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Tailored Insurance Coverage for Post-Remedial Risks

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Environmental insurance policies have not kept pace with the increasing regulatory focus on post-remedial risks. This is particularly true of small site cleanup cost overrun and long-term stewardship (LTS) risks with ongoing remediation and expected cleanup of below \$1 million. Small sites require the same sound principles of Brownfields risk transfer applied to large sites including coverage for all post-remedial risks. Risk transfer basics include: 1) define all sources of potential environmental liability, 2) use three separate but complementary, interlinked contracts, and 3) tailor the policies to fit the specified risks. Zurich's Post-Remediation Care Policy, a stand-alone policy that specifically covers the LTS risk, has not been available and may never have been written. This is because there is little need for a policy covering one risk, and the coverage is not required nor can it be effective until remediation ends. These problems limit the policy's ability to facilitate a transaction. The author argues here for the use of staged coverage under policies typically required to facilitate transactions, such as the site pollution liability policy. The first stage requires a site pollution liability (SPL) policy endorsement promising the provision of post-remediation care (PRC) coverage when it is needed, upon fulfillment of certain underwriting conditions. The second stage endorsement provides for renewal provision connected to annual certification the effectiveness of the institutional and engineering controls (IC/ECs), thus making the policy essentially automatically renewable. The author readily obtained this coverage on a manuscript basis for a small manufacturing site in New York. Large sites where significant up-front funding is available will be able to cover the LTS risk through the use of alternative risk transfer products (ART), and such products may also serve as financial assurance. In similar fashion, owners of small sites can use the SPL endorsement approach described herein, for the same purposes.

INTRODUCTION

Environmental insurance policies have not always kept pace with the increasing regulatory focus over the past few years on post-remedial risks, particularly cleanup cost overruns, including the long-term stewardship (LTS) or post-remediation care (PRC) risk. Cleanup cost cap (remediation stop loss) coverage of cleanup cost overruns is available only to sites with cleanups

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exceeding \$1 million or \$2 million; this is known as the small sites problem. Zurich's stand-alone Post-Remediation Care Policy covers the PRC risk, and has been in existence for four years but rarely if ever written. The coverage has been attached by endorsement to some cost cap policies for sites with large remediations. However, it has not been attached to site pollution liability (SPL) policies, which are typically needed for sites with ongoing but low-dollar cost remediations. Coverage for other post-remediation risks such as vapor intrusion is similarly difficult to obtain.

This article argues for a two-fold solution in the case of small sites/ transactions (where there is an ongoing remediation including institutional and engineering controls [IC/ECs] as part of the remedy): the application of the same basic principles of Brownfields risk transfer often applied to large sites/transactions and a focus on coverage for all the post-remedial risks at any particular site.

BROWNFIELDS RISK TRANSFER BASICS

Define the Risks and Consider All Sources of Potential Environmental Liability

The first step in successful transfer of environmental liabilities is always precise definition of the technical environmental risk. The contamination must be characterized and its scope defined before the risk can be allocated and transferred. Actual sources of potential environmental liability cannot be determined before this has been done, and before known conditions are distinguishable from unknown. Potential environmental legal liabilities at any site will arise out of new pollution conditions, pre-existing known conditions, or unknown conditions:

- Cleanup obligations (on-site and off)—Known and anticipated, including cost overruns, exacerbation of knowns, reopener, and costs arising from unknown and unanticipated conditions (possibly uncovered by buyer excavation activities)
- Natural resource damages
- Third-party bodily injury and property damage (including diminution in value), arising from known (vapor intrusion) and unknown conditions
- IC/EC's (over known conditions left in place)
- Operational liabilities (compliance, new conditions from ongoing operations)

Post-remedial liabilities arise from known conditions and include cleanup cost overruns, reopener, exacerbation of knowns, PRC liabilities, and future vapor intrusion. This matrix of potential liabilities can only be filled in, and

the specific risks of concern can only be identified, by looking at specific conditions and remedies. For example, at a New York manufacturing site with an ongoing VOC cleanup, where the remedy included monitoring groundwater contamination under a natural attenuation plan, and filing of an environmental easement (IC) at the end of the process, the specific risks of greatest concern were groundwater cleanup costs, third-party bodily injury due to vapor intrusion, and PRC liabilities.

Applying and Integrating the Three Contracts

For any site involving an ongoing remediation, whether large or small, there are usually three separate contracts to consider:

- The purchase and sale agreement (PSA),
- The remediation contract, and
- The insurance contract.

Each contract needs proper implementation, which can only be done by legal, engineering, and insurance experts who can draft and negotiate them so that their terms are legally sufficient (i.e., can hold up in a contractual dispute) and effectively integrate with and complement each other. The PSA and remediation agreement must have precise indemnifications, which should be supported and complemented by an insurance policy that integrates the terms of the other two agreements. For example, the indemnity for cost overruns in a guaranteed fixed price remediation (GFPR) contract can substitute for a cost cap policy that is unavailable for small dollar volume cleanups. Unfortunately, the needed expertise to achieve such integration is the exception rather than the rule at small Brownfields sites. It is very common for real estate lawyers and even real estate brokers who are unaware of the risks faced by their clients to negotiate and draft PSA's used in contaminated property transactions.

Tailor the SPL Policy to Fit Specific Risks

The SPL policy, which does not cover cost overruns, can, as indicated above, be used together with a GFPR agreement to provide coverage of all significant post-remedial risks. The SPL policy potentially covers most environmental legal liabilities, including post-remedial liabilities, and its potential coverages track the potential site environmental liabilities discussed above. Of course, such liabilities must arise from new, pre-existing unknown, or pre-existing known pollution conditions:

- Cleanup costs (on-site or off-site)—new conditions (i.e., created by ongoing operations at a site), unknown pre-existing conditions (e.g., as uncovered by buyer excavation activities) and known pre-existing conditions (e.g., exacerbation of known conditions; reopener)

- Third-party bodily injury (vapor intrusion arising out of known conditions)
- Third-party property damage (includes diminution in value and NRD.)

Coverage for IC/EC (PRC) liabilities is not listed above because none of the standard SPL policies provide that coverage explicitly, although some claim to provide it implicitly in situations where all known conditions are covered, i.e., after issuance of a no further action (NFA) letter. Other post-remedial risks caused by known conditions, such as reopener, exacerbation of knowns, and vapor intrusion, can and will be covered if the policies are tailored to address these risks. The goal for both broker and underwriter is legally sufficient language that can withstand an environmental declaratory judgment action and that complements/integrates with that of the other contracts.

Tailoring for coverage of post-remedial risks arising from known conditions is necessarily required because of an exclusion in all SPL policy forms for known conditions that have not been disclosed in the application process. Typically, such known conditions will be disclosed and endorsed onto the policy in a Disclosed Documents Endorsement. If that is all that is done, the known conditions will be covered, but it is rare that a policy used to facilitate a contaminated property transaction will cover all liabilities arising from known conditions. The typical policy excludes cleanup costs arising out of specific known conditions (on-site, off-site, areas of concern, soil/groundwater, etc.) but normally covers bodily injury and property damage arising from both known and unknown conditions. The exclusion for cleanup costs is often accompanied by a reopener endorsement that states that the exclusion will be removed upon presentation of an NFA letter. Obviously, this process requires a great deal of care. Some recent versions of the reopener endorsement have introduced uncertainty into this coverage by stating that the exclusion for cleanup costs will only be removed at the insurer's "sole discretion." Such a statement is unacceptable from the point of view of the insured, and the language should be modified to base the insurer's consent on a reasonability standard.

Tailoring for coverage of known conditions is not just a matter of getting the language right. The broker and underwriter must seek sufficient engineering/underwriting support to justify the language required. For example, if the policy covers bodily injury arising out of known conditions, it will be covering vapor intrusion. However, underwriters have increasingly been asking for more underwriting support than they did previously to provide this coverage, i.e., sufficient air sampling to prove that vapor intrusion is not a problem. A good environmental broker will work closely with the client's engineering consultant in order to provide that proof to the underwriter.

INSURANCE COVERAGE FOR THE PRC RISK

Zurich's PRC Policy

Zurich's PRC policy provides specific coverage for the PRC risk. Coverage C is for failures of IC/ECs due to "Errors and Omissions in Monitoring and Enforcing ICs" (the term "institutional controls" in Zurich's policy is used for both ICs and ECs), while Coverage D is for no-fault failures of ICs, i.e., those not due to negligence/errors and omissions in implementing, monitoring, or enforcing IC/ECs. To underwrite this coverage, Zurich requires that the IC/ECs be properly implemented, and that there be a good and detailed plan for monitoring and annual certification of the IC/ECs.

While Zurich has in the past attached the PRC coverage by endorsement to policies used in situations requiring or meriting cleanup cost cap insurance, the policy itself has rarely if ever actually been written. The reason is the lack of need for a stand-alone policy covering the PRC risk alone, and a related timing problem. IC/EC's are part of a remedy; they relate to and are used to control other post-remedial risks such as vapor intrusion. IC/ECs will not be implemented until the end of the remedial process; therefore, PRC coverage cannot be put into effect until that time. The typical SPL policy covering other post-remedial risks, on the other hand, is usually needed much earlier, at the time of closing and long before the end of a remedial process.

Two Stages of PRC Coverage Under the SPL Policy

The solution to this timing problem is to obtain PRC coverage under an SPL policy in two stages. Interim coverage under the typical SPL policy needed to close a transaction, with an endorsement stating that coverage for PRC liabilities will be provided later when proper underwriting information is provided. The coverage will be excluded until the underwriting requirements of proper implementation and an approved or approvable monitoring and certification plan are fulfilled. Stage two will be when that underwriting information is provided and the PRC endorsement is attached to the policy. The actual PRC endorsement will provide the same coverage as Coverages C and D in Zurich's PRC policy.

The endorsement will also contain a renewal provision to address the long-term aspect. Large sites with significant up-front sources of funding can always use alternative risk transfer (ART) products such as structured settlements, 501C3 trusts, finite risk, and special municipal tax districts to support long-term (i.e., longer than 10 years) periods. A small site can rely on the renewal provision of the PRC endorsement attached to the SPL policy to achieve the same goal. Renewability is directly connected to annual certification. The insured's consultant is responsible for certifying every year that the IC/ECs are protective of human health and the environment. Should there be a breach, preventing certification, the policy will respond to cover costs of bringing the

site back into compliance; this response will be followed by recertification. Therefore, the annual certification process makes it possible for the policy to be virtually automatically renewable—at the insurer's consent based on a reasonability standard.

EXAMPLE OF SUCCESS

The Site

The first stage of this two-stage coverage was recently achieved for the New York manufacturing site discussed above. This is a small, six-acre site in New York where a cleanup of VOCs has been proceeding for several years under the direction of the NYDEC, finally resulting in a Record of Decision (ROD). ICs were always known to be a large part of the remedy at this site, but the ROD made clear their relationship to the rest of the remedy and site risks. The remedy required by the ROD in this case had the following elements:

- Filing of environmental easement including restricted site and groundwater use, the easement to incorporate in addition a Site Management Plan (SMP) to be approved of by NYDEC.
- The SMP must include other elements of the remedy: groundwater monitoring of enhanced natural attenuation for a period of at least four years, an plan, an O&M IC/EC monitoring plan, and periodic certification. The IC/EC plan was also to apply to management of residual contaminated soil and evaluation of the potential for vapor intrusion.

The ROD for this site thus made it very clear how ICs and the PRC risk were connected with other post-remedial liabilities. The SMP, which included other elements of the remedy than the IC, was to be incorporated into the IC (the environmental easement), and the IC/EC monitoring plan applied to management of other post-remedial risks.

The Coverage

The fact that the site was in New York made it easier to obtain appropriate coverage for the PRC risk than would have been the case with risks in other states, since New York regulates IC/ECs much more heavily than most states. New York requires not only IC/EC implementation through filing an environmental easement but also, in recently revised section 375-1.8 of the General Remedial Program Requirements, that there be a detailed plan for monitoring and certifying the IC/ECs subject to approval by the NYDEC. Based on the ROD and other site environmental information including the RI/Fs, it was possible to obtain a quote for an SPL policy including the following coverages:

- Cleanup costs from pre-existing unknown conditions; the exclusion for known cleanup costs will be limited to on-site groundwater since the full FS indicated there was no residual contaminated soil. The exclusion will be removed upon presentation of an NFA to the insurer's consent, which will not be unreasonably withheld or denied.
- Bodily injury and property damage from known and unknown conditions, with an exclusion for bodily injury due to air contamination by TCE until additional air monitoring and soil vapor testing permits its removal.
- PRC (IC/EC) liabilities excluded until proper implementation of the environmental easement and NYDEC approval of the SMP. The insurer's consent to remove this exclusion will not be unreasonably withheld or denied.

The above bulleted points represent what was stated in a formal quote letter, in the section describing the forms and endorsements that will be attached to and modify the policy form. The actual endorsements providing the above coverage have yet to be drafted. The author has entered into a Broker of Record (BOR) agreement with the client promising that the endorsements and policy will be "legally sufficient." This is not a promise that the insurer will never deny coverage of a claim but rather that, if it does, the language will likely hold up in a declaratory judgment coverage action.

CONCLUSION

As demonstrated above, a small New York Brownfields site with an integrated remediation using ICs under New York regulations was able to obtain appropriate SPL insurance coverage of all post-remedial liabilities at that site, including PRC liabilities. The policy to which this coverage was attached can be used, because of its renewal/certification clause, for long-term coverage and for purposes of financial responsibility. New York's regulation 375-1.11 states that financial responsibility may be required for IC/EC liabilities, and the national trend is moving in the New York direction. Similar small sites can use SPL policies with PRC endorsements to provide financial responsibility for long-term coverage of the PRC risk. Additionally, large sites using ART products, for up-front funding of long-term periods and for financial responsibility, can use SPL policies with coverage for PRC and other post-remedial risks to support and complement the environmental indemnity provisions of their other contracts.