The Return of the Cost Cap

Remediation Cost Overrun Protection 2.0

2014

Environmental Services Group
Aon Risk Solutions

The Second Generation - Cost Cap 2.0

Early incarnations of remediation cost cap products were eliminated from carrier offerings in late 2009 or early 2010 while the underlying risk of remediation cost overruns and the demand for an insurance solution remained. The previous versions of cost cap insurance offered by several major carriers were tremendously popular but resulted in unfavorable loss experience. Cost caps' poor loss history coupled with the lowest interest rate environment on record, led to the disappearance of the product from the marketplace. Several environmental markets have determined that with different underwriting methodologies, coverage parameters and interest rates on the rise a new generation of cost cap products, or Cost Cap 2.0, represents an opportunity for clients and carriers alike.

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Today the EPA estimates there are over 450,000 active Brownfield projects in the U.S., collectively leveraging some $14 billion in cleanup and redevelopment funding. When dealing with large-scale contamination and remediation issues, stakeholders, including site owners, investors, banks, property developers and contractors, have always been concerned that cleanup costs will exceed estimates primarily for the following four reasons:

- Discovery of new contaminants;
- Problems with the efficacy of remediation technologies;
- Interest rate escalation and
- Regulatory changes to cleanup standards after the remediation work has begun.

For a time it appeared that these products would never be revived. However, in a highly competitive marketplace in which carriers are seeking to set themselves apart from competitors, two carriers have once again decided to take on the underwriting challenge by offering cost cap insurance coverage. Both products, which are discussed herein, ultimately are designed to help limit or contain the risks of remediation expense uncertainties.

Aon Environmental has performed a thorough review of the newly minted cost cap policies, and summarized these products for the benefit of clients seeking to transfer risk related to significant remediation efforts. For those familiar with the previous renditions of remediation cost cap products, it is important to note that the new cost cap products provide a narrower scope of coverage with a variety of conditions that have been added in order to restrict the potential coverage provided. Because past cost cap underwriting standards and policy structures led to significant losses, the new policies will be available on a limited basis and will be underwritten and drafted to specific criteria.

The AXIS Solution

AXIS Insurance's Environmental Remediation Management Policy is designed for owners, developers or other responsible parties and is not intended for contractors or consultants.

Unlike prior versions of cost cap products, the AXIS solution also offers an additional unique Protective Professional Indemnity coverage along with cost overrun protection. The Insured is afforded protection for the negligence of their contractor or consultant for both third party and first party claims.

The AXIS solution is intended for remediation projects with expected remediation expenses between $2 million and $25 million USD. The program has a maximum limit offering of $10 million USD, depending on the circumstances and information available with respect to the remediation project.

AXIS has indicated it will consider a very broad range of clean-up programs for its cost cap policies, including Brownfields, RCRA, CERCLA, State and Lead Voluntary; however, sediment and radioactive clean-ups are not target project types.

Within the AXIS policy structure the Insured retains responsibility for the self-insured retention (“SIR”) that applies to claims under all coverage parts. The SIR will represent the total projected cost of the remediation work to be performed. The policy may also contain an additional engineered margin that will be determined as a function of the outcome of the engineering of the risk, i.e., the greater the uncertainty of the risk, the greater the potential margin. The SIR plus any engineered margin is usually referred to as the “attachment point” and where coverage begins under the policy. In other words, for a project with $3 million of expected remediation costs and a 15 percent margin, the cost overrun coverage would not be triggered until the Insured is more than $450,000 USD over budget (e.g., total remediation costs incurred by the Insured would exceed $3,450,000). Therefore, $3,450,000 would be the attachment point on the policy. Coinsurance may also apply once the coverage has been triggered, depending on the type of work/cleanup, and will be used as an additional underwriting tool for some projects.

There must be an approved Remedial Action Work Plan (or in some instances, a near final plan will be accepted) in order to bind a policy. All proposed remedies and budgets will be reviewed by the underwriter along with the contracts for engineering and contracting activities.

Details of Coverage

- Indemnification coverage for cost overruns associated with an approved Remedial Action Work Plan (clean-up of known conditions)
- The policy provides coverage for both cost overruns incurred in the remediation of known pollutants as well as the costs to clean up newly identified pollutants (unknown pre-existing conditions discovered in the course of the conducting the cleanup)
- A companion policy may be placed (site environmental liability) to cover claims arising from bodily injury or property damage caused by pollution conditions
- Protective Professional Indemnity coverage is provided for the named Insured for damages arising out of wrongful acts (negligence standard) by the Insured’s consultants, contractors or remediation design professionals that exceed the limits of the design professional’s insurance
- Coverage for defense of third-party claims made against the Insured arising out of professional services
- AXIS requires Remediation Progress Reports which summarize remediation activities and expenses on not more than 90-day intervals
- The policy term is reflective of the remediation schedule and generally limited to not more than five years
- Changes in regulatory standards midway through an approved Remedial Action Work Plan must be reported through the claim process

- AXIS is currently silent on failure of remedy, but is willing to negotiate specific language to address this risk

The Beazley Solution

The Beazley Cost Cap solution differs from that of AXIS in that Beazley requires partnership with contractors in a Guaranteed Fixed Price Remediation ("GFPR") contract.

Beazley considers GFPR contracts to be attractive risks since the insured contractors have a direct interest in successful performance of the project because their profits and reputations are at stake. Beazley recognizes that the contractors engaged in these projects typically have a high-level understanding of the site conditions, conceptual site model, and remediation technologies that will be employed in order to ensure contractors remain motivated to complete the project in an efficient manner even if coverage under their cost cap policies is triggered. The Beazley program model includes coinsurance (vertical deductibles) to be paid by the contractors ranging from 15 percent to 25 percent of the costs incurred once the policies begin to pay cleanup costs.

Beazley will consider projects between $3 million and $10 million USD, with a site size limitation of approximately 10 acres. Larger sites with smaller, well-defined areas of remediation will also be considered if other underwriting criteria are met. The limit of liability available is the lesser of $10 million or 100 percent of the project remediation cost.

In order to qualify for insurance, a contractor must have a remediation work plan that has been approved by the regulator or if not, imminent approval must be pending. Coverage will be bound only after all proposed remedies and budgets have been reviewed and approved by the underwriter.

An attachment point or SIR will apply and remediation costs up to the SIR will be borne by the insured contractor after which the policy will respond. The SIR is an engineered cost estimate based on the remediation contractor's estimate. In order to establish the SIR, Beazley will perform an independent assessment of the remediation costs for the project, which may include additional costs for the items that Beazley considers necessary and may include additional contingencies. The variance between the contractor's cost estimate and the SIR depends on many factors, but the SIR usually is higher and often substantially so, since Beazley will be conservative in its establishment. In addition to the SIR, the contractor will bear the costs of a coinsurance requirement. The SIR and coinsurance are two mechanisms designed to help avoid potential moral hazards and align the interests of all stakeholders in the project.

Details of Coverage:

- Indemnification covers cost overruns associated with an approved remedial action plan that has been scheduled on the policy. The policy is designed to address scheduled activities in the remedial action work plan, providing coverage for: (1) higher concentrations of constituents; (2) greater length of time to address constituents; and (3) greater volumes discovered of a known constituent
- Remedy failure can be addressed only through the claims process and requires the approval of the insurer to amend the remedy, which will be done through an endorsement to the policy. This amendment however is subject to underwriter approval and may lead to an increase in the attachment point or changes of other terms on the policy including additional premium

- A companion policy can be placed (site environmental liability policy) to cover the cleanup costs of any unknown conditions discovered during the course of cleanup. In addition, the site liability policy can cover the liability for toxic tort claims for the project site and as a result of the known or a newly discovered constituent.
- The Insured is required to submit Cleanup Plan Status Reports according to the frequency specified in the policy.
- The policy term is reflective of the remediation schedule, but under no circumstances will the term exceed 10 years.
- Changes in regulatory standards mid-way through an approved Remedial Action Work Plan must be addressed through a modification of the policy and will require an endorsement. This is typically available only when the regulatory change does not appear to impact or increase the overall cost of the project. Otherwise changes in cleanup criteria post binding are excluded from the policy.

Summary

The AXIS and Beazley offerings provide cost cap coverage to either the site owner or the remediation contractor. The best available solution will clearly depend on the type of project and the client's objectives. The products discussed provide flexibility in addressing a client's needs and or goals for financial management of remediation projects. Both options are designed to provide a high level of cost certainty for the expected remediation costs associated of a project with AXIS supporting the site owner and Beazley providing protection for the contractor.

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