

The Environmental Manager's Guide to Environmental Liability Insurance

Those readers who have spent more than a few years in the environmental field—and those who count their experience in decades—are aware of how technology, regulations, policies, and practices have evolved to prevent and reduce pollution and clean up both historical and recent contamination. Over the years, regulations and other initiatives have curtailed many of the activities that led to the release of contaminants. Solutions, both government-driven and founded within the private sector, have arisen to address impacts to human health and the environment.

Businesses have adopted many new practices that minimize impact on both the environment and their own bottom lines. In addition to rigorous pollution prevention programs, buying green, product stewardship, ISO 14000 registration, and other initiatives that companies have embraced to address environmental impacts, many businesses have turned to the insurance market.

Insurance coverage can help make resources available to address costs that may be associated with historical and future contamination, natural

It's not your grandfather's insurance—policies have changed

resources damage, business interruption, and emotional pain and suffering experienced by residential neighbors who have to evacuate during a chemical release.

What does environmental liability insurance do? In many cases, it greases the wheels to ensure that businesses can continue to operate *and* protect the environment. An environmental liability insurance policy can have a major impact when a merger and acquisition is being planned, a brownfield site is being redeveloped, or a real estate developer wants to purchase property without worrying about shouldering the expense of proving an “innocent landowner” defense if the Phase I environmental site assessment misses a recognized environmental condition.

Environmental liability insurance is one more tool that, when joined with other advances in environmental technology and management, makes it possible for businesses and—particularly

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in the case of brownfields—units of government and public-private economic development organizations to manage and reduce environmental risk for a finite and known amount of money.

What Is Environmental Liability Insurance?

Environmental liability insurance (also called pollution liability insurance) includes several major types of policies that can protect insureds from the burden of shouldering the cost of environmental mishaps by themselves. Like all other types of insurance, environmental liability policies mitigate the risk posed by catastrophic events. Increasingly, these types of policies are

deemed necessary for companies seeking to conduct certain types of business.

Environmental liability insurance has become a familiar and indispensable tool to many businesspersons

and professionals whose work can involve environmental risk. Surprisingly, professionals in corporate finance and corporate risk management, as well as real estate investors and bankers, are often better acquainted with the intricacies of environmental liability insurance than are environmental professionals, who typically deal with the regulations that trigger claims and write the reports upon which policies may be based.

Topics Covered in This Article

In this article, we discuss two major types of environmental liability insurance:¹

- policies that help businesses and other entities (such as economic development organizations) manage the costs associated with cleanup of existing contamination (either known or unknown) and

- policies that protect businesses' ongoing operations in the event of a release or condition that occurs after the policy goes into effect.

Policies that address existing contamination, both known and unknown, are increasingly being incorporated into brownfields redevelopment and into cleanups undertaken through state voluntary cleanup programs.

Policies for ongoing operations may address events such as future spills at a manufacturing facility or accidents during the transport of chemicals, as well as potential liability that may emerge from the management of a company's wastes by a third party.

From the Ashes, a Useful Tool: A Short History

Prior to 1972, commercial general liability insurance policies had no pollution exclusions. Considering the relative lack of environmental regulation at the time, this was not all that surprising.

But as regulations were promulgated under the Clean Water Act, the Clean Air Act, the Resource Conservation and Recovery Act (RCRA), the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), and other major statutes, both businesses and insurers realized that dealing with contamination was going to be very costly.

During this time, insurers stopped covering damages that resulted from "gradual" pollution, such as slow leaks from underground storage tanks and pre-RCRA and pre-CERCLA "housekeeping issues" at manufacturing facilities. Many still covered "sudden and catastrophic" releases, however.

By 1986, the insurance industry had had enough of environmental liability and the costly cleanups that many of their clients faced as they dealt with RCRA and, particularly, with CERCLA. Insurers as a group adopted an absolute pollution exclusion within their general liability policies

for both gradual and sudden and catastrophic releases. Companies that faced environmental liabilities now had to deal with them without the benefit of insurance.

Ironically, however, once general liability insurers stopped covering environmental risk, some keen observers realized that the dearth of coverage represented an opportunity to create something new: stand-alone environmental liability policies.

Over time, these environmental liability insurance products evolved. As knowledge of regulation, environmental risk, and cleanup/control technologies and programs grew, the policies excluded less and became more useful to companies.

“By the late 1990s, the policies became truly useful,” explains Max West, Senior Vice President at Willis, an international insurance broker that handles environmental liability policies.

Not Your Typical Insurance

Environmental liability insurance policies differ significantly from general liability policies in two important ways. The first has to do with how the policies are prepared. Most common types of insurance policies (such as car insurance, homeowner’s insurance, or business general liability insurance) use standard clauses, language, and forms that adhere to state insurance regulations.

By contrast, environmental liability insurance policies are “manuscripted” policies—meaning that they are crafted to fit the insured’s needs and circumstances. According to West, an environmental insurance broker will customize the coverage to suit the potential environmental legal liabilities facing the client.

The other characteristic of environmental liability insurance policies that sets them apart from typical general liability insurance is that they pay on a “claims made and reported” basis, rather than on a “per occurrence” basis. This means that the claim must be made while the policy is in effect.

This differs from the usual “per occurrence” policies with which most people are acquainted, which allow claims to be made years later as long as a policy was in place at the time of the occurrence in question. Insured companies can sometimes negotiate an extended “discovery” period so that claims can be made after the policy would have otherwise expired, but such extensions require the payment of an additional premium.

With a “claims made and reported” provision, environmental liability insurance policies won’t pay for incidents that occurred before the insurance was in place, either—unless, as we discuss later, the policy is expressly written to address preexisting pollution conditions.

Most environmental liability policies are written for terms of one to 10 years, although the policies can be renewed as needed. As we discuss under the topic of insurance for site remediation, “reopener” policies can be written to cover the cost of addressing sites that were cleaned up to government standards and received “No Further Remediation” letters (or similar documents, depending on the terminology used by a particular state agency), but that, because of tightening standards or migration of contaminants from the original site, may require additional remediation.

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Who Writes Environmental Insurance Policies?

Insurance Companies

Writing environmental insurance policies is a specialized business. Although the environmental insurance market has posted solid annual growth of 10 to 20 percent (and, by 2006, had reached \$2.5 billion per year²), the number of in-

insurance companies offering environmental policies is small.

Major players include ACE USA, Inc., AIG Environmental, the Chubb Group of Insurance Companies, Liberty International Insurance Underwriters, XL Insurance, and Zurich North America. Others have entered and exited the field. Policy limits range from \$1 million to \$250 million per incident.

Insurance Brokers

Insurance brokers are another vital component of the environmental liability insurance market.

Brokers are the intermediaries who work with customers to define their needs and then approach insurance companies to obtain quotes for policies that can transfer their environmental risk.

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Specialized Knowledge Required

Because of the specialized knowledge required to assess environmental risks and write policies that appropriately address those risks, it is not surprising that many people in the environmental liability insurance business have either worked in the environmental field or been trained in environmental science or management.

"Most of the people you meet have a degree in environmental science or management, or they've come out of the waste management industry, environmental consulting, or a government agency, and they go to work for an insurer or a broker and learn the insurance side," says West, whose own degree is in environmental management.

West adds that one can occasionally encounter someone in the business who started out

on the insurance side and then picked up knowledge of environmental science, management, and regulations. This is a much more difficult path, however, given the large body of knowledge that must be mastered.

When Corporations Seek Environmental Insurance Coverage

Despite the fact that many environmental professionals have found homes for themselves in the environmental liability insurance field, corporate environmental managers are not the ones who typically seek out environmental liability policies.

"I'd say that on the corporate side, interest in environmental policies comes from risk managers, chief financial officers (CFOs), or legal counsel first," West says. He adds that other parties who frequently initiate inquiries into environmental liability insurance policies include those who are involved in real estate transactions or who work for lending institutions.

So, what role do corporate environmental managers and environmental consultants play? West explains that corporate risk managers and CFOs (as well as others involved in corporate finance) will go to their corporate environmental managers for the information they need to obtain environmental insurance. Managers involved in real estate transactions will also make use of the Phase I and II environmental site assessments prepared by environmental consultants. As a rule, however, persons who work on the environmental side do not typically initiate inquiries into environmental insurance policies.

Knowledge about environmental liability insurance tools also varies significantly among attorneys who practice environmental law. According to West, some are quite knowledgeable and want to be involved in drafting the policies. Judging by the proliferation of conference sessions and seminars on the topic of environmental liability

insurance sponsored by state and local bar associations, knowledge of these insurance tools among attorneys is likely to grow.

Who Buys Environmental Liability Insurance?

West has worked with companies of all sizes to help them buy environmental liability insurance. Very large corporations often have the resources to self-insure, but they may buy policies to address specific conditions or locations. “Smaller companies buy it [insurance] because if they are considering severity versus frequency, it makes sense, since a big loss could put them out of business,” he adds.

Although very small businesses, such as dry cleaners, typically cannot afford environmental liability insurance policies, “the guy who buys the strip mall where the dry cleaner is located would buy a policy so he wouldn’t be hit with the full cost of a cleanup, or the lender may require it,” West says.

Indeed, environmental liability insurance frequently finds its way into business transactions nowadays. In many cases, the insurance makes it possible for deals to happen.

While a landlord may require a tenant to indemnify him or her against the cost of environmental damage from ongoing operations by the tenant, what happens if the indemnity isn’t honored? What if the indemnitor doesn’t do what he or she promised to do?

“Environmental liability insurance removes this concern by letting a third party—the insurer—act as a back stop to the indemnitor. The tenant buys a policy, and the insurance is there to cover the cost of remediation should the indemnifying party fail to respond,” West says.

Addressing the Unknown: Cleaning Up Contaminated Sites

Cost is one of the greatest concerns for anyone who is saddled with the cleanup (or potential cleanup) of a contaminated site. Although the

adoption of risk-based cleanup programs has done a lot to reduce costs through the use of barriers, plume monitoring, institutional controls, and the like, contaminated sites can still generate costly surprises. Environmental liability insurance policies can minimize the impact of those surprises.

Environmental liability insurance that addresses the cleanup of contaminated sites can come in various forms and offer various features, depending on the site and the situation. Since these policies are manuscripts, they may include any or all of the elements discussed below.

Cost Caps

“Cost cap” insurance limits the insured’s out-of-pocket cleanup expenses. Under this type of insurance, the insured party will pay a certain specified amount for a cleanup. If the cleanup cost exceeds this amount, then the insurance kicks in to pay the additional expense. Cost caps can be important if additional contamination (that wasn’t known about at the time the policy was written) is discovered.

“An example would be if the policy was initially written to address solvent and/or petroleum contamination at a site, but during the cleanup, additional contamination was also found to be present in the soil,” explains West. “If the insured could not reasonably have been expected to know about this contamination, and the agency-approved cleanup plan is amended to require the additional cleanup, then it would be covered under the cost cap policy,” he adds.

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Prefunding Cleanups

Cleanups can also be prefunded by a client on a net present value basis—and, if desired, a cost cap can be added to prevent additional payouts.

With this type of policy, the insured pays the estimated cost of the cleanup to the insurance company, which pays out the funds as they are needed for cleanup activities. If the cost of the cleanup exceeds the estimated amount, then the cost cap insurance covers the excess.

Such an arrangement can be especially attractive to potentially responsible parties (PRPs) who are tied to contaminated sites because it allows

them to fix the price of a cleanup and walk away after they have paid their share.

“The PRPs can essentially ‘cash out’ of their liability for a contaminated site by pooling their money to prepay a policy with a cost cap. Once

they have funded the policy, they know that this is all they will have to pay,” explains West.

Although few commercial property transfers take place nowadays without the benefit of a Phase I Environmental Site Assessment that meets the requirements of the ASTM standard, not all Phase Ones catch every recognized environmental condition.

Reopener Coverage

Companies can also purchase “reopener” insurance for properties that have received “No Further Action” or “No Further Remediation” letters from state agencies. This insurance will pay for additional cleanup in the event that a “clean” site is determined to need supplementary remediation because cleanup standards have been revised downward, migration of contaminants has occurred, barriers or institutional controls have failed, or a neighbor makes a claim.

Phase I Lapses

Although few commercial property transfers take place nowadays without the benefit of a Phase I Environmental Site Assessment that meets the requirements of the ASTM standard, not all Phase Ones catch every recognized environmental con-

dition. Under the United States Environmental Protection Agency (EPA) “All Appropriate Inquiry” Final Rule, a Phase I must take into account “commonly known or reasonably ascertainable information” in order to uncover the environmental conditions at a site—but some conditions may still go undetected.

When this is the case, the All Appropriate Inquiry Rule allows property owners who have no way of knowing that their property is contaminated to escape liability for cleanup as “innocent landowners.” Launching such a defense can be extremely expensive, however. As Mary S. Busby and Pamela E. Barker have noted:

Often skipped by purchasers in the thought process surrounding the purchase of real estate and environmental liability insurance, is that CERCLA and the word lawsuit means that whether liability attaches in the end, there will be costs to defend the purchaser. These can be substantial in and of themselves.

....

You may escape the multi-million dollar cleanup cost. What you have not escaped is the cost of winning [the innocent landowner] defense. The cost of litigation is still a heavy burden, one that might seriously impact the defendant. This is a cost, some might say, that the defendant who met all the criteria [of the defense] should not have to bear. However, proving that one met the criteria and/or otherwise negotiating a settlement in a CERCLA case involves hours upon hours of your attorney’s (perhaps a team of attorneys’) time, and they will want to be paid.

....

With liability insurance in place when the need for defense from CERCLA arises,

there is no worst case. If the insured is found to have successfully defended, assuming adequate policy limits and adequate coverage is placed, the defense costs are included within the limits of the insurance policy. If the insured is found liable for the cost to clean up the site (i.e., fails in its defense), assuming adequate policy limits and adequate coverage is placed, the insurance will cover the CERCLA liability and the cost to defend the insured.³

Brownfields Redevelopment

Environmental liability insurance is so vital to many brownfields projects that EPA includes a section devoted to environmental insurance on its brownfields Web site (www.epa.gov/brownfields/insurebf.htm). Policies that cap the costs of cleanup and secure the financial interests

of lenders are of particular interest to many parties involved in brownfields cleanups. For further discussion of this topic, see the sidebar accompanying this article, entitled “EPA’s Brownfields Program Promotes Environmental Insurance.”

Environmental Liability Insurance for Ongoing Operations

Procuring and preparing insurance policies to address the environmental risk faced by ongoing operations at manufacturing and other facilities tends to be easier than obtaining policies for the cleanup of contaminated sites. This is because policies for ongoing operations are insuring against future events.

Brokers and insurers can review a facility’s operations to determine the risk they face—and use that information to help determine the premiums that providing insurance will require. West

EPA’s Brownfields Program Promotes Environmental Insurance

EPA notes that environmental insurance can help encourage successful redevelopment projects. A “success story” fact sheet on the Agency’s brownfields Web site states:

Obstacles that include unanticipated cleanup costs and fears of unforeseen liability often dissuade otherwise interested developers from investing in brownfields. Environmental insurance is one of the few tools capable of limiting both of these barriers. “It makes a brownfields deal seem less risky, provides comfort to the decision makers, and lets people sleep well at night,” explains Lynn Tracy Nerland, Assistant City Attorney for Emeryville, California. Increasingly, communities like Emeryville and other EPA Brownfields Pilots/Grantees are including environmental insurance as a tool in their multifaceted approaches to brownfields reuse.

An EPA case study recounts how Emeryville, a community east of San Francisco, relied on environmental insurance when it redeveloped a bayfront location that once had been occupied by a paint factory, a pesticide production facility, and a drum reconditioning factory. The purchase of a \$10 million pollution liability policy helped ease the concerns of the parties involved, and allowed the community to redevelop the site for residential, hotel, and retail use:

With a history of chemical production and a future of overnight accommodations and long-term residences, developers and the Emeryville Redevelopment Agency needed to feel comfortable and protected if they were going to invest in the South Bayfront area.

This policy protected the redevelopment agency during remediation from certain additional cleanup costs and bodily harm to workers. When cleanup was completed, the developers became the primary insured. As such, the developers have up to \$10 million in liability protection for a 10-year period, which includes physical harm to residents or occupants should they be affected by the project.

EPA reports that environmental insurance helped Emeryville attract \$85 million from private investors. These investments allowed the community to revitalize a key location, develop a city center, and create hundreds of jobs.

Source: U.S. Environmental Protection Agency. (2003, July). Environmental insurance helps ensure redevelopment: Success story fact sheet. EPA 500-F-03-232. Available online at <http://www.epa.gov/brownfields/success/insurance.pdf>.

explains, "There are certain compliance issues with facilities, and if a facility is in compliance, that addresses a certain amount of risk."

Information Required to Prepare a Policy

To prepare a policy and determine the premiums, a broker or insurer will want to know about the facility's release history. They will also want to know that the facility has a spill prevention, control, and countermeasures plan (if it is required to have one), as well as secondary containment around aboveground storage tanks, and some sort of leak detection system for underground storage tanks.

Information on waste management practices is also part of the mix. Companies frequently seek policies to insure themselves for costs related to wastes that are sent offsite—a lesson learned from the experiences of many companies that found themselves named as potentially responsible parties for the cleanup of waste treatment and disposal facilities under CERCLA.

In addition, some transporters require the companies for which they haul chemicals and other goods to obtain environmental liability insurance before they will provide transportation services. These policies cover the cost of cleanups and other claims in the event of an accident during transport.

In the case of insurance for ongoing operations, "we might also look at a facility's security system and how well they protect against vandalism or terrorism," West says. He adds that some insurers look at the surroundings in which facilities are located (in particular, whether they are industrial or residential) to determine the risk that may be posed in the event of a release.

Duty to Disclose

As with other types of insurance, companies have a "duty to disclose" in order to obtain a policy. "If they failed to disclose past releases, for example, that could make their insurance policy invalid," says West.

Preferential Rates for Some Trade Association Members

Some insurers give preferential rates to members of groups such as the National Association of Chemical Distributors (NACD), the Institute of Scrap Recycling Industries (ISRI), and the National Association of Real Estate Investment Trusts (NAREIT).

Extent of Coverage

Environmental liability policies can be written to cover the cost of cleaning up spills on the insured's property and on nearby sites. In addition, they can cover other potential costs, such as natural resource damage mitigation, third-party lawsuits for diminution of property value, expenses related to business interruption, claims for mental anguish and emotional distress, and the cost of medical monitoring if contaminants are released.

Conclusion

Environmental liability insurance is another tool for managing environmental risk. It can be useful to private companies, economic development organizations, and other organizations or investors that deal with real property or chemicals.

Environmental liability insurance policies can help ensure that both historical and future contamination is addressed in a timely manner. This reduces risks to human health and the environment from contaminants, while also providing a mechanism that allows businesses, investors, nonprofit organizations, and governmental units to take on cleanups without worrying that the financial end result may be bankruptcy.

Environmental liability insurance policies can help ensure that both historical and future contamination is addressed in a timely manner.

The insurance industry has become a key player in environmental management. The options that environmental liability insurance offers for dealing with historical and future contamination are greater and more flexible than ever before.

Notes

1. In this article, we do not address the “Errors and Omissions” policies that environmental consulting firms and re-

mediation contractors typically carry. We also do not discuss specialty issues such as lead, mold, or asbestos.

2. Heffes, E. M. (2006, April 1). Environmental policies seen as mainstream. *Financial Executive*. Available online at http://www.thefreelibrary.com/_/print/PrintArticle.aspx?id=144751749.

3. Busby, M. S., & Barker, P. E. (2004, September). CERCLA’s “All Appropriate Inquiry” Rule—Does it alleviate the need for environmental liability insurance? Acquiring commercial real estate that may be contaminated under the current rule. *Gallagher Environmental Risk & Insurance Advisor*, 3(4), 1–4. Available online at http://www.ajg.com/portal/server.pt/gateway/PTARGS_0_21938_411477_0_0_18/EnvSEP.04.pdf.

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