EMERGING OPTIONS IN ENVIRONMENTAL INSURANCE

By Maura McCaffery[1]

ABSTRACT: By paying a one-time insurance premium, many people involved with contaminated real estate have used environmental insurance to quantify and transfer the risk associated with environmental contamination. Quantification of environmental risk is especially important when the property in question has known contamination, and at properties now referred to as Brownfields properties. As the market for environmental insurance grows, the cost of these policies is becoming more affordable, and under appropriate circumstances, can be attractively priced, especially when purchased on a portfolio basis or on a per project aggregate basis. Further, there are currently insurance policies available to suit various different players in the real estate arena—owners, landlords, tenant, buyers, sellers, lenders, and environmental consultants. For environmental consultants, environmental insurance may enable more competitive bids, obviating the need to transfer an unquantifiable risk onto the client.

INTRODUCTION

The owner of a real estate portfolio buys environmental insurance for the property at an attractive price to protect against future environmental problems. An environmental consultant purchases contractors pollution liability insurance to protect against liability for releases caused by site assessment work performed at a state-listed site suspected of having underground storage tanks. A seller is able to close a deal by paying a one-time premium for environmental insurance for the buyer so the buyer is comfortable that any contamination encountered during construction will not add additional costs to the project. Another seller purchases environmental insurance to address a known ground water contamination condition, which may or may not require additional remediation depending on the final form of draft regulations, and structures that insurance so that at closing it will be assigned to the buyer but the seller will remain as an additional insured on the policy. An environmental consultant purchases errors and omissions liability insurance to protect against potential claims by the potential purchaser of the property for failure to find buried drums of chlorinated solvents on the property.

What do these situations have in common? They are all examples of business people dealing with real estate who have used environmental insurance to quantify the risks associated with environmental contamination and to transfer those risks by paying a fixed price in the form of a one-time insurance premium. Quantification of environmental risk is especially important when the property in question has known contamination, and at properties now referred to as Brownfields properties.

When it was first introduced several years ago, environmental insurance was expensive and coverage provisions were not always clear. Now, the cost of these policies is much more affordable and, at least occasionally, can be attractively priced, especially when purchased on a portfolio basis or on a per project aggregate basis. These pricing changes are largely due to increased underwriting experience on the part of the carriers.

In addition, while the language in the current policies is neither perfect nor easy reading from the perspective of the insured, the carriers in most instances are more willing than before to negotiate specific language changes and to tailor coverage to particular situations.

As a result, environmental insurance is now a much more attractive risk-reduction technique than in previous years, and can often be used as one of several risk-reduction measures in facilitating transactions involving contaminated real estate.

OVERVIEW OF TYPES OF POLICIES PRESENTLY AVAILABLE

A number of different types of environmental insurance are currently available. They include the following:

- Contractor pollution liability insurance: covers the insured for third party claims, including cleanup expenses, arising from a release caused by the insured's consulting or engineering work. Often, property owners and other interested parties can be named as additional insureds.
- Environmental errors and omissions liability insurance: covers the insured (typically engineers and consultants) for any act, error or omission, including those that are pollution related, resulting from the insured's investigation of property, professional recommendations, or the conclusions or remediation design concerning the property.
- Environmental remediation insurance (also called first party pollution cleanup insurance): covers investigation, defense, and remediation costs associated with the cleanup of contamination on the insured's property and any migration of contaminants from the insured's property onto adjacent land. Typically, only those releases that occur prior to policy inception and that are not discovered until after policy inception are covered. However, some policies provide coverage for contamination arising after policy inception, e.g., midnight dumping and tenant-caused releases. Additional named insureds may be included, such as secured lenders.
- Pollution legal liability insurance: covers liability to third parties for off-site bodily injury, property damage, and cleanup costs caused by contamination emanating from specifically covered locations. Typically, these policies only cover claims made during the policy period. One critical distinction between the pollution legal liability policies and environmental remediation policies described earlier is that the pollution legal liability policies generally do not include coverage for the remediation of the insured's property.
- Integrated environmental insurance (also called environmental protection insurance): covers the types of risks also covered by environmental remediation insurance, but often also covers claims for bodily injury.
- Stop loss coverage: covers traditional environmental remediation costs in combination with self-insurance principles. This type of policy is particularly suitable for those properties with known environmental problems. In essence, the insured accepts a substantial deductible, i.e., the stop loss amount, which includes the estimated cost

[1]Assoc., at the law firm of Goulston and Storrs, 400 Atlantic Ave., Boston, MA 02110.

Note. Discussion open until December 1, 1997. To extend the closing date one month, a written request must be filed with the ASCE Manager of Journals. The manuscript for this paper was submitted for review and possible publication on February 25, 1997. This paper is part of the ***Practice Periodical of Hazardous, Toxic, and Radioactive Waste Management***, Vol. 1, No. 3, July, 1997. ©ASCE, ISSN 1090-025X/97/0003-0105–0106/$4.00 + $.50 per page. Paper No. 15241.

of cleanup, plus an additional amount for cost overruns, and the insurer bears the risk of cleanup costs in excess of the stop loss amount, up to the policy limit.

- Future contamination insurance: covers remediation of contamination from an insured's ongoing operations. Typically, the contamination must be discovered and reported during the policy period.
- Finite risk financing: covers prospective and retrospective environmental impairment exposure and can provide closure and postclosure liability funding, as well as financial guarantees concerning the costs of the future environmental cleanup. Funding for anticipated cleanups, for example, can be established through payment of equal premiums over a designated period of time. Many financial and accounting benefits attach to this type of coverage.
- Pollution insurance for financial institutions: covers lenders who hold a security interest in contaminated property. The policy coverage is triggered when the loan goes into default.

BENEFITS OF ENVIRONMENTAL INSURANCE COVERAGE

The primary benefit afforded by environmental insurance coverage is that in exchange for a fixed, one-time premium, certain environmental risks can be transferred during the term of the policy, with the result that the insured may achieve a much greater degree of certainty than would otherwise be the case. As evidenced by the different types of policies described earlier, both current and prior property owners, industrial operators, landlords, tenants, environmental consultants, and lenders can utilize one or more types of these risk reduction measures.

In addition, in a transactional setting, it may be possible to substitute environmental insurance policies for traditional indemnity and hold-harmless agreements. For prospective purchasers of property, this may lessen the purchaser's need to be concerned about the seller's continued financial strength. Owners and landlords of real estate may wish to consider environmental insurance policies as a part of prudent portfolio management. Further, for consultants and engineers, having this insurance may mean the difference between getting the contract and losing it to your competitor. Environmental insurance may also enable consultants and engineers to offer more competitive bids, no longer needing to transfer an unquantifiable risk onto the client.

It is also worth noting that most environmental remediation policies are direct pay policies. This means that the insurer pays the covered costs up front, as opposed to reimbursing the insured for costs only after they are incurred.

At least one insurer provides multisite portfolio coverage, which may be attractive to those property owners holding more than one piece of real estate. Under this type of coverage, properties are insured on a per-site basis under a multisite administrative umbrella. Each individual site must undergo an environmental site assessment, but the coverage is managed as a single group, thus reducing costs to both the insurer and the insured. Moreover, properties can be added to or deleted from the umbrella coverage.

COST OF PORTFOLIO AND INDIVIDUAL PROPERTY INSURANCE: A FEW EXAMPLES

Portfolio coverage against possible on-site cleanup costs and third party claims for five years, for approximately 160 properties consisting of office buildings, shopping centers, hotels, vacant land and multifamily units with varying degrees of environmental contamination: for a $2,000,000 limit of liability and a $100,000 deductible, the one-time premium costs approximately $280,000, equaling approximately $340 per site per year.

Insurance coverage against possible on-site cleanup costs and third party claims for a single property in downtown Boston, improved by retail space but with a known historical use as a small dry cleaning operation: for a $5,000,000 limit of liability and a $50,000 deductible, a five-year policy costs approximately $29,000, equaling $5,800 per year.

ISSUES WHEN PURCHASING ENVIRONMENTAL INSURANCE

As an initial matter, environmental insurance policies are relatively new and the terms of these policies vary markedly depending on the insurer, as very few form policies have been developed to date. Thus, it is critical to analyze each coverage and exclusion item, not just the certificate of insurance. Also, because environmental insurance is fairly new, the premiums do not reflect significant actual risk and claims experience. This lack of experience can make it difficult to predict exactly how the insurer will handle particular claims in the future.

Policy terms generally range from three to five years, or, in some instances, for the duration of property ownership. When negotiating the policy term, it is important to determine whether the term matches the needs of the particular client or transaction. Another important question is whether the policy is assignable and, if not, whether the insurer will reimburse the owner for a portion of the premium in the event the owner sells the property during the policy term.

Environmental remediation policies differ on whether contamination that arises after the inception of the policy constitutes a covered risk, often depending on which coverages have been selected. Additionally, coverage often depends on how the contamination arose, e.g., due to the owner, a tenant, a midnight dumper, or off-site migration. Careful consideration should be given to the question of which coverages should be put in place. Relevant factors include historical information concerning the property, the neighborhood in which it is located and its anticipated future use.

Site inspections are commonly required prior to entering into an environmental insurance agreement, and typically the consulting firm conducting the investigation must follow the insurer's testing protocol, usually similar to the ASTM testing protocols. Consultant and engineers should try to learn if the client is requesting the environmental assessment for purposes of obtaining environmental insurance, and if so, determine the insurer's testing protocol before commencing work.

CONCLUSION

Environmental insurance can provide real benefits to people dealing with contaminated property, including current and prior property owners, consultants and engineers, tenants, landlords, and lenders. In general, premiums differ depending on the special needs of the insured, the duration of the policy, the nature of the property's current and historical use, and the nature and quantity of the known contaminants. Often, the most important variable to the premium amount will be whether the property is part of a larger portfolio or, for consultants and engineers, whether the insurance is purchased on a per project aggregate basis.

Environmental consultants and engineers, armed with contractors pollution liability insurance and environmental errors and omissions liability insurance, are now able to better quantify the risk of providing assessment and remediation services, a reduction in risk, which can often be translated into a cost benefit to the client. In addition, consultants familiar with the range of risk reduction options available to prospective Brownfields developers and other private parties are seen as problem solvers and thus significant assets to the project team.