Environmental Insurance 101
An Overview For Business Lawyers
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Everyone has heard the horror stories. A property purchaser becomes responsible for contamination left by a prior owner or occupant. A lender forecloses and becomes liable for millions of dollars of environmental cleanup costs. A company acquires the stock of another and ends up with a substantial loss because the acquired company’s environmental liabilities exceed its assets. A significant transaction fails to close at the last minute because of unresolved environmental liabilities.

For nearly every environmental horror story, there are means of avoidance, such as: escrows earmarked for environmental costs, more intensive due diligence, indemnity agreements and environmental insurance. Of all these tools, environmental insurance is increasingly being touted as a solution to potential environmental nightmares. Does it live up to the hype?

The answer is: sometimes yes and sometimes no. The products have a wide range of value in that they facilitate closure of challenging transactions that probably would not be completed in the absence of these products, or transfer significant financial risk from small, financially weak entities to highly rated financial giants. However, other solutions offered by environmental insurance can be more illusory than real — either they do not solve the problems at hand, or they will not cover all of the issues of potential concern. So, buyer beware. Or, at least use due care.

The insurance industry is currently selling three main types of environmental insurance policies. They are: pollution legal liability insurance policies (pollution policies); cleanup cost overrun insurance policies, which are sometimes also called “cost cap” policies or “remediation stop loss” policies (cost overrun policies); and
lender liability policies, which are sometimes also called secured creditor impaired property insurance policies (lender liability policies). Each type of policy and its intended uses will be briefly summarized below.

**Pollution policies.** These policies usually cover owners of, or investors in, real estate. The policies offer a smorgasbord of coverages for on-site cleanup costs, off-site cleanup costs, potential third-party claims and even business interruption resulting from contamination at the insured property or certain nonowned properties. The policy purchaser can choose from this smorgasbord of coverages and pay a different premium depending on the coverages selected. The policies can be written to cover a single property or a group of properties.

The smorgasbord usually includes coverages for:

- Cleanup costs associated with on-site pre-existing contamination;
- Cleanup costs associated with on-site "new" contamination;
- Third-party bodily injury and property damage claims resulting from on-site injuries and on-site contamination;
- Third-party bodily injury and property damage claims resulting from injuries off-site caused by contamination that migrated from the covered property;
- Third-party claims for cleanup costs associated with pre-existing contamination that migrated from the covered property;
- Third-party claims for cleanup costs associated with new contamination that migrates from the covered property;
- Third-party claims (including claims for cleanup costs, bodily injury or property damage) arising from on-site injuries on scheduled nonowned properties;
- Third-party claims (including claims for cleanup costs, bodily injury or property damage) arising from off-site injuries associated with scheduled nonowned properties;
- Claims for bodily injury, property damage or cleanup costs associated with contamination resulting from transportation of materials or wastes;
- Business interruption associated with on-site contamination.

If your eyes glaze over just reading the list of available coverages, you are not alone. Even experienced professionals can get lost in the maze of distinctions that are used to differentiate the covered risks from the noncovered risks. Instead of covering every conceivable environmental risk, pollution policies narrowly categorize numerous types of environmental risks and provide coverage only for the categories specifically purchased. Policy exclusions also take away portions of the coverages. Hence, a pollution policy will not cover all risks arising from pollution, even if the policyholder buys all of the standard coverages.

A buyer (or adviser) must carefully read the policy form before buying the policy to see what is covered and what is not. One should pay particular attention to the defined terms and exclusions. The definitions and exclusions are often the key to unlocking the scope of coverage. If the definitions, exclusions and other policy terms do not provide the coverages needed by the buyer, the buyer should attempt to negotiate endorsements or policy changes to meet the buyer's objectives. If the needed coverages are not available, an alternative risk management tool will need to be considered.

Three key exclusions found in most standard pollution policies bar coverage for costs and claims arising from:

- known contamination — that is, contamination that is in existence at the time the policy is purchased and is known by the policy purchaser;
- deliberate noncompliance with any applicable law, order or instruction of a governmental agency; and
- a claim by one insured against another insured (the so-called "insured v. insured" exclusion).

Endorsements modifying or clarifying these (and other) standard exclusions can sometimes be negotiated.

Pollution policies are claims-made policies. That means that the claim must be discovered (and usually reported) during the policy period. Claims made before or after the policy period are not covered. If the policy covers a five-
year period and a claim is made on the first day after the five-year policy period ends, there will be no coverage. Hence, the policy period — and possible extended reporting periods — are among the most important terms to be negotiated when purchasing a pollution policy.

Pollution policies generally do not cover cleanup costs associated with known contamination — that is, contamination discovered before the policy is purchased. This lack of coverage is often misunderstood by people who are unfamiliar with environmental insurance. Many people hear the name "pollution policy" and they assume all pollution is covered. That is not so. If a property owner or purchaser wishes to protect against unpleasant surprises resulting from known contamination, a pollution policy generally will not work. But a cost overrun policy might.

Pollution policies usually impose a duty to defend on the insurer. But, unlike most general liability policies, the defense costs deplete policy limits and once policy limits are exhausted (whether by payment of defense costs or by indemnity payments), the insurer's duty to defend is terminated.

Cost overrun policies. Cost overrun policies cover remediation costs that exceed the amount expected to clean up a property or group of properties. These policies essentially "cap" (subject to the policy limits) the cleanup costs to be borne by the policyholder. A cost overrun policy allows the policyholder to quantify the costs of a cleanup effort and to assign some or all of the risk of cost overruns to an insurer. This type of insurance allows buyers and sellers of real property to negotiate a purchase price, knowing that cleanup costs are effectively capped.

Cost overrun policies are issued in reliance on a remedial action plan for the covered property. The costs associated with the remedial action plan are estimated. The policy covers additional cleanup costs that may be incurred as a result of unknown contamination or known contamination that is worse than anticipated. It also covers unanticipated costs (subject, of course, to the deductible and the policy limits).

Like pollution policies, cost overrun policies are also claims-made (and usually claims-reported) policies. That means that the "overrun" or excess costs must be incurred and reported to the insurer during the policy period to be covered.

Lender liability policies. This type of policy is intended to cover lenders who rely on real estate as collateral to assure the repayment of loans. The policy provides protection to the lender for:

- the loan amount if the borrower defaults and there is pollution at the property;
- third-party claims arising from pollution at the property; and
- cleanup costs incurred by the lender after foreclosure.

Lender liability policies only protect the lender. They do not cover any of the borrower's risks and costs, although a borrower can conceivably benefit indirectly from a policy payment. For example, if a borrower defaults, the lender forecloses, and the insurer pays cleanup costs, the borrower will indirectly benefit by having its potential liability to third parties extinguished by the insurer-funded cleanup. But even in that circumstance, the borrower may be liable to the insurer for cleanup costs incurred by the insurer.

Lender liability policies can facilitate loan closings and real estate transactions by reducing the need for indemnity agreements, escrow accounts and multiple environmental site assessments. In the past, many lenders have relied on environmental site assessments to attempt to minimize their exposure to contaminated properties. Lender liability policies provide greater protection to lenders (assuming the insurer remains financially solvent) than reliance on an environmental site assessment.

Like any other contract, the value of any particular insurance contract can be assessed only after a careful analysis of the contract's terms and conditions. Many times, the "off the shelf" insurance contract will not adequately address the buyer's most critical needs. The contract may need to be modified to provide the most value to the buyer.

Some of the more common policy issues, including commonly negotiated policy provisions, are:
Policy term. In most cases, the policyholder will want the longest possible policy period. From the policyholder's perspective, it usually doesn't do much good to insure against unknown pollution for a very short period of time. Once the policy period has expired, the policyholder must either buy more insurance or go bare. Insurers typically offer pollution policies covering five or 10 years. But longer periods (sometimes substantially longer periods) may be negotiated. Renewal rights can also be negotiated but, for the reasons identified more fully below, a right to renew may be less valuable to a policyholder than a longer initial policy term.

Policy limits and deductible or self-insured retention. Along with the policy term, the policy limits and the amount of the policyholder's self-insured retention or deductible are negotiated for every policy.

Pollution policies covering known pollution conditions. Since pollution policies generally do not cover cleanup costs for conditions known at the time the policy is issued, a prospective policy purchaser who is looking for this kind of coverage must either negotiate a revised policy form (which will not always be possible) or find another way of managing this risk. Under some circumstances, an insurer may be willing to provide coverage for known conditions but this would be an exception to the norm.

For example, the known conditions are not expected to require further remedial action under applicable regulatory standards, then an insurer might be willing to provide coverage for known conditions. Marketplace conditions — whether the insurance market generally is hard or soft — and site-specific circumstances are probably the two most critical factors in determining whether coverage for known conditions will be available.

Identification of known conditions or disclosed documents. If no coverage is being provided for known conditions, a policyholder would be well advised to identify, by endorsement if possible, the conditions that were known at the time of policy issuance. This can help avoid later disputes about known versus unknown conditions. The known conditions can be identified by a narrative identification or a listing of existing documents such as site assessments.

If the identification of conditions or listing of documents is incorporated into a policy endorsement, the endorsement will establish the insurer's and the policyholder's agreement concerning the conditions that were known to exist at the time of policy issuance. The identification of known conditions in this fashion will not completely eliminate the potential for future disputes but it should at least narrow their boundaries.

Additional insureds or right to add new insureds. Parties with a known interest in the property at the time a policy is purchased can be added as additional insureds at that time. But subsequent events may also create the need to add additional insureds. The policyholder's business activities don't stop. Property owners sometimes want to sell their properties. New loans from new lenders may be sought. Property owners may enter into new partnerships or joint ventures.

A policy purchaser may want to negotiate an endorsement that will allow additional insureds to be added on the policyholder's written request, which may not be unreasonably withheld by the insurer.

Any time an additional insured is added (or contemplated), the potential application of the "insured vs. insured" exclusion should be evaluated. This exclusion is common in many types of insurance policies and precludes third-party liability coverage for a claim brought by any insured party against another party that is also insured by the same policy.

So, for example, if one party (seller) buys environmental insurance and then later sells a property to another party (buyer) and the buyer is added to the policy as an additional insured, the "insured vs. insured" exclusion would normally bar coverage for a claim made by buyer against seller.

Assignment rights. After an environmental insurance policy is issued, a policyholder may wish to assign a policy (for example, in connection with the sale of the property). Therefore, when purchasing the policy, the buyer may want to negotiate an endorsement that will allow the policy to be assigned to
a subsequent transferee or that the policy may be assigned on written request, which will not be unreasonably denied.

Cancellation and renewal. Some insurers will agree by endorsement that, once issued, a policy will not be canceled by the insurer. In addition, some insurers in the past have agreed that the policyholder shall have the right to renew the policy at the end of the policy term unless certain conditions occur, such as a material breach or misrepresentation by the policyholder or the loss of reinsurance by the insurer. Of course, from the policyholder's perspective, a promise to renew that does not specify the renewal premium isn't really much of a promise. A longer policy period is more valuable to an insured than an undefined right of renewal.

Choice of law, jurisdiction and venue. Many of the standard-form environmental insurance policies contain provisions indicating that the policies will be governed by New York law and that any coverage disputes will be adjudicated in New York. These provisions may be perfectly acceptable to a New York policyholder. But some policy purchasers may not want to be governed by New York law or to have disputes resolved in New York.

In many circumstances, this may be a matter of convenience — a policy purchaser located outside of New York will prefer a more convenient forum. In some instances, however, the choice of law or forum may involve substantive legal issues.

Insurance law is a creature of state law. The law of one state on a particular issue may be more or less favorable to insurers or policyholders than the law of another state. If there are particular issues of concern to a policy purchaser, the purchaser may wish to consider whether the law of another state (other than New York) may be more favorable with respect to the issues of concern.

Most business people are not terribly interested in the theoretical availability of environmental insurance coverage. They want to know the answers to two very practical questions: How much does it cost? After collecting the premium, will the insurer really pay my claim? Unfortunately, there are no simple answers to these simple questions.

How much does it cost? The cost of an environmental insurance policy is similar to the cost of a car — it depends on the make, the model, the year of manufacture, and a multitude of other factors. When the EPA surveyed the environmental insurance market several years ago, it found that premiums ranged from $5,000 to $1 million for policies with coverage limits ranging from $100,000 to $40 million, with widely varied deductibles. (EPA Fact Sheet, "Potential Insurance Products for Brownfields Cleanup and Redevelopment," available at http://epa.gov/brownfields/html-doc/insurance.htm). A more recent and detailed EPA survey is also available on line. (http://epa.gov/brownfields/insurebf.htm)

If policy pricing can be compared to automobile pricing (with pricing varying from model to model and vendor to vendor), then policy buying can likewise be compared to automobile buying. It pays to shop around. There is no reason to walk into the nearest car dealership and pay full price for the first car in sight. It also pays in the long run to beware of the unreliable car salesperson working for Fly by Night Auto Sales.

After collecting a large policy premium, will the insurer pay my claim? Cynics believe that the insurance companies are highly skilled at collecting premiums but woefully inept at paying claims. Most environmental claims submitted in the past (under general liability policies) were denied, they say, so why would anyone fork over more premiums now to buy new insurance products from companies that have no intention of paying claims?

It is true that environmental claims historically have not been well received by insurers and that many environmental claims were not paid without litigation. But those environmental claims were, for the most part, made under general liability policies, including policies that contain different types of pollution exclusions. A more appropriate inquisit is whether the insurance industry has a good track record of paying claims under the types of environmental policies currently being sold. The answer to that is: It is probably too soon to tell.
The types of environmental policies currently being sold are relatively new. There is little publicly available information from which a consumer can draw meaningful conclusions about the level of claims-handling aggressiveness for these new policies.

Nevertheless, experience suggests that policyholders should not expect claims in general — and large claims in particular — to be automatically paid without very close scrutiny by insurers. It is not uncommon for environmental claims to involve dollar amounts with seven or more figures. Claims of this magnitude will receive careful scrutiny regardless of whether they arise under environmental or other types of insurance policies.

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