

Options for Providing Low-cost Insurance for Third-Party Claims Related to
Brownfield Sites

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The Virginia Department of Environmental Quality

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With the passage of HB 463 (The Brownfield Restoration and Land Renewal Act), the 2002 General Assembly directed the Department of Environmental Quality to evaluate options for providing low-cost insurance against third-party claims arising out of environmental contamination from brownfield sites. The following report is DEQ's submittal.

BACKGROUND

One of the barriers to the restoration and redevelopment of brownfield sites is the fear from developers that a neighboring property owner will file a law suit against them for damages or other losses incurred as a result of environmental impacts emanating from their brownfield site. These potential losses can be a devaluation of real property value, business interruption, or other. The most common method to help protect developers from third party claims is through the use of environmental insurance. Once thought to be too expensive, environmental insurance has become a viable option to transfer risk and help stabilize a developers long term environmental cost exposure.

Commercial insurance is readily available from several companies and can be obtained through registered agents. In general, there are three kinds of policies available:

1. Secured Creditor Policies protect the bank in a similar way that private mortgage insurance works for home purchases. In general, it insures the balance of the loan in the event the developer defaults for any reason. However, the policy does require that environmental contamination be present on the property subject to the loan for the policy to be triggered. Secured Creditor insurance does not protect the developer against third-party claims.
2. Pollution Legal Liability Policies, or PLL, insures against known and/or unknown environmental conditions. This is a customizable policy that can include third party bodily injury and/or property damage, along with clean up of offsite contaminant migration. PLL can also cover later discoveries of environmental conditions including changes in cleanup standards. Business interruption, legal defense costs, fines, penalties, and natural resource damages can also be included in coverages. Premiums are paid one time, up front. There is typically a time limitation on the coverage (typically up to 10 years), during which period a claim must be filed. Policies can often be renewed after the initial period.
3. Cleanup Cost Cap Policies, or CCC, is a stop loss policy that covers those costs of clean up in excess of a given amount and applies to cleanup as described in the clean up plan, including neighboring properties if so included in the plan. It "caps" the amount of money a developer or other entity would have to pay out for cleaning up the property that he is developing. As an example a cleanup is estimated to cost \$3,000,000. A developer could purchase a policy to cover the cost that exceed \$3,000,000. In this instance the developer would pay the first \$3,000,000 of cleanup cost then pay a deductible (usually 10% of the expected cost or \$300,000 in this example). After that the insurance policy would pay for the cleanup cost to the limit of the policy (limits can range from \$500,000 to \$150,000,000). Since CCC

insurance typically applies only to cleanup costs, it is not direct insurance against third-party claims.

For PLL insurance, policy costs and deductibles vary depending primarily on what coverage is being provided and on the extent to which actual contamination conditions are known at the site. In general, the costs of premiums range from as low as 4 percent up to 20 percent of the insured amount.

OVERVIEW OF OPTIONS

There are four general options for providing environmental insurance against third-party claims:

1. Virginia can allow claims to be made against the Commonwealth up to a fixed, maximum value.
2. Virginia can pay the entire premium or subsidize a portion of the cost.
3. Virginia can pre-negotiate rates and coverages and let the insured pay the whole premium.
4. Virginia can leave insurance to the site owners.

Option 1: Virginia can allow claims to be made against the Commonwealth up to a fixed, maximum value.

While some states are subsidizing costs, no state is fully funding insurance. The option to allow claims to be made against the Commonwealth up to a fixed, maximum value is not recommended as it places the Commonwealth in an undesirable, open ended financial position.

The open-ended cost of this option results from the following factors:

- a) The universe of potential "brownfields" properties is unlimited.
- b) The universe of potential third party claimants is unlimited. It is not necessary for a third party to own land immediately adjacent to the property in order to bring a third party action. The third party can be anyone whose property value or health has been effected by the current or past use of the brownfields property.
- c) The universe of potential contaminants to be addressed is large and diverse. Unlike the petroleum storage tank program (VPSTF), which addresses only petroleum pollution, the Brownfields program must deal with many different contaminants, each of which carries its own level of real and/or perceived risk. It is therefore even more difficult to predict what damages might be alleged or awarded in third party claims.
- d) Third party claims for bodily injury or property damage are among the easiest to initiate and among the most difficult to assess. Third party claims are most likely to

be claims for perceived health effects (bodily injury) and perceived diminution of property value (property damage). Pollution-related third party claims can be easily manufactured and easily “won”, even in the formal court system, and creating a state fund to cover third party claims creates an incentive to file such claims. Additionally, the value affixed to the injury or damages can be quite subjective. DEQ’s tank program (VPSTF) is now starting to see this phenomena develop, and is finding that it is quite costly (time and money) to defend the VPSTF against such claims. In fact, DEQ does not believe that it can expect to be entirely successful even at limiting the amounts paid out on each third-party claim.

Some believe that third party costs can be controlled by simply requiring that the veracity and value of the tort first be established in court, and then the state simply pays whatever the court decides. This is not always a satisfactory solution, however. The state, unlike an insurance company, will not be a named party in these third-party lawsuits, and does not take part in the court proceedings, even though the state will ultimately be “paying the bill”. From the property owner’s perspective it is often easier to “settle” for any amount up to the maximum coverage provided by the state than it is to vigorously defend themselves. The state has no way to ensure that the property owner has vigorously defended themselves against the suit, or that the plaintiff and the defendant are not actually colluding to bring the claim.

Option 2: Virginia can pay the entire premium or subsidize a portion of the premium cost.

This option also could easily become an open ended liability for the state unless the universe of eligible brownfields properties is clearly limited and the state’s contribution for each eligible property is capped. Even then, this option does not necessarily achieve the goal of limiting the cost of insurance to the brownfields property developer or of guaranteeing that insurance would be available for every brownfields property. Unless there is vigorous competition within the insurance industry to insure these sites, or unless the state steps in to directly control the total premium that will be charged for the insurance, this option may simply have the effect of driving up costs of insurance at those sites that are considered most insurable, while less insurable sites still cannot get the coverage they desire.

Nevertheless, a few other states are either considering this option or have already implemented one similar. Massachusetts, widely recognized as having a very successful insurance program, pre-negotiated rates and coverages for its brownfield customers and pays 50% of the premium cost. Mass pre-negotiated rates for all three of the aforementioned coverages. In roughly 4 years, the insurance program in Massachusetts has provided coverage for 139 brownfield properties, expending approximately \$2.5M for third party insurance premiums and \$700K for non-third party insurance premiums for a total cost (to date) of \$3.2M. In addition, Massachusetts has expended approximately \$1M to date administering their program.

California’s proposed program is very similar in that it would include all three coverages. Like Massachusetts the California Program would subsidize a portion of the premium for PLL coverage. It also allows for a subsidy of up to 80% of the Self Insured Retention (or deductible) of the Cleanup Cost Cap Insurance.

Wisconsin purchased a Pollution Legal Liability policy at a premium cost of \$12,500 (10 year, \$10M with sublimits of \$1M per site) that provides coverage for properties the state designates as brownfields or other contaminated sites designated as eligible by the state. It is required that source removal be performed. For example, a leaking underground storage tank would have to be removed. Although not really a third party insurance program, the policy does pay costs of cleaning up groundwater if a natural attenuation remedy at the site fails to correct the groundwater problems. In this program, Wisconsin allows a developer to purchase a Brownfield with groundwater contamination. If after one year the groundwater contamination has not degraded the developers gets a 'complete walk' from liability for groundwater cleanup if the developer pays a fee of \$5,000 to \$10,000 (dictated by parcel size). The state then uses those funds to "schedule" that piece of property on its PLL policy. If the groundwater situation worsens in the future and requires active remediation, the state files a claim and the insurance covers the cost of cleanup. This allows the state to go forward in complete confidence knowing that they no financial exposure with respect to cleanup costs due to the failure of the natural attenuation remedy.

Ohio is considering the purchase of a cleanup cost cap policy for all the brownfield sites that receive cleanup grants for the "Clean Ohio Fund". And while CCC would not address third party claims, Ohio's program could possibly be used as a model for later study. The State of Ohio believes it should protect its resources should a grantee have misestimated the cost of cleanup. Therefore, if the grantee runs out of money before the cleanup is completed the insurance policy may kick in to cover the cost overruns and bring to project to completion

Option 3: Virginia can pre-negotiate rates and coverages and let the insured pay the whole premium.

This option is often discussed as a good first step that States can take to assist their developers with their environmental insurance needs. The benefits to the developer include time savings, a clear understanding of what information is necessary to purchase insurance, more efficient policy purchasing, and competitive pricing. Pennsylvania, for example, is undertaking this effort in order to provide insurance product information and pricing to their developers without the long term financial risk to their own state program. At the time of this writing, the results of Pennsylvania findings are unknown.

On the other hand, the pre-negotiated coverage may not be exactly the type of coverage that the developer desires. Also, properties have to qualify for the insurance. It is possible that conditions discovered on the property would disqualify it for the pre-negotiated insurance. Therefore, this option may only benefit the "known insurable" properties.

Option 4: Leave insurance to the individuals.

Presently, many state brownfield programs leave it to their participants to evaluate coverages, options, and rates on their own. However, with the passage of the federal brownfield bill and subsequent grant funding available to subsidize insurance, many states are considering pursuing Option 3 or 4 as a means by which to assist developers, at least initially.

It should be noted that the recently passed Federal Brownfields legislation allows grantees to use these Federal funds to purchase environmental insurance. This can be done in many ways, including having the grantee buy the coverage for itself and/or for some other entity that is agreeing to cleanup the site. Also, the U.S. Department of Commerce's Economic Development Agency has indicated it also can make grants to governmental entities for the purchase of environmental insurance (Options 1 or 2). The Federal government recognizes the value of environmental insurance and these funds could be used in assisting the development of an environmental program for Virginia. At the time of this writing, EPA is in the process of developing guidance to assist developers and communities with applying for these grants.

CONCLUSIONS AND RECOMMENDATIONS

Environmental insurance is proven to be a valuable and effective tool for developers to help reduce and transfer their long term legal and financial risk at brownfield sites. And as part of Virginia's developing brownfields program, the Commonwealth can take an active role to help provide further incentives, through the use of environmental insurance, to developers to make brownfield redevelopment a feasible and viable option and bring environmental restoration and economic development back to Virginia communities.

DEQ does not have any recommendations for legislative action at this time. Based on the information gathered through this report, DEQ intends to undertake the following actions:

1. DEQ will work with the environmental insurance industry and the redevelopment community to identify further opportunities for reducing the costs of environmental insurance.
2. DEQ will encourage and promote the use of private insurance by providing the information about environmental insurance on DEQ's Brownfields/Land Renewal Web Page.

DEQ staff are also attending EPA sponsored workshops pertaining to environmental insurance and will continue looking for ways that insurance can be used to promote brownfield redevelopment in Virginia.