

Environmental Insurance and Risk Management Tools in Brownfields Cleanup and Redevelopment

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Information does not reflect the views of the U.S. Environmental Protection Agency

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Overview

- Risk Management Approaches to Brownfields Cleanup and Redevelopment
- Environmental Insurance for Brownfields
- Negotiating Environmental Insurance
- Environmental Insurance Claims
- Environmental Insurance Examples
- Additional Information Resources
- Questions and Answers

Risk Management Approaches

Arthur Harrington, Godfrey and Kahn

Brownfields Redevelopment – The Players

- Sellers
- Buyers
- Tenants
- Potentially Responsible Parties (PRPs)
- Developers
- Lenders and Investors
- Environmental Regulatory Agencies
- Land Use Regulatory Agencies
- Local Officials
- Economic Development Officials
- Insurance Companies

Brownfields redevelopment participants often have competing goals

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Sellers -- Sell property quickly, maximize price and get relief from future liability

Buyers -- Buy and develop quickly, Limit liability, Maximize resale value and flexibility

Tenants -- Conduct business without interference and with no exposure to liability for environmental cleanup and/or from employee claims

Responsible Parties -- Limit liability, Remove contingent liability from books

Developers – Develop quickly, limit liability

Lenders -- Not assume any environmental liability

Maximize chance of repayment

Maximize resale value if foreclosure occurs

Environmental Regulatory Agencies -- Cleanup conducted to a level to protect human health and the environment

Land Use Regulatory Agencies (Redevelopment Agency; City issuing entitlements) -- Approve project maximizing benefits to the city

Insurance Companies -- TBD

Types of Risk Management Tools

- Due Diligence
 - Conducting All Appropriate Inquiry
 - Understanding pre-existing conditions and impacts on development
- Private Party Contractual Protections
 - Indemnities
 - Representations and warranties
 - Covenants
 - Conditions to closing
 - Releases
 - Fixed price and risk transfer contracts with contractors
- Financial Tools
 - Escrow accounts
 - Purchase price adjustment
 - Grants and loans
- Environmental Insurance
- Federal and State Regulatory Protections

Considerations when Choosing a Risk Management Tool

Due Diligence	<ul style="list-style-type: none"> ■ May later prove to have been incomplete ■ Science evolves
Escrows	<ul style="list-style-type: none"> ■ Actual costs may exceed escrowed amount
Indemnities/Representations/Covenants	<ul style="list-style-type: none"> ■ Willingness of indemnitor to execute ■ Financial risk of indemnitor
Environmental Insurance	<ul style="list-style-type: none"> ■ Availability and cost ■ Terms and exclusions (e.g., claims made) ■ Liability limits
Statutory/Common Law Recourse	<ul style="list-style-type: none"> ■ Bankruptcy/Dissolution of PRPs ■ Litigation expenses ■ Time
Statutory Safe Harbors	<ul style="list-style-type: none"> ■ Potential lack of certainty ■ Burden of proof
No Further Action Letters/Comfort Letters	<ul style="list-style-type: none"> ■ Re-opener ■ Exclusions

Key Risk Management Points

- Every deal is unique
- There is no environmental panacea – each tool has shortcomings
- A combination of tools gets the deals done
- The key is to avoid liability gaps

Environmental risk management for property transactions is evolving

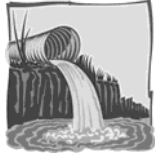
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Environmental Insurance

Kenneth Anderson, Aon Environmental

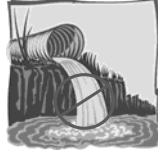
History of General Liability Insurance

Pre - 1972
NO pollution
exclusions



Generally considered
to cover liability for
pollution

1972 - 1985
“Gradual ”
pollution exclusion



Typically, involves a
“sudden and accidental”
or “expected and
intended” exclusion.
There are great debates
related to coverage.

1986 - Present
“Absolute” pollution
exclusion



Removes virtually any
coverage for pollution
in primary and excess
liability coverage

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General Liability Insurance became more restrictive in response to stricter environmental regulations (CAA, CWA, CERCLA, RCRA) and concern about additional claims

History – Comparison of Insurance

The Early Days of Environmental Insurance

- Inexperienced carriers/underwriting
- Little competition among insurers
- Generally, restricted coverage
- Low limits relative to potential exposure
- Relatively high premiums and deductibles
- Extensive and costly engineering surveys often needed
- Applicant had no guarantee of a quote being offered
- Mostly regulated companies bought coverage
- Variable/emerging environmental regulations

Environmental Insurance Today

- Underwriting involves experienced environmental professionals
- Competition among carriers
- Often a great deal of underwriting subjectivity
- Coverage tailored to site-specific conditions
- Cost-effective premiums
- Multi-year policy terms available
- Significant limits of coverage available
- Deductibles more reasonable
- Expansion of coverage
- Payment of claims much more common than litigation
- Regulations more stable

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OLD

Coverage restrictions: by endorsement or stand alone

Inexperience: Underwriters were GL insurance oriented trying to learn environmental

NEW

Tailored coverage: designed specifically for environmental conditions; is tailored to each site; intent is clear to cover pollution

Environmental Insurance Policies for Brownfields

- Policies are individually tailored for each project
- Generally, policy holders can include buyers, sellers, and intermediary owners (e.g., redevelopment authorities)
- Principal coverage types include:
 - Pollution Liability (PL)
 - Cost Cap (CC)
 - Lender Pollution Liability (LPL)
 - Finite-/Blended-Risk

There are dozens of types of environmental insurance available

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Pollution Liability

- Basic Coverage
 - Cleanup of unknown pre-existing and/or new pollution conditions at or emanating from the site
 - Third-party bodily injury and/or property damage claims caused by pollution conditions at or emanating from the site
- “Additional” Coverage
 - Business interruption/construction delay costs
 - Pollution-related claims at scheduled non-owned disposal sites
 - Pollution-related claims related to transportation of waste/product
 - Natural resource damage claims
 - Diminution of property values
- Claims made and reported coverage
- Terms
 - Multi-year periods available: typically 5 years up to a maximum of 10 years
 - Premiums: typical \$50,000-100,000; minimum \$5,000-\$10,000
 - Limits: typical \$5-20 million; minimum \$1 million
 - Minimum deductibles: \$5,000-\$10,000 each incident

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Claims made and reported coverage: I.e., Claims must be made against the insured and reported to the insurer during the policy period for events that happened during the policy period

Cost Cap

- **Basic Coverage:** Unanticipated increase in costs of a known cleanup due to one of the following:
 - Cost overruns for remediation expenses
 - Changes in regulatory standards/laws
 - Discovery of new contaminants or more of same – on and off-site
- A remedial action plan and associated cost estimates typically required by the insurance carrier
- **Terms**
 - Period: typically the length of the cleanup project
 - Premium: ranges 8-20% of the limit purchased
 - Limits: available limits may be capped at 2 to 3 times the expected cleanup costs, \$1 million minimum
 - Buffer Layer/Self-Insured Retention (SIR) above cleanup costs of 10-30%
 - Co-insurance may be required where the insured pays a proportion of all costs above the deductible or SIR
 - Underwriting fee may apply

Lender Pollution Liability

- **Basic Coverage:** Policy pays for covered loans once a loan default occurs where pollution conditions exist, which may include:
 - Collateral value
 - Loan balance (typically the lesser of loan balance or cleanup costs)
 - Cleanup costs
 - Legal defense
 - Contract damages
 - Bodily injury/property damage
 - Business interruption/extra expense
- Sometimes lenders require property owner to purchase this insurance as terms of the loan
- **Terms**
 - Period and premium are negotiable
 - Limits: typical \$5-10 million; minimum \$1 million
 - Deductibles: \$25,000 and up

Finite-/Blended-Risk

- Basic Coverage
 - Transfers financial liabilities from of environmental liabilities to an insurance carrier:
 - Responsible party pays the insurer the entire present value of the projected cleanup cost when the insurance is obtained plus risk premium for timing, excess costs and liability coverage
 - Insurer takes on the financial responsibility for cleaning up the property
 - Combines coverage for known and unknown environmental liabilities
 - Typically, incorporates Pollution Liability and Cost Cap insurance elements
 - Involves a timing risk (i.e., if expenses are paid out faster than expected)
- Terms
 - Most terms are highly project specific
 - Period is negotiable, but is typically more than 10 years

Preferred insurance solution for longer cleanups

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Typical insureds include:

Companies with historical environmental liabilities on their balance sheets

Large cleanup projects, including brownfields and Superfund sites

Environmental Insurance for Brownfields – Summary

Environmental Insurance Can...

- Reduce uncertainty
 - Unknown contamination
 - Third-party claims caused by pollution
- Support indemnities
 - Buyers and/or sellers
- Support due diligence
- Firm sale price and may even enhance it

Environmental Insurance Cannot...

- Eliminate all uncertainty
 - Reduce yes, eliminate no
- Replace indemnities
- Replace due diligence
- Automatically enhance sale price
- Pay for conditions specifically excluded by the policy

Negotiating Environmental Insurance Coverage

Kenneth Anderson, Aon Environmental
Arthur Harrington, Godfrey and Kahn

Negotiation Considerations

- Have knowledgeable and experienced brokers, attorneys, and environmental consultants
- Have critical environmental information about the property, particularly information as to remedy and costing
- Present the contractual arrangements and any regulatory agreements to the underwriter
- Ensure availability of regulators to answer questions and speak to the status
- Understand the nature of the risks to be insured and the trigger points at which coverage will respond

Negotiation Considerations (continued)

- Adapt environmental insurance policies to each individual “site” or “deal”
- Read policies carefully – there are more than 100 policies currently in the marketplace and each one is quite different
- Combine policies with indemnities, contractual obligations, guarantees, bonds, and other risk management tools
- Use qualified environmental risk specialists to provide the necessary depth of expertise in insurance and risk and incorporate them early in the process to maximize the results

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Be sure to mention

- 1) The Process: E.g., a broker puts the request out for bid.
- 2) Manuscripting the policy

Negotiation Issues for Pollution Liability Policies

- Limitation of Carrier's Subrogation Rights
- Limiting Carrier's Cancellation Rights
- Limiting the Prohibitions on Actions against Carrier without the Insured's full compliance of the policy terms
- Modifying Mandatory Arbitration Provisions
- Separation of Obligations of Additional and Named Insureds
- Clarification of Deductible Obligations among multiple Insureds
- Limiting the Known Pollution Condition Exclusions

Negotiation Issues for Cost Cap Policies

- Modifying the Carrier's prohibition against Assignment of Policy by the Insureds
- Limiting the Carrier's Subrogation Rights
- Clarifying the Contractual Distinction between known and unknown pollution conditions to favor the Insured for coverage issues
- Modifying the Coinsurance Participation obligation where there are multiple Insureds
- Clarification of Future Use condition for the property to favor the Insured for coverage
- Careful clarification of the scope of the Approved Remedial Plan
- The need to clarify the Termination Date of Remedial Plan coverage
- Understanding the Need to Coordinate Reopener coverage for such conditions under the Pollution Legal Liability Policy

Selecting an Insurer

- Specialization in environmental insurance
- Financial strength and rating
- Years in the environmental insurance market
- Commitment/availability of resources
- General reputation and history of claims payment
- Coverage available
- Pricing

What is the premium cost a function of?

- Limit of liability purchased
- Self-insured retention assumed (i.e., threshold the insured must pay before the policy starts to pay)
- Stage of remediation
- Size of the site or deal
- Level of characterization and due diligence
- Level of regulatory agency oversight/involvement
- Portfolio vs. single property
- Level of competition
- Future site use and surrounding occupancies
- Degree of variability of risk
- Expected remedial costs and degree of volatility

Environmental Insurance Claims

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Claims Submission and Documentation

- Notify the broker that placed the policy
- Timely submit the claim
 - Check the policy for specific notice requirements
 - “...as soon as possible...”
 - “...as soon as practicable...”
 - “...within ____ days of notice/knowledge...”
 - Review the policy for specifics on notice, including timing, to whom the claim is to be addressed, particulars of the claim, etc.
- Keep accurate records
- Document notices

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What percentage of claims are settled?

Claims Submission Process

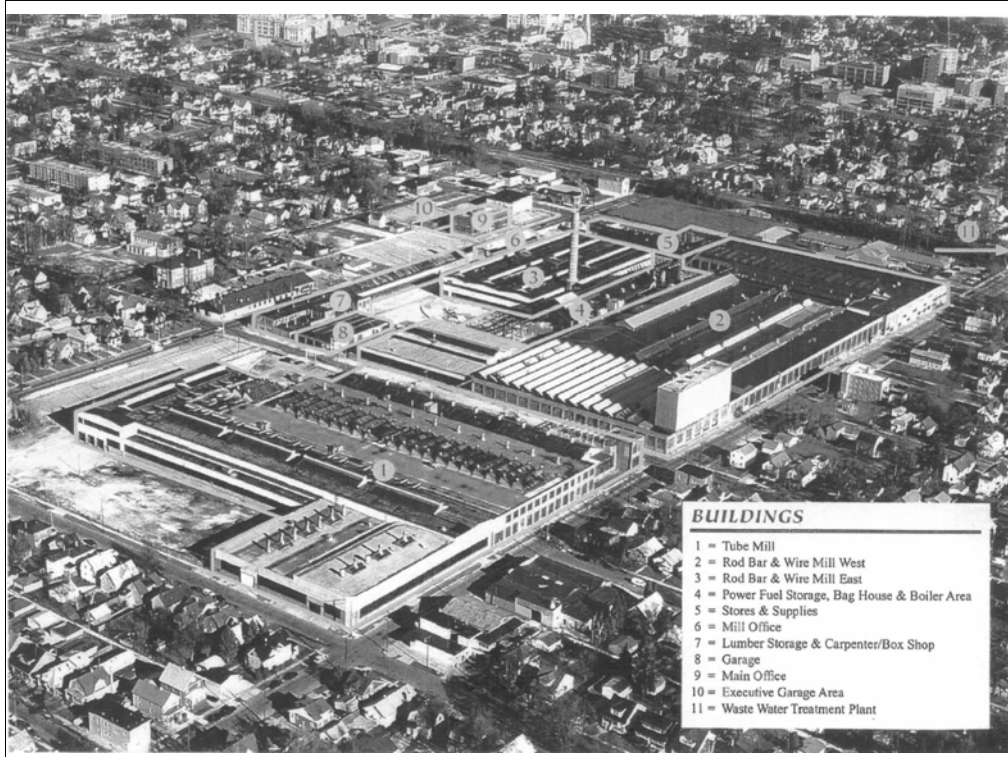
- Insured submits claim
- Insurer acknowledges in writing receipt of claim, assigns a claim number, and assigns a claims adjuster
- Claims adjuster issues letter accepting coverage, declining coverage, or accepting coverage with a reservation of rights
- Second letter typically cites policy provisions to support position taken by insurance company

Environmental insurance policies are fairly new – therefore there is no body of law on claims disputes like CGL policies

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Environmental Insurance: An Insurance Application to a Brownfield Project

Arthur Harrington, Godfrey and Kahn



Background

- Former American Brass Foundry
 - 100 year history as a foundry
 - 29 Acres
- Current ownership/status of property
- Property is vacant
- Known soil and groundwater contamination

Pre-Negotiation Strategy

- City threatened condemnation with municipal exemption liability for clean up
- City threatened cost recovery for remediation necessary to support residential redevelopment
- Estimated cost difference for industrial versus residential remediation was in excess of \$15 million

Negotiated Agreements

- Deal Summary
- The Exit Strategy Contract
- Property Conveyance Settlement Agreement
- Pollution Legal Liability Select Cleanup Cost Cap Insurance Policy

Summary of Deal

- City takes title to property
- City pays \$5 million
- ARCo and Outokumpu (OCK) pays \$5.075 million through AIG
- ARCo and OCK pays City \$765,000 for fencing/capping obligations
- TRC to decontaminate and demolish buildings
- TRC assumes remediation liability
- AIG insurance policy purchased by ARCo, OCK, and the City
 - Benefits are assignable to future site owners

Exit Strategy Contract Parameters

- TRC obligated for building demolition
- TRC assumes remediation responsibility to baseline remediation
- City assumes remediation responsibility above baseline remediation
- TRC Hold Harmless obligations
- City Barrier Obligation
- Payment to TRC through Commutation Account (managed by AIG)
- Future industrial development on the property is prohibited

Property Conveyance, Settlement Agreement, and Release

- Land transfer to the City
- City release and agrees to indemnify ARCo and OCK
- City's indemnification and assumption obligations does not include certain specified claims

The AIG Insurance Policy

- Ensure that TRC performs its Cleanup
- Insurance policy paid by TRC out of payments made by the parties
- 30-Year Term
- No Deductibles
- Insurance Coverage
 - On-site and off-site cleanup for pre-existing contamination
 - Third party claims for off-site cleanup (\$11 million)
 - Remediation cost cap insurance (\$15.7 million)
- Insureds: City, ARCo, OCK, as well as any future owners and developers

Funding Sources for City

- \$1 million Brownfield grant from Wisconsin Department of Commerce
- \$1 million Brownfields loan/grant from U.S. EPA
- Tax incremental financing for balance of \$5 million City share

Planning Strategy

- City retained Urban Land Institute for unbiased master plan for site
- ULI will prepare a comprehensive suggested development plan with full public input
- Expected property redevelopment plans involve:
 - Commercial development on the West end
 - Residential and school proposed on the East end

Questions and Answers

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Additional Information
Resources