The Environmental Liability Continuum in the Construction Project Timeline

By John J. Heft

When managing the environmental liability of a construction project, the direction tends to focus on pollution conditions resulting from project activities, errors and/or omissions of the general contractor, subcontractors or the architect and engineer. Environmental claims, however, can also arise from other scenarios such as the discovery of unknown pre-existing conditions at a site being redeveloped, or from third parties alleging bodily injury and/or property damage. These third parties could be tenants in a building undergoing renovation or from neighboring property owners living or working adjacent to a Brownfield site.

As the redevelopment project progresses, various pollution insurance products are often used to help manage environmental liability.

Prior to Construction

Redevelopment site owners, for instance, may be exposed to a variety of environmental issues, such as:

- Soil and groundwater contamination resulting from historic operations at the site or neighboring sites;
- "Unknown" legacy environmental issues including "phantom" underground storage tanks and old disposal areas or lagoons;
- Construction debris containing hazardous materials from previous site capital improvement activities, and;
- Damage to natural resources.

"Clean" environmental due diligence, such as a Phase I Environmental Site Assessment (ESA), and even the more intrusive Phase II ESA may not be enough to protect against the "discovery" of unknown pre-existing contamination at the site. The combination of these risks, as well as lender requirements and contractual requirements including environmental indemnifications provided in purchase and sale agreements have prompted more property owners to transfer the risk via environmental insurance.

Environmental Impairment Liability, also known as Pollution Legal Liability (PLL), has been the workhorse of the environmental insurance marketplace for over 20 years, comprising approximately 60 percent of the environmental insurance policies purchased in 2006. Approximately 60 percent of all of the PLL policies purchased resulted from real estate transactions and approximately 80 percent of the insured parties involved were first-time buyers.

PLL is a claims-made and reported premises liability policy that provides coverage for bodily injury, property damage, defense and remediation/clean-up that results from pollution conditions (both sudden/accidental and gradual) or events at, on, under, or emanating from a covered location. Offered for one or multiple locations with policy terms of up to 10 years, coverage can be tailored to include liability for known and unknown pollution conditions, as well as clean-up/remediation for unknown pre-existing or legacy pollution conditions associated with the property.

Project Site Contamination

Some estimates tally over 400,000 contaminated, non-performing or abandoned properties, or Brownfields, located throughout the U.S. For the owners of contaminated real estate, a unique set of issues may arise during the property's redevelopment giving rise to important questions that need to be addressed:

1) If indemnification is in place, is it reliable?
2) How do I cap my known clean-up/remediation liability?
3) Does a mechanism exist to cap my known environmental liabilities?

These questions can be answered through environmental insurance or a combination of insurance and liability transfer.

Remediation Cost Cap (RCC), also known in the insurance marketplace as Remediation Stop Loss (RSL), insurance coverage is used for capping known environmental liabilities at contaminated properties. RCC provides risk transfer insurance above the known contamination (minimum between $1M and $2M) and the buffer or deductible layer, which is set between 10 percent and 30 percent of the remediation cost. Limits are available up to $50 million with policy terms of up to 10 years. Typically, RCC coverage is placed in conjunction with PLL coverage, thus providing protection against cost overruns for known conditions and protection against third party liability claims for both known and unknown pre-existing contamination.

An environmental liability transfer or finite solution may be appropriate for a more sophisticated liability scheme involving contamination excess of $5M to $7M. For the property owner, the benefits of this approach are many, including:

- The contractor/consultant assuming the environmental liabilities via a Liability Transfer Agreement;

- Guaranteed clean-up via a guaranteed fixed-price remediation (GFPR) contract providing cost certainty to the owner of the clean-up price;
- EPA and state regulatory integration, and;
- Possible reserve and tax benefits since the clean-up costs are pre-funded and liability is transferred to a third party.

During Construction

When redeveloping a property, contractors and owners confront real or perceived, known or unknown environmental liability everyday in several areas including jobsite operations, historical conditions on the project site, transportation, and disposal liability. Each area must be explored to identify risk exposing contractors and owners to environmental liability.

Jobsite Operations: This includes fumes, emissions and spills from chemicals (volatile organic compounds) applied during construction (finishers, sealants, curing compounds, floor coatings, adhesives, etc.) that can cause respiratory hazards to third parties. Accepting supposedly "clean" fill from unknown origins and finding out at a later date that it was contaminated with petroleum or other hazardous substances. Release from improper or inadequate storage of fuel tanks on site.

- Heating, ventilation, air conditioning (HVAC) construction or maintenance errors, causing release of airborne bacteria, mold or carbon monoxide build-up, in addition to mold resulting from water intrusion or moisture encapsulation.

Historical Conditions on the Jobsite: Errors and/or omissions can result during the assessment process. Typically, Phase I assessments are limited in scope and therefore can easily miss areas of contamination or concern.

- Leaking underground tanks or other contamination on the perimeter or near the job site that may contribute to contamination on the jobsite.

Transportation and Disposal Exposures During Construction: Spills of contents (e.g., fuel, asphaltic cement, etc.) during transport resulting in pollution from collisions with various structures (e.g., pole-mounted transformers, above ground tanks, etc.). Superfund liability for the inadvertent disposal of waste materials or unknown contaminated soil.

- Improper disposal of waste contaminated soil on the project site or at unregulated facilities.

There are several insurance options for both the general contractor and subcontractors working at the project site and for the owner of the property. The owner of the property should ensure that the contractors working at the job site evidence CPL coverage. CPL provides coverage for third-party bodily injury, property damage, clean up costs and defense costs which arise from covered operations performed by or on behalf of the contractor or named insured. CPL also provides coverage to the named insured for vicarious pollution liability from subcontractors.

The site owner can also purchase environmental insurance coverage for added protection in the event the contractor's CPL policy is exhausted. Owner's Protective Environmental Insurance (OPEI) was developed to provide owners of construction projects an alternative to costly project contractor's pollution liability policies. OPEI is a first party policy that extends coverage to the owner for damages the owner incurs from contractor's pollution liability created by the project's construction team.

OPEI also offers "difference in coverage" above general contractor's CPL insurance, a "sliding" self insured retention and defense costs to the owner for third-party claims and above the underlying contractor's pollution liability policy, extending coverage to the owner in the event the underlying policy is deficient in coverage.

OPEI costs 25 – 40 percent less than project contractor's pollution liability policies. There are many advantages in having an owner controlled program, such as primary protection for the owner, consistency in coverage and reduced cost. In addition, the program is structured to ensure the general contractor's CPL policy pays for covered claims in a timely fashion.

Post Construction

Okay, so the redevelopment project is completed and construction is finished; you conducted environmental due diligence pre-construction, purchased PLL and required your ground crew and subcontractors to evidence CPL coverage and now you think you are in the clear from environmental claims. Correct? Maybe not.

As the owner of the property you may encounter pollution conditions three, four, or even five years after completion of the project. In addition to CPL and OPEI coverage, you also want to ensure that the contractor has completed operations coverage included within their CPL policy. Completed operations coverage will address third party claims for pollution conditions made after completion of the project. An example of this is the discovery of mold as a result of an improper installation of the roofing system by the roofing subcontractor or HVAC by the HVAC contractor. These claims can be significant and cause loss of income through relocation of tenants while the problems are corrected.

Having the proper environmental insurance with adequate limits is essential during a redevelopment project. That's because the lack of adequate environmental insurance coverage can pose disastrous results that include costly remediation and the loss of business income directly due to project delays. **SLDT**

About the author: John Heft has 18 years of environmental underwriting experience providing environmental insurance and risk management solutions for a variety of industry sectors including chemical, petrochemical, energy, manufacturing, real estate, universities and healthcare. John is currently with New Day Underwriting Managers LLC of Bordentown, NJ and can be reached at 877-NDU-8008.