



ENVIRONMENTAL INSURANCE FOR CONTAMINATED PROPERTY TRANSACTIONS

By: Suzanne M. Avena, Esq.

Many real estate deals disassemble when the specter of contamination arises as a potential issue on the target property. One or more of the deal parties – or their attorneys – either run from the deal, or run to their respective corners to dig in their heels until the other party gives sufficient concessions. However, either strategy doesn't often get the deal done. Environmental insurance can bridge the gap between the parties. Environmental insurance offers an independent source of cost recovery to multiple insureds and is available from several major underwriters such as AIG, XL, Zurich and ACE. However, these policies can be complicated, with different forms issued by different companies. The application and underwriting process is equally complex. With the recent rise in the number of Brownfield (contaminated property) transactions, developers have come to rely more and more on their attorneys to evaluate whether the policy truly covers the risks the client seeks to insure.

The Application Process

Since the insurance policy is only as good as the company that issues it and its assets, it is important to qualify that the companies you are considering are financially rated A or better by AM Best, have a solid history of "writing" environmental insurance and have a good claims paying history. Likewise, clients, or their attorneys, should select an insurance broker who has particular experience with environmental insurance placement. The broker, along with the attorney and environmental consultant, will be preparing the "underwriting package" to be distributed to the insurers for rating. At a minimum, the application and underwriting package usually needs to be accompanied by a Phase I Environmental Site Assessment ("ESA") and depending on the results of the Phase I, a Phase II ESA may be required. If there are other environmental reports and correspondence with applicable environmental agencies, the insurance company will need these, as well as a "term sheet" describing the development project. Your broker should "market" the deal to more than one underwriter to initiate a competitive process for premium indications. Quotes are typically issued for a range of limits of liability, self-insured retentions and policy periods, so that insureds can have alternatives from which to evaluate price versus coverage.

Environmental policies are "claims made" which means that the

loss must be incurred and the claim first reported during the policy period. Prompt written notice must be provided in the event of a claim or a probable claim. The insured should certainly mitigate loss in the event of a claim, but not initiate cleanup without notification, since there is a duty to cooperate with the insurer in the management of a claim and the insurer may select or at least will have to approve all contractors and/or consultants used in response to the claim.

Pollution Legal Liability Policies

Lets say your client is a developer with plans for a condominium complex at the site of an old warehouse. But the problem is the past use of the property resulted in contamination for the few storage tanks that were on site. Plus the use of surrounding property also has some issues, with one corner being used as a vehicle maintenance facility. The seller is not offering an indemnity and in fact wants a release from all environmental claims. Furthermore, your client's lender (or investor) is looking for some assurance that the deal won't collapse if unexpected pollution conditions are discovered during excavation, or if construction is delayed or if claims arise.

This is the perfect application for a "Pollution" or "Remediation Legal Liability" or "Environmental Impairment" (collectively, "PLL") policy. This type of policy is site-specific and covers claims arising from pollution conditions at, on or migrating from the insured property. It offers insurance for (1) required cleanup by government agencies, (2) legal defense expenses and (3) third party bodily injury and property damage claims arising from either pre-existing or new pollution conditions that are discovered and reported during the policy period.

Other coverage grants are available for additional premium, such as contractual liability, non-owned disposal site coverage and business interruption and extra expense coverage (including delay damages). Since most insurance policies typically only cover tort liabilities, contractual liability coverage backstops specified obligations of the parties such as the indemnity contained within the purchase and sale agreement, which must then be scheduled onto the policy. Non-Owned Disposal site coverage is offered to protect insureds from future claims in the event the scheduled disposal sites to which they transport their waste from the insured property become federal or state superfund sites, subject to required government cleanup, or subject to third party claims. First party Business Interruption Loss provides coverage, following a specified deductible period, for business income (rental income, payroll expense and rent for temporary premises), extra expense and delay expense arising from a pollution condition.

PLL Policy Factors and Terms

The parties to be insured must decide on a policy period, which in today's market can be as long as ten years for pre-existing pollution conditions and as long as five years for new pollution conditions coverage. A one-time premium is paid upfront and is usually fully-earned (non-refundable) at policy inception. Even if the parties plan on selling the site after a short period, the insurance is assignable and can be used as a marketing tool to assist in property transfer.

Insured parties must also decide on the limits of liability for the term of the policy, since all coverage grants are subject to the policy

IN THIS ISSUE

- [Environmental Insurance For Contaminated Property Transactions](#)
- [Responding to Fire Department and Environmental Control Board Violations](#)
- [Environmental Disclosures and the SEC: Are New Reporting Requirements on the Horizon?](#)

limits and shared between the insureds. The decision on limits will depend on a risk assessment of the potential environmental liabilities relating to the target property and its planned use. Clients can turn to their environmental consultants and attorneys to help them with this assessment. Additionally, parties must choose a self-insured retention (SIR) or deductible, which must be satisfied in the instance of each claim before the policy is triggered. Thus, an “aggregate SIR” should try to be negotiated for the lifetime of the policy to eliminate an unlimited number of co-payments for claims. This also enables multiple insureds to contribute a set amount to be set aside up-front for claims instead of debating who pays each time a claim comes up.

One term that causes much confusion in the placement of environmental insurance is the designation of the insureds. Usually, the development entity is named as the Primary Named Insured, responsible for the control of payment of premium, self-insured retentions and claim application. Other Named Insureds may be added to the policy, which might include other major investors in the deal. However, being a Named Insured is a coveted status that should be awarded sparingly, as it gives these entities direct access to the policy limits of liability. Alternatively, Additional Insureds may be listed on the Policy, which merely have vicarious access to the policy limits, as they must be named in an action along with the Named Insureds and in the event of a claim and must apply to the Primary Named Insured for coverage. Additional Insureds might include lenders or property management companies. As previously mentioned, since the more insureds the greater the potential for the policy limits to be eroded, one strategy to consider is to set sub-limits of liability for certain insureds.

With a PLL policy, the scope of coverage can be expanded or restricted either through endorsement or by definition. For example, attorneys should check the definitions of “Cleanup” or “Remediation” to see if it includes restoration which can be important if mold claims are involved. Also check the definition of “Property Damage” to see if it includes natural resource damages and property diminution claims, other common and potentially costly environmental claims. “Bodily Injury” should include other typical claims arising out of environmental exposures such as claims for mental anguish and emotional distress even in the absence of physical injury. This is where the attorney gets very involved in negotiating policy language.

PLL Policy Exclusions

One major exclusion that usually appears by way of endorsement in PLL policies is “Material Change in Use”. For example, if the insurance company agreed to insure a light industrial use which is later changed to heavy industrial use, this will vitiate the policy, as the insurer views this as insuring beyond the bounds of what was underwritten to be covered. Policies also generally exclude known underground storage tanks, unless they are in compliance with laws and specifically scheduled onto the policy by way of endorsement. Unknown “phantom” tanks are covered, if, after appropriate due diligence they were not discovered.

Other PLL policy exclusions include payment of fines and penalties, workers compensation claims, claims resulting from intentional non-compliance, nuclear hazards, pollution conditions resulting from the use of vehicles and claims resulting from war, hostile acts or terrorism. Additionally, the policy excludes pre-existing pollution conditions already known to the insured, specific contaminants such as asbestos and lead paint within buildings, radioactive materials and certain naturally occurring pollution conditions such as radon. More current exclusions relate to claims resulting from mold or other indoor air conditions, contamination discovered during the course of a capital improvement and failure to comply with engineering or institutional controls.

There are other environmental policies available that perform other uses in contaminated property transactions, such as Cost Cap or Reme-

diation Stop Loss insurance, which insure against cost overruns in the cleanup of known contamination. A full discussion of such insurance is beyond the realm of this article. Suffice it to say, however, in each case of the placement of environmental insurance, the enlistment of a team of legal and technical professionals with knowledge and experience in this can mean the difference between claims paid or not.

RESPONDING TO FIRE DEPARTMENT AND ENVIRONMENTAL CONTROL BOARD VIOLATIONS

By Jordan M. Freundlich

This article focuses on two of the more common notices of violation that you may receive in the ordinary course of business: violations cited by the New York Fire Department (“FDNY”) and the New York Environmental Control Board (“ECB”). The types of violations cited by the FDNY and ECB are similar in many respects, and can range from minor infractions (such as improper signage or accumulation of debris) to more serious infractions (such as damaged oxygen tanks or failure to have 24/7 supervision of nitrogen tanks.) The following is a summary on what you should be aware of in the event you receive a violation notice from either the FDNY or ECB.

With respect to both the FDNY and ECB, an inspector that discovers a violation will issue a preliminary notice of that violation. With the FDNY, this paper is called a Violation Order. With the ECB, this paper is called a Notice of Violation. Generally, a Violation Order will describe (i) the alleged violation(s), and (ii) the steps necessary to come into compliance. The Violation Order will provide a certain number of days to come into compliance or a Summons will be issued.

An ECB Notice of Violation is similar in that an inspector will describe the alleged violation(s), including the Rule or Code provision alleged to have been violated. Attached to the Notice of Violation is a Certificate of Correction. If a completed Certificate of Correction is mailed in within a set number of days, with proof of compliance attached thereto, the Respondent does not need to attend the scheduled hearing, and will avoid a penalty. If you are alleged to be a repeat offender, that is, if you are alleged to have repeated a past violation, it will be so indicated, and you will need to appear at the scheduled hearing.

If you do not comply with an FDNY Violation Order within the stated time period, a summons will be issued, and you must appear in criminal court on a set day and time. If the named Respondent is a corporation, company, hospital, etc., an attorney can appear on that entity’s behalf without a business person present. However, summonses will sometimes be issued in an individual’s name, usually an engineer, and then the named individual must appear at the hearing. It is still recommended that counsel also appear.

At the hearing for the FDNY Violation, the counsel and/or employee will have the opportunity to meet with corporation counsel, who represents the City, and will either provide corporation counsel with proof of compliance, or will inform corporation counsel of any progress made towards compliance. If corporation counsel is satisfied that compliance has been reached, the criminal misdemeanor will likely be negotiated down to just a violation, and a fine is also negotiated. If compliance has yet to be reached, corporation counsel may agree to an adjournment to allow the Respondent time to come into compliance. In either event, counsel will then appear before the Judge who will hear the agreement reached with corporation counsel, and will generally order that agreement. If the summons was issued in the name of an individual, most courts will allow a change into the name of the corporation at the time a plea deal is reached, so that it will be the entity’s responsibility to pay any fine issued, and not the responsibility of the individual employee.

Continued on page 3

At an ECB hearing, there is no corporation counsel with which to negotiate prior to appearing before a judicial hearing officer (“JHO”). A representative of the agency or department that issued the Notice of Violation will be present at the hearing. The JHO will tape record the hearing, as opposed to criminal court, where the hearing is transcribed by a court reporter. At the hearing, counsel is given the opportunity to prove compliance. The JHO will render a decision at a later date and will send the decision via mail. If compliance was reached prior to the hearing, a reduced fine will be assessed. If the Respondent is found to be a repeat offender, the fine assessed is much greater, so it is advisable to learn from previous violations, and to make sure you do not commit a repeat violation. If compliance has not been reached prior to the hearing, an adjournment can be requested.

Finally, in both the FDNY and ECB hearings, the Respondent is generally provided time to render payments of any assessed fine. The fines can range from a couple hundred dollars to many thousands of dollars, depending on the nature of the underlying violation.

ENVIRONMENTAL DISCLOSURES AND THE SEC: ARE NEW REPORTING REQUIREMENTS ON THE HORIZON?

By Afsheen A. Shah, Esq.

The financial implications of a changing climate, its impact on our environment and the resulting effect on existing environmental disclosure requirements are rapidly becoming areas of mounting concern for the business community. Companies are facing increased activism from investors and shareholders for enhanced environmental disclosures so as to better enable investors to assess the risk posed by potential liabilities. A steady push is also being made for stricter compliance and increased oversight by the Securities and Exchange Commission (“SEC”) with respect to its disclosure process.

Despite the call for greater transparency, up until now environmental reporting for most corporations has been deficient. Many attribute this fact to the leniency of the current disclosure requirements. Existing laws require companies to disclose in SEC filings any information which an investor would consider important or “material”. However, only “probable” and “reasonably estimable” liabilities must be reported under current guidelines. This leaves management with ample room for interpretation, often leading to selective disclosure in order to hide expensive environmental liabilities and make the company appear more attractive to investors. Corporations have even gone so far as to disseminate “green reports” comprised of little more than a showcase of their environmental good deeds.

Experts and stakeholders who rely on environmental disclosure information, as well as many members of the non-profit environmental community, have expressed concerns that because no specific guidelines are imposed for the information to be included in financial reports, often, the information provided is insufficient for potential investors to protect themselves from financial risks associated with any unknown liabilities.

In August of 2002, the well regarded Rose Foundation for Communities and the Environment (the “Foundation”), along with twenty environmental and community foundations, submitted a rule-making petition to the SEC requesting that it heighten disclosure standards. The Foundation also released a report documenting the negative effect of environmental liabilities on shareholder value. The report identified various aggressive accounting and asset management tactics which could be used to commit environmental accounting fraud to make a company look more attractive to potential investors.

The Sarbanes-Oxley Act of 2002 (“SOX”) has also focused on environmental disclosures. Under SOX, not only are corporations subject to harsh penalties for issuing misleading financial statements, but officers and Board members are now required to comply with

higher standards of disclosure. Directors may now face personal penalties and sanctions, including disgorgement of bonuses and income, for any their failure omissions, misstatements and/or inaccurate information.

In July of 2004, the United States Government Accountability Office (“GAO”) conducted an initial study concerning environmental disclosures to the SEC to determine whether improved disclosure requirements should be implemented. It issued three recommendations to increase the tracking and transparency of environmental information available to the SEC and the public. The additional goal of these recommendations was to improve communication between the SEC and the EPA. First, the GAO recommended that the SEC electronically track information from its filings so it could be easily analyzed across multiple filings. Second, the GAO urged the SEC to create a searchable database of SEC comment letters and corresponding company responses and to make the database be accessible to the public. Finally, it recommended that the SEC work with the EPA to explore means of taking advantage of EPA data relevant to environmental disclosures, in order to help the SEC make cases for enforcement of its requirements.

Added pressure for heightened disclosure requirements is also being imposed by non-governmental groups (“NGOs”) as well, particularly in relation to climate change. Composed primarily of institutional investors, these NGOs want the SEC to enforce disclosure requirements which concern material risks posed by climate change and any effect such change may have on operations and profitability of public companies. NGOs also want shareholders to be able to vote on resolutions requiring companies to report on financial risks associated with climate change.

A compelling incentive cited in favor of heightened disclosure is the strong correlation between environmental compliance and profitability. Evidence reveals financial benefits and a greater showing of profitability for corporations taking a proactive approach with respect to environmental management and enforcement. Generally, companies with sound environmental practices have superior stock market performance. The overall perception is that a successful environmental management system is indicative of solid management and performance in general and hence, a solid investment. In addition, corporations with a strong environmental policy are, overall, more cost and energy efficient, often having ecologically aware manufacturing productions and lower compliance costs. As a result, their competitive advantage in comparison to corporations without a “green” management system is often higher. The EPA has noted that that environmental information, including a corporation’s compliance history and involvement in a federal enforcement action, may be used by the public to guide purchasing and investment decision and that full and fair disclosure of the company’s environmental liabilities is pertinent for an accurate reflection of its financial condition.

Moreover, properly performed disclosures enhance corporate performance by improving a corporation’s ability to forecast its financial future. To the extent a corporation conducts a thorough analysis of its environmental liabilities and their potential financial impact, it will be able to better position itself economically and plan for its financial future. It can also determine whether any potential liability will exceed its projected income or the value of current assets. Improper SEC filings can threaten corporate profitability and shareholder value by deflating stock trading value due to the expense of environmental compliance. Studies have even revealed that companies may face negative impacts amounting to more than 10% of shareholder value for undisclosed environmental liabilities.

Further, a misstatement in an entity’s financial statements pertaining to any unrecognized, misclassified or improperly valued environmental liability which ultimately requires the re-filing or restatement

Continued on page 4

