

# Environmental Compliance & Litigation *Strategy*

August 2001

## FOCUS ON ENVIRONMENTAL INSURANCE

### Considerations Regarding Environmental Insurance Policies as Project Tools

By Diane R. Smith

New types of insurance policies that cover environmental risk can facilitate projects on “environmentally challenged” properties by protecting project participants against some of the unavoidable risks inherent in brownfields development. Brownfields projects are those that return property that is unusable for productive use due to environmental conditions. Brownfields are becoming the only fields available in some areas, however. The number of “clean” properties suitable for development is decreasing in many urban areas, because unaffected parcels are already fully developed. More and more industrial, commercial and even residential projects are being proposed for property whose history poses the risk of significant, unexpected costs if contamination is discovered or exacerbated as on-site work progresses.

The new environmental insurance products can be a significant hedge against additional costs that can destroy the economics of a project. However, because the various policy forms in use today are all different, it is important to carefully review the specimen policy to ensure that it will do what you want, should a claim arise. Use of these new “tools” is justified only when the specific policy being considered is evaluated in the context of the specific project. The worth of a policy depends on its terms, and the policy terms should be tailored to fit the project and the risks. This article outlines some of the questions that should be asked when considering using one of these new “tools.”

#### Exactly What Must the Policy Cover to Make It Worthwhile?

Environmental conditions that a policy will pay to remedy, and the types of damages it will pay, should be clearly stated and understood, as should any exclusions. For example, if there was an old settling pond on a property, will the policy cover bodily injury and health claims of exposures to the dusty

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sediments in the old pond area? Does the policy cover agency demands for remediation of both the property itself and adjacent properties affected by the conditions on the insured property? Will the policy cover nuisance claims that may arise as a result of odors caused by remediation activities? Will it cover damage to nearby wetlands? Will it cover asbestos that is present as a result of demolition of existing on-site buildings? What about naturally occurring asbestos, or lead paint chips in soil?

What items of cost or damages will the policy pay for? Does coverage include the cost of investigation,

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bonds to release liens or attachments, costs of appeal bonds or pre- and post-interest judgment?

Are claims for both on-site and off-site bodily injury or property damage, personal injuries (such as emotional distress), cleanup costs and property damage all covered? What about business interruption?

The possibility of off-site migration of on-site contaminants, with resultant loss of value of affected properties, should be evaluated, since migration is a common occurrence. Does the definition of property damage include diminished value?

Does the policy cover "toxic torts" such as bodily injury, or both bodily and mental anguish and other such injuries that can be the result of exposures only?

Are preexisting pollution conditions covered only if they were disclosed to the insurer before the policy was bound, or only if they were unknown to the insured prior to binding? Some policies provide that

they will "pay on behalf of the insured for remediation expense resulting from pollution conditions on, at, under or emanating from the [property] *first discovered* and reported to the [insurer], during the policy period." This language provides coverage for both preexisting and "new" contamination. It also covers contamination that is on, or that came from, the insured property, which is "first discovered" during the policy period, and for contamination that begins during the policy period.

Compare the following text, from another policy form. In that policy, the insurer agrees "to pay clean-up costs on behalf of the insured, on or under the insured property, if such clean-up costs are sustained *solely* by reason of the discovery during the policy period of pollution conditions on or under the insured property which *commenced prior to [the policy's effective] date.*" This language, unlike



## Environmental Compliance & Litigation Strategy

Law Journal Newsletters  
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New York, N.Y. 10016

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Editorial e-mail: [dwenger@amlaw.com](mailto:dwenger@amlaw.com)  
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the first, covers only conditions that commenced prior to the policy's effective date. It could also be read to cover only conditions that are *solely* the result of undisturbed pollution, rather than conditions that could be made worse by on-site work. This language would not cover contamination on adjacent properties.

Yet another policy form states that the insurer will pay "environmental cleanup costs sustained by reason of pollution conditions at, on or under an insured property in excess of concentrations or amounts allowed under applicable environmental standards, provided that such pollution conditions are discovered by an insured during the policy period. As a condition precedent to coverage, the insured must have reported such pollution conditions to the appropriate governmental agency(ies) in accordance with applicable environmental standards in effect as of the date of discovery." This language covers both new and existing conditions, as long as the pollution is "discovered" after policy inception, and only if contamination was also reported to a regulatory agency on a timely basis. Many reporting requirements are "immediate," and many insureds do not report contamination "immediately."

"Existing" might also be later argued to be a "new" condition, if, for example, a "new" pollutant makes an existing condition worse, and the policy covers only "existing" conditions. Carrying coverage for both existing and new pollution conditions helps to eliminate any risk that the insurer will later argue that a pollution condition is actually "new," and, therefore, that there is no coverage under the policy. It may also be desirable to purchase coverage for "existing" conditions even though remediation has already been completed prior to development, and the site is considered "closed" from a regulatory standpoint. Experience in dealing with "formerly" affected sites quickly leads one to the conclusion that it is

virtually impossible to ensure comprehensive knowledge of subsurface conditions, even with the most extensive remedial investigation. If a decision is made to buy coverage just for existing conditions, will it be possible to distinguish "existing" from "new" contamination should a claim arise?

### Who Is Covered by the Policy?

There are parties other than the property owner to consider covering by the policy, to maximize the policy's worth to the project. It is usually wise to consider the lenders for future purchasers of the property, for example. It is usually possible to sell property only if the sale can be financed, and it is much easier to get financing if potential lenders are afforded the benefits of an environmental insurance policy. Possible requirements and concerns of future tenants, as well as potential liability arising out of those tenants' activities, may also be a concern.

Consider spelling out in the policy exactly what will be required to add additional parties as insureds, if and when they are identified in future transactions. Approval of adding future purchasers can, for example, depend on whether or not increased risk will result from the development of the property as proposed by those future purchasers, even though those uses may not be now known. "Increased risk" could, for example, be stated to depend solely on whether a new use will trigger more stringent cleanup standard requirements by regulatory agencies.

### Does the Policy Include Contractual Liability?

Often, policies will exclude liability assumed by the insured by contract, unless the contract is designated as an "insured agreement." What if the insured executes an indemnity that covers "all damages" even if the indemnitee's negligence was partially the cause of the loss? Will the policy cover liability of both the insured and the indemnitee, or liability of the insured only? What if

they agree to cover even the other party's *sole* negligence? What the policy will not cover is as important as what it will cover.

### How Long Will the Policy's Protection Be in Place?

Most, if not all, environmental insurance is written on a claims-made basis. That means that the policy only covers claims presented to the insurer during the policy period, regardless of when the event causing the claim occurred. The "claims-made" basis may make a policy less valuable to a client with potential long-term exposure, such as third-party disposal site cleanup liability, which goes on forever. Without an extraordinarily high premium, policy terms rarely exceed 10 years, but it may be possible to negotiate a renewal option, with a specified premium, at the outset, or the right to reinstate policy limits, in the event that a large claim erodes coverage. Is it worth buying protection for only 10 years, when the disposal facility is new, and is unlikely to have problems for decades?

A particularly important question is whether there will be coverage after the property has been sold. Many policies contain language stating that the policy will not remain in effect if the property is sold. This particular exclusion takes on special meaning where the whole point of the development is to quickly "flip" the property.

### Deductibles and 'Self-Insured Retention'

The self-insured retention (SIR), often called the "deductible" for the policy, is the amount that the insured will have to pay out of its own pocket. An SIR is designed to "keep insureds honest" by imposing some cost on every claim. The SIR or deductible is negotiable and has a great impact on the premium. It may be wise to accept a higher SIR where risk is low, or where the insured wishes only a "safety net" for a catastrophic situation. SIRs usually apply per "occurrence." The

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definition of an "occurrence" should therefore be examined. Will nearly simultaneous leaks from an underground pipeline, for example, be considered one "occurrence," thereby requiring only one SIR? Some carriers offer an aggregated SIR, which effectively buys a "cap" on future out-of-pocket costs. The SIR can also be structured so that once an insured incurs a certain level of SIR, the SIR for future claims is reduced.

### **Common Exclusions**

Common policy provisions include exclusions of coverage for:

- Liability assumed by the insured by contract;
  - Removal of, or claims for exposure to, asbestos;
  - Removal of, or the costs of remediation of leaks from, underground storage tanks, if the existence of such tanks is known to the insured and not disclosed to the insurer before the policy's effective date;
  - Use or operation of a vehicle or craft beyond property boundaries;
  - Fines, penalties or punitive damages;
  - Damages arising from willful, fraudulent, dishonest, intentional or deliberate noncompliance with law;
- or
- Cleanup costs for removal of lead paint, or claims based on injury due to exposure to lead paint.

### **Conclusion**

As Charles Darwin pointed out, "It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change." The tools available for handling risky projects are changing. Where development of contaminated property is concerned, it is important to adapt and respond with the best tool. It is also important to remember the immortal words of Will Rogers: "The road to success is dotted with many tempting parking spaces." Choose the right one.

