expected remediation costs
- Remediation costs erode same single SIR
- Potential co-insurance requirement in insurance layer
- Can be combined with PLL

Policy Term and Coverage:

- 10 year term
- Limits typically capped at 1X remediation costs

Pricing/Premium:

- Typically 15% to 20% of insurance layer



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Combined PLL / CCC Example



Former Industrial Manufacturing Property

- Advised Seller of contaminated property during transaction and negotiated manuscripted 10 year cost-cap policy with $6MM coverage for cost overruns
- Cleanup exceeded $600K SIR during policy period
- Policy covered ~ $2 MM in costs above SIR, including legal costs associated with preparation and negotiation of ELUR (as covered “Clean-up Cost”)

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Secured Creditor – Program Structure

- Available for traditional and institutional lenders
- Covers risks associated with:
  - Default by borrower due to clean up costs (generally pays lesser of the remaining loan balance or cost of required investigation and remediation)
  - Clean-up costs incurred by the lender post-foreclosure
  - Third party BI/PD and clean-up costs pre- or post-foreclosure
- Lender may require premium be paid by borrower at closing
- May even be available when known pollution exists
  - Subject to certain exclusions

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Secured Creditor Example

Traditional (Bank) Lender

- Environmental issues associated with loan financing
- Borrower to purchase medical office building on historically contaminated industrial/commercial property (former felt manufacturer on-site)
- On behalf of lender, negotiated terms and conditions of both policies to fit the deal and best protect the interests of the bank as a secured lender
- PLL Policy: 10 year policy (pre-existing and new conditions) with $10MM limit and $50,000 SIR; Premium ~ $75,000. Bank to be Additional Named Insured.
- Secured Creditor Policy: 5 year policy with $9.5MM limits to cover term and loan amount (plus “extra expenses”); Premium ~ $57,000.



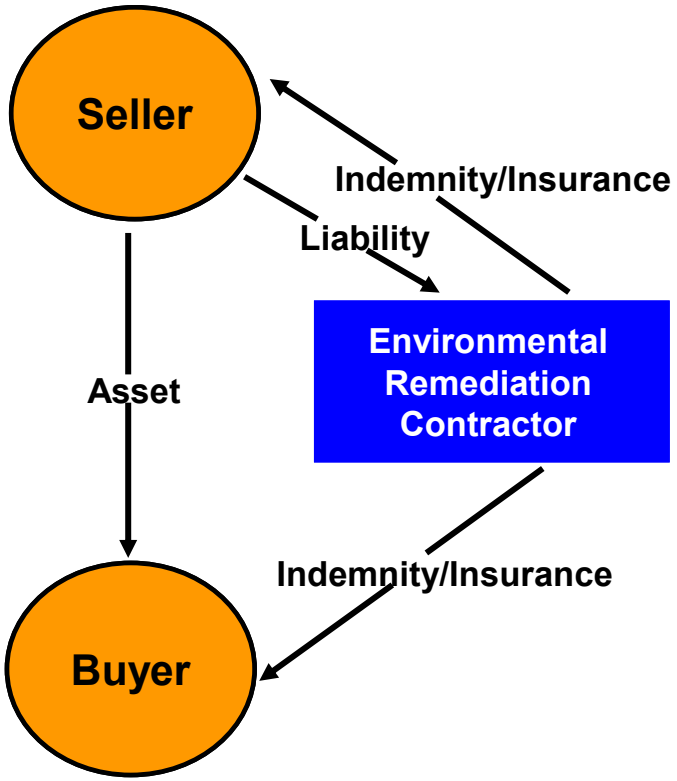


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Bonus Slide!

Risk Transfer – Program Structure

- Seller realizes value without future commitment
- Buyer/Developer – site remediated to standards necessary for planned use
- Buyer obtains assets without future cleanup risk
- Neither party dependent upon other's long-term stability
- Redevelopment gets done
- Backstopped by environmental insurance



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Key Takeaways

1. Put the right team together
   - For example, municipality, economic and community development corp., private developers, lenders, EPA, state environmental agency, etc.
2. Understand the big picture and the parties' collective and respective goals and perspectives
3. Work with experienced consultants/experts
4. "Begin with the end in mind"

and most importantly . . .

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Environmental issues shouldn't become the "tail that wags the dog"



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Questions?



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