Legacy Environmental Liabilities

Over the course of their history, most large companies have created a legacy of corporate entities that have been acquired and divested. In the structuring of these acquisitions and divestitures very little attention was paid to the management and assignment of historic environmental liabilities.

Managing Environmental Legacy Liabilities

Until recently, most Purchase Sale Agreements for both asset and stock purchases incorporated a "my watch/your watch" indemnity provision, simply stipulating that each party is responsible for the environmental liabilities that were caused under its time of ownership.

While the simplicity of the indemnity concept is attractive in the throes of completing an acquisition or divestiture, the solution can be fraught with complexities and problems:

- The nature of environmental conditions does not generally lend itself to a simple apportionment of costs if a pollution condition is discovered.
- The nature of an indemnity itself implies a credit risk by the indemnitee against the indemnitor.
- The indemnity is also subject to future litigation as the indemnity itself is not a 'liquid asset' readily convertible to cash.

For many large organizations who trace their history back over 50 years it is not unreasonable to project that they have bought and sold hundreds of entities and properties. Each entity bears the stamp of their corporate ownership and that stamp is the ticket for regulatory agencies and the plaintiff's bar to seek recourse for environmental damages.

A contributing factor is that more former manufacturing facilities are being taken down and replaced with the harbingers of today's economy including office buildings, multi-family housing and urban infill projects. Environmental conditions stemming from long dormant operations of the past are being discovered and remediated and the costs of these remediations (and associated third party claims) are increasingly finding their way back through to the prior owners of the sites.

Potential Solutions

As mentioned above, the contractual transfer of these liabilities is not in itself a complete solution as environmental legacy liabilities have pierced indemnities and corporate veils thought to be impermeable. However, other tools are available to effectively manage the risks posed by legacy environmental liabilities, including:

- General Liability policies placed before the advent of the absolute pollution exclusion in 1986;

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- Environmental/Pollution Legal Liability (PLL) policies;
- Cleanup Cost Cap (CCC) policies; and
- Risk Transfer/Liability Buy out Companies.

General Liability Policy Recovery

Much attention has been focused on recovering the costs of environmental liabilities from 'old' General Liability policies. Unfortunately, while these policies typically offered occurrence-based coverage with unlimited defense, they were often offered by a legacy of insurers who are now facing their own financial issues. Examples include Home Insurance, Reliance Insurance, Kemper and many other carriers. Additionally, a general liability policy placed before the dawn of the pollution exclusion in 1986 may address legacy third party bodily injury or property damage arising from a pollution condition, however the policies are never able to address the first party clean-up costs associated with the discovery of a pollution condition at an owned or leased property. This process can still yield results but requires a specialized team of investigators and resources.

Environmental /Pollution Legal Liability Insurance Policies

A growing number of companies are implementing comprehensive environmental programs designed to cover their legacy environmental liabilities. These legacy environmental programs typically include the following coverage:

- Clean-up/remediation of pre-existing pollution conditions on, under, or emanating from the insured property, which commenced prior to the inception of the policy.
- Bodily Injury or Property Damage resulting from pollution conditions on, under or emanating from the insured property, which commenced prior to the inception of the policy.
- Bodily Injury or Property Damage of parties, other than the owners or operators of the non-owned disposal site, and/or clean-up resulting from pollution conditions on, under, or migrating from the non-owned disposal site attributable to wastes sent to the facility prior to the inception of the policy.

The coverages may incorporate the following terms and conditions:

- Policy Limits up to $300,000,000 are relatively easy to build by strategic engagement of various carriers;
- Policy terms up to 10-years;
- Retentions can vary depending on the nature of the site and can be crafted to incorporate high SIRs ($500,000 to $2,000,000 per incident) if a known condition is being addressed;
- Coverage for known and unknown divested properties; known divested properties are normally scheduled and blanket coverage language can be provided for unknown properties;
- Bodily Injury and Property Damage can often be secured for known pollution conditions as well as unknown conditions; known pollution conditions may require a slightly higher retention;
- Purchase and Sales Agreement(s) (PSA) can be scheduled as insured contracts to accommodate indemnities provided by parties to those agreements.
- Re-opener coverage can be included to provide coverage for previously completed remediation projects.

Typical underwriting information necessary to place a legacy environmental program includes:

- Available environmental data on sites – typically recently completed Phase I or Phase II Environmental Site Assessments;
- Copies of PSAs;

- Corporate history of acquisitions and divestitures;
- History of enforcement and/or legal actions at sites;
- Historic land use and activities at sites.

Cleanup Cost Cap Insurance

This coverage was very popular and used by both companies with environmental liabilities and engineering/contracting companies that conduct remediation as a business. In 2009, AIG and other key markets providing this coverage chose to stop offering the product, reasoning its poor loss history and low interest rates made it unprofitable. Until recently, no markets picked up this market area.

In 2013, AXIS and Beazley cautiously entered the cost cap insurance market, offering this coverage under very strict and specific parameters. The terms and conditions associated with this coverage have become stricter and the minimum premium has increased.

Cost Cap coverage is used to control cost overruns on remediation projects and can be used by either the property owner or the remediation contractor/consultant as a not-to-exceed back-stop. The policy can cover costs due to changes in cleanup standards; newly discovered contaminants; and greater extent of known contamination than originally estimated. The policy and premium are based on engineering cost estimates; the planned remediation must be in an advanced planning stage including regulatory approval and the insurance carrier generally requires a completed Remedial Action Plan before coverage can be considered.

The AXIS and Beazley offerings provide cost cap coverage to either the site owner or the remediation contractor. Generally, premiums for this coverage start in the range of $300,000 and require significant cost-sharing provisions by the Insured. The best available solution will clearly depend on the type of project and the client's objectives. The products 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 project remediation costs with AXIS supporting the site owner and Beazley providing protection for the contractor.

Environmental Risk Transfer Companies

Still, another market has emerged to aid companies with legacy environmental liabilities. Generally, these companies will purchase property with known or perceived environmental liabilities from the organization with the legal liability for remediation and accept the liability that is associated with the site as its own. Environmental Risk Transfer companies are also willing to address the environmental liability only without taking possession of the property under certain circumstances. In either instance this is done by contract with careful language crafted to describe the known conditions and the terms under which the acquiring company will accept the liability. The liability company assumes the environmental liability of the property, including cleanup and in some cases the tort liability that may arise from the historic operations. These companies can be either real estate focused organizations or technical environmental engineering organizations. Their approach to managing these sites will vary depending on the model they apply. However, the common approach used by both is to invest the resources and technology to perform the required remediation at the sites and upon receipt of a no-further-action letter from the regulating agency, the property is often marketed or developed for a higher and better use.

Aon has established relationships with a number of these firms and can assist clients in coordinating the process. Often, the buy-out firm will place insurance as a back-stop to their investment, but it is not always required of the transaction.

Each transaction is unique to the property and the nature of the purchasing and selling organizations. When the real estate value can be assessed and determined to have higher value than the combined investment the viability of a solution is favorable.. The likelihood of regulatory acceptance must also be high. The liability company will work to reduce the environmental liability, either through implementation of an accepted remedial action plan or demonstration of no further risk under a redevelopment scenario.

Often a combination of these approaches is used, but the common goal is that the environmental regulators are satisfied with the level of mitigation and the site can be redeveloped with the approval of the regulators. These organizations may rely on insurance products, as well as their regulatory relationships and engineering and technology expertise. Generally, they do not possess legal expertise in house and will utilize local environmental attorneys to assist in working through relevant transfer and liability issues. And, certain of the real-estate based organizations do not maintain the relevant environmental engineering resources in house to implement the planned remediation or regulatory negotiations.

Bespoke Excess of Environmental Indemnity

Aon will craft this unique bespoke environmental policy when one party to the transaction is relying on the indemnity provided by another party. Coverage excess of indemnity is structured to “drop down” for the named insured if the indemnitor does not perform their obligations. In general, there are no exceptions to the non-performance within the policy. The indemnitor may not perform due to bankruptcy, non-response, or alternate priorities or direction. The coverage is designed to drop down no matter the reason for the nonperformance. This structure is particularly attractive when there is a known cleanup obligation the seller is retaining in a property transaction or merger/acquisition. Negotiating the coverage contract excess of this agreed remediation liability would provide cleanup cost coverage for the insured if the seller did not complete the remediation obligation or did not complete the remediation obligation in the agreed timeframe.

Structuring coverage excess of an indemnity in a Purchase and Sale or other contractual document can provide broader coverage for known environmental conditions, including cleanup of known conditions, but is highly dependent upon the financial condition of the indemnitor. Current financial information for the indemnitor is critical for negotiating this coverage. In addition to financials, the following are important to consider when using this approach:

- Are there items that the indemnity does not cover? For example, are known remediation costs provided only for onsite issues?
- Does the indemnity “sunset”? If the indemnity does not extend for the term of the policy, there may be limitations to coverage.
- Is the indemnitor a limited liability corporation (LLC), or is the indemnity from the parent? Indemnification from an LLC without the financial backing of the parent may not be acceptable to some underwriters.

This approach is used in transactions and when an Environmental Transfer Company is engaged to assume the contractual responsibility for environmental conditions.