



# Environmental Insurance: A Risk Management Tool for Contaminated Property

March 2006

**E**nvironmental insurance can be a necessary part of many contaminated property transactions. It allows the risk associated with a contaminated site to be quantified as a manageable business risk – not as a "deal breaker" – providing a valuable risk management tool.

## Transactions suitable for environmental insurance:

- ◆ Sale or purchase of real property
- ◆ Development of real property
- ◆ Lease of real property
- ◆ Financing of real property

## Environmental insurance can:

- Improve marketability and allow a buyer to obtain financing for the property.
- Quantify the environmental risk associated with the property.
- Provide financial stability for the cleanup – essentially making the property as attractive as a "Greenfield."
- Reduce risk, especially for unexpected costs.

*But remember...* insurance is only as good as the provider. Therefore, it is important to identify a financially stable provider in light of the long-term liabilities associated with the transaction. Environmental insurance is limited in duration and to the other coverage terms of the policy. Policies typically contain a number of exclusions that must be considered when evaluating the long-term cleanup responsibilities.

## Why buy environmental insurance?

### Improving Marketability



- Insurance purchased by a municipality or private developer can provide extra assurance that, in the event of a cost overrun, funding for the cleanup will be provided quickly and the project will remain on schedule.
- General liability insurance policies typically do not cover environmental risks.
- Most environmental policies allow multiple parties (e.g., purchasers, lenders, sellers, and tenants) to be added to the policy, providing assurances to those parties and their investors.
- Lenders, in turn, feel more comfortable lending against a site that has a policy ensuring adequate funding for a timely and thorough cleanup response.

### Coverage for Numerous Situations\*

- ✓ Pre-existing contamination discovered after acquiring the property.
- ✓ Claims by third parties for personal injury or property damage.
- ✓ Failure of the cleanup remedy (whether remedy is instituted by the Government or the Grantee).
- ✓ Remedy change (the risks associated with regulators later imposing more stringent cleanup requirements).
- ✓ Business or work stoppage resulting from discovery of pollution.
- ✓ Natural resource damages.
- ✓ Risks associated with transporting contaminated soil to a landfill.
- ✓ Remediation expenses exceeding original cost estimate.

\* Depending upon the circumstances, some damages attributable to the United States but incurred by a purchaser may be the liability of the United States as seller pursuant to CERCLA Section 107 and/or CERCLA Section 120(h).

## Insurance Policies

**Names of policies differ by provider. The four most common variations are listed below:**

- **POLLUTION LEGAL LIABILITY** – This type of policy is designed to cover onsite or offsite claims against the current or previous owner for bodily injury or property damage arising from pre-existing contamination. It is possible to obtain coverage for both known and unknown pre-existing contamination. This type of coverage also typically covers regulatory re-openers and legal defense costs. It does not cover cleanup cost "overruns." (See below.) Another option that may be available under a pollution legal liability policy is coverage for business interruption as a result of newly discovered contamination. Generally, policy periods are for one to ten years.
- **CLEANUP "COST CAP" OR "STOP GAP"** – This type of policy covers the insured for costs in excess of the approved remediation plan, i.e., remediation cost overruns. The policy pays up to an agreed-upon amount when the costs of the remediation plan are exceeded. The policy can be structured to include coverage for offsite cleanup costs on surrounding properties. The coverage typically runs until the cleanup is completed. This type of coverage has become more difficult to obtain in recent years unless the anticipated remediation is fairly expensive (e.g., cleanups expected to cost \$2 million or more).
- **FINITE RISK** – This type of policy is still available for very big deals (e.g., \$50 million cleanup). Under this type of policy, the entire present value of the projected clean-up cost is pre-paid to the insurer. Then the insurance carrier either acts as escrow agent disbursing funds to the cleanup contractor upon reaching designated milestones and/or takes on the financial responsibility for the cleanup. Although the term is negotiable, this policy is typically issued for more costly clean-up projects lasting more than five years.
- **SECURED LENDER** – This type of policy typically pays the lesser of (i) the anticipated cleanup costs or (ii) the loan balance in the event that a borrower defaults on loan payments or if there is a loss in the value of the collateral, due in some way to the pollution condition. The policy can pay for clean-up costs, loan balance, legal defense, contract damages, bodily injury/property damage, and business interruption/extra expense.

## Application to Federal Real Property Transactions

- Local governments, a major recipient of federal property, may not be aware of the availability and utility of these insurance products. It is important, therefore, when structuring and negotiating a contaminated property transfer, that recipients be apprised of the environmental insurance option.
- In some Federal transferee policies, the insurance company has waived its right of subrogation against the Federal Government. This is important because, generally, after the insurance company pays a claim, it seeks reimbursement from another responsible party. Through a waiver of subrogation, the insurance company agrees not to sue the Federal Government for reimbursement for claims paid or owing.
- Environmental insurance may be particularly useful in "early transfers" where the transferee will conduct the cleanup of the property after transfer. It is not, however, limited to those types of transactions. Environmental insurance does not eliminate the Federal Government's legal liability under applicable environmental laws.
- Insurance providers sometimes perform other services as part of the policy development process (i.e., site assessments, risk assessments, and cleanup cost estimates) that can be helpful in quantifying the risk of the property. The recipient should not expect to rely on the carrier's independent assessment activities, however, in evaluating the nature and extent of the environmental risk and the appropriate type and amount of environmental insurance coverage. This information may be used as a means of comparison with the bona fide remediation estimate.

*Cautionary Note:* Only a handful of current policies have provided coverage for unexploded ordnance (UXO) and radiological and biochemical wastes. Some policies will not cover lead-based paint or asbestos. It is important to understand the limitations associated with the coverage options and the scope of all exclusions contained in the policy.

## Coverage Options



- **Claims-Made** – Claims can only be made during a set policy period. For example, if the insured is covered for five years, the claim would have to be filed during that time period. The insured, in some cases, can purchase extended coverage. This is by far the more common of the two coverage options.
- **Occurrence-Based** – Coverage is for future, undiscovered contamination and is determined when the release actually occurs, not when the claim is filed. Therefore, as long as the release took place during the term of the policy, coverage is provided even if the claim is filed after the policy has expired. For example, if the insured was covered for the years 2008–2013 and a release occurred in 2009, but was not discovered until 2015, a claim could still be filed in 2015. Very few environmental insurance products are offered on an occurrence-based basis.

## Policy and Deductible Ranges

Generally, the price of insurance is driven by the level of site characterization, the nature of the constituents of concern, the nature of the reuse (e.g., whether residential or industrial), the terms of the policy and limits of liability, the amount of the deductibles, and the expected costs of remediation. Generally, the insured party can structure the program so that its specific financial and risk management objectives can be achieved.

- Policy coverage ranges typically from \$1 million to \$25 million depending on the options purchased under a particular plan (although higher limits up to \$100 million are available).
- Deductibles typically run anywhere from as low as \$25,000 to as high as \$2 million.

Premiums are paid on a one-time, up-front basis, with the cost depending upon a wide range of variables including the type of contaminant(s) on the site, the extent and toxicity of the contamination, the intended future use of the premises, and a wide range of other factors.

## Where can I find information on environmental insurance?

US EPA's Environmental Insurance Products for Brownfields Cleanup and Redevelopment:

<http://www.epa.gov/brownfields/insurebf.htm>

Appendix from Improving Access-to-Capital, Site Transition, and Brownfield Redevelopment Programs Through More Effective Environmental Risk Management – Insurance for the Non-Specialist:

[http://www.earthtrack.net/earthtrack/library/Access to Capital\\_Envir Insurance Appendix.pdf](http://www.earthtrack.net/earthtrack/library/Access%20to%20Capital_Envir%20Insurance%20Appendix.pdf)

HUD's Environmental Insurance for Brownfield's Redevelopment: A Feasibility Study:

<http://www.huduser.org/publications/econdev/envins.html>

DoD's Using Environmental Insurance in DoD Property Transfers: A New Tool for Managing Cleanup Risk

[https://www.denix.osd.mil/denix/Public/ES-Programs/Cleanup/ei\\_factsheet.pdf](https://www.denix.osd.mil/denix/Public/ES-Programs/Cleanup/ei_factsheet.pdf)

Center for Environmental Policy and Management, Kentucky Institute for the Environment and Sustainable Development, University of Louisville, Louisville, KY

<http://cepm.louisville.edu>

Society of Property and Casualty Underwriters' "User's Guide to Environmental Insurance":

<http://erraonline.org/usersguide.pdf>