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GUEST COMMENTARIES

Protecting Against Environmental Liabilities

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"Green" has become the decade's new catchphrase. Businesses and individuals alike are constantly searching for ways to reduce energy use, waste and the harmful greenhouse-gas emissions that their organizations emit into the environment. But, long before "carbon footprint" became a common phrase, commercial real estate owners and developers nationwide have been concerned about the possible environmental impact and/or liabilities produced by their activities.

In the past, potential environmental liability concerns could provide a major "deal breaker" in the sale or transfer of commercial properties. Sellers want to be free of environmental liability after the sale. Buyers, on the other hand, did not want to assume liability for a site that could possibly have some degree of contamination. Likewise, prospective investors and lenders/financial institutions were understandably concerned about unexpected cleanup costs, delays and environmental liabilities that could derail an otherwise promising real estate project.

And they had every reason to be, based on the results of several high-profile claim cases. For instance, consider a situation that arose at a shopping mall in Southeastern Pennsylvania. A mall employee called 911 complaining of symptoms produced by a odorless, colorless gas. After the fire department arrived, eight people were taken to a local hospital, treated with oxygen, and released. It was determined that the gas emissions were caused by a chimney collapse that sent carbon monoxide into the ventilation system. In addition to necessitating the close of the mall, several bodily injury claims were filed by affected parties that led to $250,000 in legal defense costs

In other cases, some commercial real estate owners have seen even more significant losses. In one case, the owner of a strip shopping center recently purchased the center from another entity who owned the shopping center for approximately five years. During a capital improvement and expansion, perchloroethylene (PCE)-contaminated soil and groundwater was encountered from former dry-cleaning activities at the site. The current owner conducted environmental due diligence prior to the acquisition; however, the Phase I Environmental Site Assessment did not identify a former dry cleaner at the property; and in fact, declared no Recognized Environmental Conditions at the site and did not recommend a Phase II Environmental Site Assessment. Apparently, the dry cleaner was at the site long before the prior owner owned the property. The shopping center expansion activities ceased until all of the resultant PCE-contaminated soil and groundwater was remediated. The clean-up costs totaled nearly $1,200,000.

As the above-mentioned situations show, commercial property owners have significant environmental worries. Other environmental risks commonly associated with commercial real estate may include but are not limited to:

- Contaminants from known and unknown historical usage/operations or neighboring properties;
- Construction debris containing hazardous materials;
- Sick Building Syndrome, i.e., carbon monoxide, mold, or bacterial air releases from faulty heating, ventilation or air-conditioning systems;
- Hazardous chemical storage (laboratory chemicals, medical wastes from doctor and dentist offices, dry-cleaning solvents (PCE or perchloroethylene), pesticides and herbicides used both indoors and outdoors, etc.);
- Inadequate containment for hazardous materials, waste and process areas, and at loading/unloading areas;
- Lead, asbestos, polychlorinated byphenols (PCBs) and radioactive material;
- "Midnight dumping" on vacant land parcels;
- Past landfills, lagoons, and other solid-waste disposal areas (from former industrial uses);
- "Contaminated" surface water runoff; and
- Leaking underground or aboveground storage tanks or piping.

Managing the Risks

Environmental liabilities do not need to be an obstacle to a property transfer, acquisition or securing financing for a purchase if they are proactively identified, managed and mitigated.

Commercial real estate developers and owners alike have mitigated their environmental exposures over the past several years either contractually; through the use of environmental insurance or by employing the combination of both. External pressures to address environmental impairment of commercial real estate (store fronts, strip centers, malls, offices) continues to mount via the pressure asserted by financial institutions to protect loans through environmental insurance and owners wanting to add environmental hold harmless and indemnification language to their lease agreements. Other drivers include private-equity firms wanting to ensure a maximum return on their investments; and sellers of the real estate assets wanting to walk away free from the potential of future claims from unknown legacy environmental issues.

At the top of the ($2.5B annual premium) environmental insurance market are the five leading environmental liability insurers of AIG, XL Capital, Zurich, ACE USA, and Chubb, which account for approximately 90% of the total premiums written. However, the remaining 10% of the environmental liability insurance market is growing with a number of very solid insurers providing at least some form of environmental liability insurance. These markets include Liberty, Markel Underwriting Managers, American Safety, Freberg Environmental/Hudson and Everest. Great American Environmental has also become the latest entrant (April 2008) into the environmental insurance marketplace with offers of a broad array of coverages including site as well as contractors pollution liability and combined contractors pollution/professional liability coverage.

Available Coverages

Each environmental liability insurer offers its own manuscripted coverage forms. To complicate matters even more, each insurer offers a portfolio of environmental liability coverage forms, with the largest carrier offering up to 15 different coverage forms totaling over 100 forms in the marketplace. We will however, focus on Premises Environmental Liability/ Pollution Legal Liability (PLL) coverage.

PLL provides coverage for pollution conditions or events on, at, under or migrating from a covered location(s). Coverage is afforded for third-party bodily injury, property damage, clean up costs and legal defense expense. A unique feature of many PLL policies is their ability to offer various and different coverage parts under one policy form. Such coverage parts include, but are not limited to:

- New pollution conditions;
- Existing pollution conditions;
- On site clean-up coverage;
- Transportation coverage;
- Non Owned Disposal Site (NODS) coverage;
- Business interruption including Loss of Rental Income;
- Mold liability coverage and clean-up;
- Fines and Penalties and Punitive Damages where allowable by law; and
- Natural Resource Damages.

PLL is an effective risk-management tool for commercial real estate for a number of reasons. The coverage helps fill the "environmental gap" left in most general liability policies for owners of property and operators of facilities or sites. It, therefore, helps reduce the uncertainty about environmental liability associated with the property and provides simple asset protection from potentially catastrophic environmental events associated with day-to-day operations. In today's environmental insurance market, available programs can be tailored to address the diverse needs of each property and can be structured to meet a variety of requirements and objectives, including, but not limited to, regulatory obligations, contract requirements, lender requirements, landlord obligations, and business objectives. Another important aspect of coverage offered under PLL that should be understood is, if a known environmental condition exists at a site, that the policy may be structured to provide coverage for the existing contamination.

With increasing concern about environmental liabilities, commercial real estate developers and owners are likely to take greater advantage of the environmental insurance market. Fortunately, it is a market that has continued to adapt and broaden its environmental risk management offers to keep pace with the growing demands of the real estate owners and lenders.

John J. Heft is VP of New Day Underwriting Managers, LLC, a specialty resource for agents and brokers, assisting them and their clients in finding appropriate, high-quality environmental and construction-related professional liability insurance coverages. More is available on www.newdayunderwriting.com.