

# Environmental Insurance and Risk Management Tools in Brownfields Cleanup and Redevelopment

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*Disclaimer: This presentation is the compilation of input by multiple insurance industry representatives. 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

**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

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

## 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

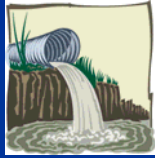
# Environmental Insurance

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

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

### 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**

# 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

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**

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

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

Kenneth Anderson, Aon Environmental  
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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

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**

# **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