

RISK MANAGEMENT

Natural Resource Damages: A Sleeping Giant?

by **John J. Heft**

Anyone who operates a chemical, petrochemical or bulk petroleum terminal facility has likely encountered a natural resource damages (NRD) claim. But since NRD claims have historically only been assessed after a catastrophic environmental contamination event, such as the 1989 Exxon Valdez disaster, many risk professionals may not have had any experience with them at all. This may be about to change, however, with many now referring to natural resource damages as a "sleeping giant" due to the potential for vast recoveries under a host of federal and state laws.

Before moving onto a more detailed discussion of this type of claim, first, it is important to ensure we understand the necessary language.

Natural resource damages can be defined as compensation for injuries to natural resources sustained in the course of a spill or release of contamination or pollutants to the environment, with "injuries" referring to any measurable adverse change in the physical or chemical quality or viability of the resource. Damages, (considered residual damages, i.e., they cannot be addressed by remedial or corrective action) may be assessed on the reduction in quantity or quality of natural resource services, with "resource services" referring to the physical and biological functions performed by natural resources (food, habitat, drinking water and recreation), including the human use of those services.

Natural resources are also governed by a number of federal laws including the Superfund (the Comprehensive Environmental Response, Compensation and Liability Act or CERCLA), the Oil Pollution Act of 1990 (OPA) and the Clean Water Act. The protected elements include "land, fish wildlife, biota, air, water, drinking water supplies and other such sources" that are held in trust of the public or trust resources. The State of New York, for example, has designated the NYS Department of Environmental Conservation (DEC) as the natural resource trustee.

An NRD claim is defined as the injury to, destruction of, or loss of natural resources, including the costs for a natural resource damage assessment. Such assessments, which are typically directed by the natural resource trustee, consist of analyzing the injury and determining the appropriate restoration or service options during a damage settlement.

Superfund and OPA-through enforcement by the Environmental Protection Agency (EPA) as well as various state statutes-not only hold parties responsible for the remediation of hazardous waste sites, contaminated properties and oil spills not only liable for remediation, but also for the resulting NRD. Historically, NRD-related fines have been assessed as a result of a catastrophic ecological disaster (Exxon's NRD settlement totaled \$900 million after Valdez); however, states are now attempting to seek restoration and compensation for damages involving natural resources involving routine pollution.

Enforcement

Under both Superfund and OPA, responsibility for protection of natural resources falls with federal, state and tribal trustees. No one individual "owns" a natural resource; they are held in public trust.

Both Superfund and OPA provide authority for any and all of federal, state, community and Native American tribal officials to be designated as natural resource trustees on behalf of the public. Trustees are defined as designees that have information and technical expertise about the biological effects of hazardous substances, as well as the location of sensitive species and habitats that can assist EPA in characterizing the nature and extent of site-related contamination and impacts. Trustees have been given responsibility for restoring injured natural resources. The two major areas of trustee responsibility under Superfund and OPA are; the (1) assessment of injury to natural resources, and (2) the restoration of natural resources injured or services lost due to a release or discharge.

To meet these responsibilities, both statutes provide several enforcement mechanisms. The trustees then have three principle options:

- Sue in court to obtain compensation from the potentially responsible parties (PRPs) for NRD and the costs of assessment and restoration planning.
- Conduct assessments or restorations in accordance with certain standards specified by the federal government and file a claim for reimbursement from the trust fund established under OPA.
- Participate in negotiations with PRPs to obtain PRP-financed or PRP-conducted assessments and restorations of NRD.

NRD Claims

NRD claims have been defined as claims that arise from the release of hazardous substances that have resulted in injuries to natural resources or the deprivation of natural resource services. Federal NRD claims have been most prevalent with respect to rivers, lakes, estuaries, harbors and other sites involving sediments that contain persistent hazardous substances like polychlorinated biphenyls (PCBs) and other chlorinated compounds and heavy metals. State NRD claims have tended to focus on contaminated groundwater, however, NRD litigation can involve various regulatory agencies-federal, state, local or Native American-and often result in monetary damages.

The following arguments represent examples of just that, and show how large, state-level NRD claims can affect any large company.

Occidental Chemical Corporation (OCC) agreed to pay New York state \$12 million over a four-year period in a 2006 NRD settlement based on an assessment of damages to the state's resources, specifically the loss of recreational fishing benefits resulting from imposing fish consumption advisories due to the presence of elevated contaminants in the fish.

In 2005, the New Jersey Department of Environmental Protection (NJDEP) announced an innovative agreement with DuPont to compensate the public for injuries to groundwater at eight hazardous sites in New Jersey. The settlement includes the planting of 3,000 trees in urban areas, the preservation of 1,875 acres of land, payment of \$500,000 to the state for water restoration projects and construction of a boat ramp along the Salem River.

During the past year NJDEP announced a major initiative to address more than 400 claims, and collect up to \$950 million in NRDs from 66 corporations. This was the follow-up to the NJDEP filing over 100 NRD lawsuits during the summer of 2007. Since 2002, NJDEP and the attorney general's office have recovered approximately \$29 million from the settlement of NRD claims. The NJDEP is also working with 95 additional responsible parties representing about 850 sites that seek to voluntarily resolve their liability for NRD.

NRD Pitfalls

The NJDEP filings may be in jeopardy as a result of an August 24, 2007 ruling by the Superior Court of New Jersey dismissing an attempt by the NJDEP to recover \$260,000 in an NRD claim against ExxonMobil for benzene and toluene groundwater contamination that adversely impacted drinking water wells in the Hillwood Lakes area of Ewing, New Jersey. The court found that the NJDEP had not provided sufficient expert support to uphold the assumptions utilized in the mathematical formula for calculating NRD in

groundwater.

In addition, the New Jersey government allowed the statute of limitations to expire on June 30, 2007 for the proposal of formal NRD regulations; thus impacting this and thousands of other NRD cases. As a result, the NRD lawsuits may be in jeopardy since companies involved in cases or settlement discussions where the NJDEP calculated NRDs using the formula used in the ExxonMobil decision, could use it as a bargaining chip and force NJDEP to develop additional scientific justification for the formula on a case-by-case basis. As a result of this, other states' trustees are taking a wait-and-see approach regarding the New Jersey cases prior to proceeding with an aggressive NRD strategy.

The meaning of all this remains to be seen. It is clear, however, that the potential of an NRD claim could be of great concern to a buyer of a business, a merger partner and to a lender contemplating a loan transaction. A lender will have concerns that any potential exposure could impact adversely on the credit-worthiness of its borrower. A buyer of a business and a potential merger partner will be concerned that they might also be liable for the NRD claim.

Risk Management Techniques

One of the risk management techniques to mitigate a corporation's exposure to NRD claims is the use of pollution legal liability (PLL), which is intended to provide pollution liability coverage for environmental risks associated with the ownership/lease of property or operating a facility or site. PLL has applicability to virtually every industry that owns, leases, acquires or divests real estate. PLL provides coverage for pollution conditions or events on, at, under or emanating from a covered location(s). Coverage is also afforded for third party bodily injury, property damage, clean up costs and legal defense costs.

Over the past several years, environmental insurance carriers have begun defining NRD in their PLL specimen policy forms with specific coverage intent in mind—that is, whether or not to provide coverage for NRDs since they are assessed in addition to remediation expenses or clean-up costs. The definition of property damage, in the PLL, typically includes physical injury to or destruction of tangible property, including the resulting loss of use thereof. Although, this definition appears to include coverage for NRD, most carriers have included a definition for NRD to clarify their position. The language mirrors the definition provided under CERCLA:

"Natural resource damage means physical injury to or destruction of, including the resulting loss of value of, land, fish, wildlife, biota, air, water, groundwater, drinking water supplies and other such resources belonging to, managed by, held in trust by, appertaining to, or otherwise controlled by the United States...any state or local government, any foreign government, any Native American tribe, or, if such resources are subject to a trust restriction on alienation, any member of a Native American tribe."

Other environmental insurance carriers do not offer NRD coverage in their "specimen" policy forms but have the ability to provide the coverage via an endorsement to the policy up to policy limits which can be as high as \$50 million for one carrier. Underwriters in states where NRD has received a lot of press (i.e., New Jersey), may attach sublimits, high deductibles or provide outright exclusions depending on the type of location to be covered under the policy.

Another risk management technique involves the transfer of environmental and NRD liability to a third party.

A large New Jersey chemical manufacturer owned and operated a manufacturing facility from the late-1950s until the late-1970s. Since the late 1980s and pursuant to a 1992 administrative consent order between the NJDEP and the company, the site has undergone significant investigation and interim emergency cleanups to address environmental contamination with an associated cost of \$5 million undertaken by the responsible parties.

The original company, including a subsequent subsidiary company, entered into an environmental liability transfer agreement with a nationally recognized environmental consulting firm and its environmental insurance carrier. The agreement was designed to transfer the environmental and NRD liabilities and to allow a cleanup of the site to proceed and avoid significant transaction costs and delays. The chemical

company negotiated a liability transfer agreement and an environmental insurance policy with both the environmental consultant and the environmental insurance carrier with both accepting responsibility for essentially all historical environmental and NRD liability in exchange for the up-front funding of the remediation and the purchase of the insurance policy. Consequently, the liability transfer will result in a cleanup by a nationally recognized environmental remediation company backed by a multi-billion dollar insurance company that may otherwise have resulted in the cleanup being significantly delayed by the bankruptcy filing of the chemical manufacturer and possibly end up requiring public funding.

***John J. Heft, M.S.** is vice president at Bordentown, New Jersey-based New Day Underwriting Managers, LLC, a specialty intermediary for insurance agents and brokers with expertise in environmental insurance, environmental risk management and construction-related professional liability.*

Reprinted from Risk Management Magazine.

Copyright Risk and Insurance Management Society, Inc. All rights reserved.