

Negotiation of Environmental Insurance: *Policy Clarifications that Insurers May Give*

By Donald C. Nanney and Chris Falbo

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Environmental insurance has become an important element of many real estate transactions. Environmental policies are needed for coverage that is no longer provided by Commercial General Liability (CGL) insurance due to the Absolute Pollution Exclusion in most standard CGL policy forms. Environmental policy forms have evolved over the past fifteen years, and the language has grown more sophisticated. However, various ambiguities and gaps still exist with the potential for coverage disputes in the future. Environmental insurance companies may consider modifying their policy forms in order to clarify the intent of coverage. Gilchrist & Rutter's Don Nanney sat down with Chris Falbo, Arthur J. Gallagher's Environmental Specialist, to discuss the leading environmental policy forms and clarifications in policy terms that insureds should consider requesting and that insurers may give.

I. PRELIMINARY CONSIDERATIONS

A. Policy Forms for Discussion

Don Nanney: Chris, what are the leading environmental insurance policy forms that we should discuss?

Chris Falbo: There are seven or eight carriers that write environmental insurance in today's marketplace. Let's discuss the forms provided by AIG Environmental, XL Environmental, and Chubb Environmental Risk. Each of those carriers writes a large volume of Pollution Legal Liability (PLL).¹ Differences in the way each coverage form is written highlight several of our key points. Also, my experience working with each policy form makes analysis easy.

DN: There are, of course, other types of policies that may contain elements of coverage for environmental liabilities or losses. Those forms include some CGL policies (those that

provide limited coverage as an exception to an Absolute Pollution Exclusion), Cleanup Cost Cap, Dry Cleaner, Underground Storage Tank, Contractors Pollution Liability, Treatment, Storage or Disposal (TSD) Facility and other specialty forms. Some of the language issues regarding PLL coverage may apply to those other forms as well. But we will focus mainly on the PLL policy forms, after we cover some preliminary items.

B. The Insured's Goal for Policy Negotiation

DN: In general, insureds want environmental policies to cover what the CGL policies exclude: first party remediation costs and third party bodily injury and property damage liability arising from the release of pollutants. What other ancillary coverages can be built into these forms?

CF: Some of the most popular additional coverages to consider for PLL policies include Business Interruption arising out of a pollution event, a release arising out of Transported Cargo, or the release of an insured's materials at a third-party facility, leading to liability as a responsible party.

DN: The goal of policy negotiation is to get the coverage that the insured expects and pays for by making sure the intent of policy language is clear. An insurance policy is a contract, so we are talking about how to draft an environmental insurance contract that provides the intended coverage. Just look at the litigation over old CGL policies. For example, take the Stringfellow Acid Pits in Southern California. After thirteen years, the parties are still litigating over what is considered to be a Sudden and Accidental Occurrence, among other policy terms in dispute.² The goal is to avoid or minimize potential pitfalls like these by carefully crafting your environmental insurance policy.

C. Potential for Disputes

CF: When insurance companies began to impose Qualified Pollution Exclusions³ on CGL policies back in the 1970s, followed by Absolute Pollution Exclusions⁴ in the 1980s, a few carriers believed that they could cover these exposures, but they had to be smarter about how they did it. These carriers reviewed the litigation surrounding environmental coverage under CGL policies and crafted language that they felt would provide the intended coverage while protecting the carrier from unanticipated claims. I have spoken with a number of companies that currently offer PLL insurance. All of those companies told me that they have not seen any lawsuits to date regarding specific language issues in any of

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their policies. However, a number indicated that they would expect such issues to arise in the future. So we should be aware of the pitfalls and clarify policy language where we can.

D. How Negotiable?

DN: Actually, we are beginning to see some coverage litigation under newer policies. We will discuss a couple of those cases, but first, Chris, just how negotiable are PLL policies?

CF: The short answer is that it depends. All carriers will provide modifications to a certain extent. I have never known of a carrier to reject all requested modifications of its existing language. I have worked as an underwriter at a large environmental insurance company and now as an environmental insurance broker, so I have been on both sides of the request to make changes to an insurance form. In my experience, there is a willingness at least to consider most modification requests. Much of the time it comes down to the technical aspects of the deal. Currently, I think that brokers and insureds find that most insurance companies are fairly flexible.

DN: The nature of the policy, the policy limits and expected premium may affect the carrier's willingness to negotiate. I have had experience where a standard form was offered on a take-it-or-leave-it basis: for example, coverage for a small corner service station or for a dry cleaner, where the insurer's cost of negotiation would eliminate any profit. But I think that you are correct that carriers will consider policy changes for larger PLL policies where they can spend a reasonable amount of time negotiating and endorsing a policy and still make money.

E. Cleanup Cost Cap v. PLL Coverage

DN: Let's focus now on two recent cases arising under newer environmental policy forms. The first case involved a Cleanup Cost Cap policy obtained from Kemper

Insurance Company.⁵ The policy was written to provide cost containment for a remediation strategy known as Alternative B for the Cyprus Foote Mineral Company Lithium Ore Processing Facility Superfund Site located in Pennsylvania. That remedy was expected to cost \$3.4 million. The policy included a \$16.5 million Limit of Liability and self-insured retention of \$3.5 million. The premium was \$300,000. The ultimate remediation cost of the project escalated to approximately \$11.2 million because of a change in the remediation strategy required by the U.S. Environmental Protection Agency. Kemper denied coverage for the cost overrun and was sued. The court ruled that the policy language broadly covered whatever the EPA determined was necessary to complete the remediation and was not limited to cost overruns on the originally contemplated Alternative B. The court found that Kemper was liable for \$5.6 million of the remediation costs and ordered further proceedings to determine whether the other \$5.6 million in cleanup costs were also covered by the policy. Now that was a great investment of \$300,000 in premium money! It's interesting to note that the underwriter for Kemper who wrote this policy had no environmental experience whatsoever.

CF: It's also interesting that Kemper is no longer in the environmental insurance business.

DN: The second case is fairly typical in that it involved the removal of a number of underground storage tanks and associated remediation.⁶ A Cleanup Cost Cap policy was obtained to cover the remediation project. The plaintiff obtained a PLL policy as well. Why would they have done that?

CF: To answer that question I need to explain the difference between those policy forms. Cleanup Cost Cap policies are designed to provide cost containment for remediation projects, in order to protect against cost overruns. Typically the minimum size of the remediation project ranges between \$2 million and \$4 million, for these policies to make economic sense.

Some of the factors that underwriters use to evaluate these projects include the size and type of the remediation, as well as the experience of the consultant who will be doing the work.

PLL policies are basically designed to cover unknown Pollution Conditions, including the cleanup of those conditions, and for bodily injury or property damage arising from those conditions. Although designed to cover unknown contamination, this type of policy can also be used to cover known contamination, as long as the levels of the pollutants are not considered "actionable." In other words, the levels are not likely to trigger a regulatory order for cleanup. You can use a PLL policy form to provide what is known as Reopener or remediation warranty coverage. In such a case, the Pollution Conditions have been remediated to a specified regulatory level, but if that level is lowered in the future, you may be required to do additional remediation to achieve the newly established level. A PLL policy can provide coverage for this contingency. A typical approach would be to purchase a Cleanup Cost Cap policy to cover a remediation project and also purchase a Wrap Around PLL policy to cover any unknown Pollution Conditions that could be discovered. Once the remediation is complete, coverage for the residual contaminants would be provided by the PLL policy under a Reopener provision.

DN: So in this case, both a Cleanup Cost Cap policy and a PLL policy were put into place. During site remediation, some underground storage tanks that had not been identified previously by the environmental consultant were found, causing the remediation project to go over budget. The PLL policy written for the site contained an exclusion for any costs associated with the planned remediation of the property. The insured sued the environmental insurance carrier, arguing that since the presence of the underground storage tanks had been unknown, the PLL policy should cover the costs associated with their remediation. However, the trial court ruled



that the discovery of the tanks was connected to the remediation of the site and, therefore, those tanks were excluded from coverage. Was that a correct ruling?

CF: Yes. This brings up an interesting feature of Cleanup Cost Cap policies. Typically these policies will have two coverage grants. The first is for the known Pollution Condition to be remediated, the planned cleanup. The second is for unknown pollution that is identified during the remedial process. In other words, if during excavation of metals-contaminated soil you discover volatile organic contamination that needs to be remediated with a different strategy, causing increased costs, that situation would be covered by the second coverage grant of the Cost Cap policy. This is an optional coverage on the policy. We always recommend that clients buy this coverage, because once you start remediating, you never know what you might find. This scenario would not be covered under a PLL policy, unless it is contamination identified in a totally separate part of an insured property that was not undergoing remediation.

DN: Is coverage available on a PLL policy form for cost overruns arising out of unknown conditions associated with remediation?

CF: No, it would have to be purchased as optional coverage under a Cost Cap policy. The insured in the underground storage tank case apparently did not obtain that optional coverage, leaving a coverage gap between the Cost Cap policy and the Wrap Around PLL policy.

F. Underwriting Information

DN: What do environmental insurance underwriters require in order to write a policy?

CF: They require what are known as Phase I and possibly Phase II Environmental Site Assessment reports. A Phase I is a preliminary inspection to assess the potential for a property to be affected by

pollution. It consists of a historical review, a regulatory agency search, a site inspection and interviews with knowledgeable people to determine the likelihood that a particular site may have been contaminated. If the Phase I reveals a property has the potential to be contaminated, a Phase II is conducted, where soil or groundwater samples are collected and analyzed by a laboratory to confirm or refute the possibility of contamination. At least a Phase I is likely to be required for real estate transactions where a buyer or lender wants insurance against environmental risks associated with the condition of the property. For a policy covering future releases of hazardous substances from the future operations of, let's say, a manufacturing facility, not preexisting conditions, those reports probably wouldn't be required, since the carrier can do a physical inspection of the operations to underwrite the risk of a future pollution event. It depends on the coverage you're trying to achieve.

II. DISCUSSION OF POLICY FORMS AND ISSUES

A. AIG, Chubb and XL Policy Forms

DN: Now that we have covered some preliminary considerations, let's focus on the AIG, Chubb and XL policy forms that we have chosen for our discussion.⁷ All three forms are Claims Made and Reported.⁸ The coverages appear similar but are structured differently, and AIG appears to have a broader suite of coverage options than Chubb and XL. Are all coverages available from all carriers?

CF: Yes. Each carrier will offer essentially the same menu of coverages. Some of these coverages are incorporated into specific policy forms, while others may be added by endorsement. Any environmental insurance carrier will offer the essentials of the coverage – remediation costs, and defense and indemnity for Bodily Injury or Property Damage claims, arising out of Pollution Conditions at Insured Property.

DN: AIG's insuring agreement, labeled Coverage A, is broken into two provisions. The first is coverage for cleanup costs incurred when the insured discovers preexisting Pollution Conditions in excess of regulatory levels at an Insured Property. This coverage is commonly referred to as the Discovery Trigger, and it essentially provides first party coverage for remediation of pollution. Secondly, Coverage A provides coverage for Loss resulting from preexisting Pollution Conditions and is third party coverage. Although structured differently, the same coverages are available in the Chubb and XL forms.

B. Known Conditions; Remediation Warranty Coverage

DN: AIG's Coverage A states that it provides coverage if the preexisting Pollution Condition is discovered during the policy period. That limits the coverage to conditions that are unknown at policy inception. What about existing Pollution Conditions that are known to the insured?

CF: The carriers will require that those conditions be disclosed and will add what is known as a Disclosed Documents endorsement to address that situation. This endorsement should include phrasing to this effect: "Pollution Conditions identified in these scheduled documents are deemed to be discovered and reported during the policy period," to ensure that there will be coverage for those conditions.

DN: This is critical for remediation warranty coverage. The off-the-shelf PLL forms (like AIG's Coverage A) are written to apply to preexisting, unknown conditions that are discovered and reported during the policy period. The form must be modified by endorsement in order to add remediation warranty coverage for known conditions. Similar modifications would be required in order for the policy to cover other contingent risks from already known conditions, such as third party bodily injury or property damage claims that have not yet arisen.



C. The Lawsuit Trigger Gap

DN: Now would be a good time to discuss the Lawsuit Trigger gap.⁹ The issue at the heart of this gap revolves around the meaning of the word “damages” that is used in the definition of Loss in all three policy forms, which cover, as Loss, “monetary awards or settlements of compensatory damages” arising from Bodily Injury or Property Damage due to covered Pollution Conditions. The California Supreme Court has ruled that the word “damages” means “monies ordered by a court” and, therefore, without an actual lawsuit in court both defense and indemnity coverages are not triggered.¹⁰ It is different in some other states, but in California, the courts have come down on the side of the insurance companies on this interpretation issue.

I’ve had the experience with an insurance carrier that entered into a settlement subject to a reservation of rights pending that ruling of the California Supreme Court, whereupon the carrier backed out of the settlement and demanded repayment of monies already advanced, arguing that since there was no lawsuit, its policy coverage was not triggered.

The next time I had occasion to place a policy, I obtained a comfort letter from the carrier acknowledging that the policy intent was to provide coverage even without a lawsuit, notwithstanding the case law interpretation of “damages.” It is often more cost-effective to deal with environmental problems on a voluntary basis, without being recalcitrant in order to force a regulatory agency, for example, to file suit. Most insurance carriers will tell you that they prefer this approach as well, and that their policies are designed to respond in these instances. But that is not the case if the coverage trigger requires “damages.”

As I said, I started getting comfort letters to address the Lawsuit Trigger gap. However, on a transaction that Chris and I handled in 2006, an insurance carrier that had previously provided a comfort letter informed us that it would no longer do so, essentially to

preserve its right to deny coverage where the coverage trigger includes “damages” and there is no lawsuit. At that time we were also negotiating with another carrier. This carrier was willing to do better than a comfort letter. It actually endorsed its policy to broaden the definition of Loss so that it would apply even without a lawsuit.

CF: When Don first approached me with this transaction and his concern with regard to the potential gap created by the definition of Loss including the term “damages,” I told him that I didn’t think any insurance company would modify its definition, which is fundamental to the scope of the insurance risk. However, Don proved very persuasive, and I was pleasantly surprised that we were successful in achieving a highly favorable modification.

DN: So in this particular case, the insurance company that wasn’t willing to negotiate lost the deal, while the one that was willing to change the policy language and close the Lawsuit Trigger gap won the business. You will notice that the definition of Loss for first party Cleanup Cost coverage refers to cleanup “expenses” rather than “damages,” so the same concern doesn’t apply. However, you do need to address it for the third party coverage related to Bodily Injury or Property Damage. If you don’t modify the policy, an actual lawsuit may be needed to trigger coverage, even though the insured may be expecting to have insurance defense of a mere claim, demand or order.

D. Pollution Conditions v. Occurrence; Self-Insured Retention

DN: New PLL policies do not contain the word “occurrence” that is a key term of many CGL policy forms. Instead, PLL policies refer to Pollution Conditions or Pollution Incident.¹¹ A review of the CGL policy litigation involving bodily injury due to exposure to asbestos illustrates the importance of how an “occurrence” is defined and, by implication, how the term Pollution Conditions is defined in newer

policies. Is the “occurrence” the immediate cause of the bodily injury, i.e., when the exposure to asbestos fibers took place? If so, there would potentially be many different occurrences consistent with many different events and exposures. Or is the “occurrence” the remote or underlying cause, i.e., when the asbestos was made and distributed as a product? If so, there may be a single occurrence regardless of when and how exposures later took place.

The significance is that where there are multiple occurrences, each one may have a separate policy limit and deductible, which can expand the available coverage as well as expand the applicable deductibles. A single occurrence would have a single policy limit and deductible. It can cut either way as to whether it is more advantageous for the insured to have multiple coverage limits or a single deductible.

CF: It can in the sense that, if you have multiple releases that lead to separate Pollution Conditions, then you have the potential for having to bear a retention amount for each Pollution Condition, leading to a substantial deductible obligation. Where this exposure can become a major issue is with real estate portfolio entities that have a large number of properties. It would not be unusual for these entities to experience losses at a number of their properties, leading to an expensive bill for retentions.

DN: In a recent California appellate case involving asbestos, the insured was a manufacturer that had been sued by thousands of claimants alleging bodily injury due to exposure to asbestos. The manufacturer wanted multiple occurrence treatment to expand the available coverage limits, whereas the insurance company argued for treatment as a single occurrence with a single policy limit that was exhausted, ending the insurance company’s defense obligation under the policy. Based on the policy language, the court ruled that the covered “occurrence”



was exposure to asbestos, so that all the exposures could not be treated as a single occurrence under aggregation provisions. The case was returned to the trial court to determine how many occurrences were involved.¹²

The opposite result was reached in a case involving methyl tertiary butyl ether (MTBE). In that case, there were seventy-seven lawsuits filed against a manufacturer by different plaintiffs alleging different injuries at different places and times due to the hazardous nature of the product and the manufacturer's failure to warn of the hazard. The insurance company argued that separate "occurrences" took place when MTBE-containing gasoline was spilled or released from underground storage tanks. The manufacturer argued that the production and distribution of gasoline with MTBE constituted the "occurrence," when the material was released into the stream of commerce. The distinction was important because the policy had retention of \$250,000 for each occurrence and an aggregate retention of \$5 million before coverage would apply. The insured conceded that it had not incurred more than \$250,000 for the defense of each of the underlying seventy-seven lawsuits. The court ruled that there was a single covered "occurrence," which was when MTBE entered the stream of commerce as the underlying cause of all the property damage and resulting lawsuits. Thus, there was a single "occurrence" and the case was sent back to the trial court to determine whether the insured had met its single self-insured retention so that the insurer's duty to defend the many underlying lawsuits was triggered.¹³

It is interesting that, although these courts reached opposite conclusions as to what is an "occurrence," the result favored the insured under the circumstances of each case. But insureds don't always win coverage disputes. A goal of policy negotiation is to clarify the policy language sufficiently so that the time and cost of coverage disputes can be avoided.

It is also interesting that, although PLL policies refer to Pollution Conditions rather than "occurrence," the terms have, in some respects, similar language and significance.¹⁴ Thus, although we haven't seen it yet, there is the potential for coverage disputes to arise on this issue like they have for CGL policies.

Chris, can the term Pollution Conditions (and the language that would aggregate "continuous, repeated or related" conditions into a single Pollution Condition) be negotiated and modified in order to avoid similar disputes?

CF: Those terms are fundamental with the insurers as they go to the heart of the coverage risk. Environmental insurance carriers want to tie the Pollution Conditions to an actual release of pollutants and are resistant to modifying the language to say anything different. This is how their actuaries evaluate loss trends on these policies, so any deviation from use of these terms could invalidate how they set up loss reserves and develop premiums. Those terms are never modified to my knowledge. Of course, I thought the same thing regarding the definition of Loss, but I don't know that anyone has really focused on the definition of Pollution Conditions and the related aggregation provisions and provided alternative language that would clarify the policy in a way that would avoid the kind of coverage disputes that have arisen under the term "occurrence" and that would make sense to the carriers.

DN: Well, that gives us something to work on for future policies, if a clarification is feasible.

E. Aggregate Deductibles

DN: Where there is a possibility of multiple Pollution Conditions, each subject to the self-insured retention or deductible, is it possible to aggregate or cap the deductibles?

CF: Yes. We typically ask for it on the policies that we place. Let me explain how

it works. Assume you have a typical retention for one of these policies at \$50,000. What an aggregate deductible allows you to do is essentially cap that retention exposure. The most common cap is four times the Each Incident deductible, which would mean the cap in this case would be \$200,000, after which a maintenance or nuisance deductible, likely to be \$10,000 in this example, would apply. So if you had four separate Pollution Conditions that each exceeded the deductible amount, any additional Pollution Conditions would have the reduced deductible.

DN: Altering your example a bit, what if the insured discovers and reports five separate Pollution Conditions, with three of them costing \$50,000 and the other two costing \$20,000 and \$30,000, respectively. Can those two be aggregated to satisfy the last \$50,000 that is needed to reach the \$200,000 cap?

CF: As long as the ultimate deductible cap is reached, it won't matter how the deductible was aggregated. In the case you cite, the combination of the \$30,000 and the \$20,000 would satisfy the remaining \$50,000 deductible and trigger the cap. The \$50,000 per incident deductible would then disappear and the lower maintenance deductible would apply to any further incidents. Until the aggregate cap is reached, the \$50,000 deductible would continue to apply on a per incident basis to determine when the insurance company must start paying for the incident.

F. Duties of the Insured: When Multiple Insureds?

DN: That brings us to another issue. Paying of the deductible is stated in each policy form as one of the Duties of the Insured. But what if you have more than one Insured on a policy? Who is responsible for paying the deductible?

CF: The insurance companies would expect the First Named Insured, the entity



that is listed on the policy's declarations page, to be responsible for paying the deductible.

DN: But in a deal that you and I did recently, we modified this provision significantly. We had a client who was going to redevelop a large parcel in Southern California that had an industrial past. The plan was to develop some parcels and sell off others, depending on the market conditions prevailing at time of development. For the parcels to be sold off, the developer desired to offer prospective buyers, as part of the sales package, the option of becoming Additional Named Insureds under its policy, so that they would have the same protection as our client against Pollution Conditions preexisting the development project. With this coverage option already in place, the parcels might be more marketable in a competitive environment. But we also wanted those buyers to have some of the duties of an Insured as they relate to the specific parcels they bought, including notifying the insurance carrier of Pollution Conditions and paying any deductibles. How were we able to address this objective?

CF: Typically, the redeveloper will purchase PLL coverage, and may add buyers of parcels as Named Insureds, but the redeveloper would remain as the First Named Insured and retain the duties listed in the PLL policy. In this case, the underwriter was reluctant initially to entertain the structure Don describes. However, by providing detailed information on the type of transaction the insured was looking to accomplish for the property, we were able to convince the underwriter to design a flexible endorsement, that allows us to list Additional Named Insureds, to specify the parcels for which they are insured, and to delineate their duties for that particular parcel. It is the first endorsement of its kind that I have ever seen.

G. Non-Accumulation of Limits

DN: Now I want to ask about the provision regarding Non-Accumulation of Limits. What is this provision all about?

CF: It dates back to the concerns that arose for insurers when courts ruled that CGL policies without pollution exclusions do cover pollution conditions. The courts also ruled in some cases that successive CGL policies cover the same release or pollution condition as long as it continued, allowing insureds to accumulate or stack the limits of successive policies and force a higher payout. The PLL forms have been designed to avoid this happening. The insurance industry wants one policy and limit to cover a specific release: the policy that is in force at the time of the release or its discovery. Environmental insurance carriers watch this issue closely. As far as I know, it has never been litigated to see if it would hold up in court.

DN: AIG and Chubb both have these provisions, but XL does not. Would either AIG or Chubb be amenable to eliminating this provision if asked?

CF: No. This used to be a fairly common request when I began my career in underwriting, and in my experience at AIG, it was never deleted.

DN: What if you have a situation where you have, for example, an AIG policy in place for a number of years, then you switch to XL, then back to AIG? What policy or policies and limits would apply to a Pollution Condition that is continuing in nature throughout those policy periods?

CF: Again, it would depend upon when the release of hazardous substances occurred. Once you switch carriers, make sure you have a retroactive date that matches when you first commenced coverage. That way anything that is discovered will be covered by the newer policy.¹⁵ This is a common provision for environmental insurance carriers to offer.

H. Burning Limits for Defense Costs

DN: Another provision of all three policy forms is that legal expenses or defense costs will erode the policy limits. Will the carriers offer a separate limit for these defense costs?

CF: Each carrier handles this issue a little differently. None of them likes to offer a separate limit, but AIG will do it for an additional premium. On the other hand, XL will offer it only if it is a regulatory requirement like you see in the federal Resource Conservation and Recovery Act where hazardous waste Treatment Storage and Disposal (TSD) Facilities are required to have Defense Cost coverage outside of the insurance limits.

DN: How much would the additional premium be to purchase a separate limit for defense costs?

CF: Typically, insurance carriers will charge an additional 10% to 15% for the separate limit.

I. Definition of Claim

DN: The definition of a Claim specifies that it must be a written demand seeking a remedy or alleging liability. But does the definition of Claim need to be broader? For instance, you may not get a written demand seeking a remedy or alleging liability but rather a request for information from a regulatory agency, which could result in significant expenses being incurred. Will the carriers broaden the definition of a Claim?

CF: They will do it, but not readily. In my experience, it depends on the size of the transaction. For a deal in the \$500,000 to \$1 million in premium range, such a request is much more likely to be considered than for a transaction that involves a minimum premium of \$10,000.



DN: On the other hand, we have readily obtained endorsements clarifying the definition to include “governmental orders,” correct?

CF: That is correct.

J. Reasonable and Necessary Cleanup Costs

DN: In reviewing the definition of Cleanup Costs, I note that both AIG’s and Chubb’s definitions include the provision that these costs have to be “reasonable and necessary,” while XL’s definition doesn’t include that phrase. Will either AIG or Chubb delete it?

CF: Not in my experience. It is a key notion of environmental insurance that the costs have to be in line with industry standards for a remediation. Although XL’s definition doesn’t contain the phrase, it will mandate that any cost it pays for must be reasonable and necessary as well. I am currently involved in a claim where XL has disallowed some expenses, claiming that in fact they were unnecessary.

DN: In the same context, the phrase “to the extent required by law” presents a similar problem. It can create a gray area, implying a good deal of discretion on the part of the regulator. Do you need to obtain regulatory directives in order to obtain coverage, or can you do a voluntary cleanup?

CF: The way the policy forms work, the environmental regulations will determine the cleanup standard. If there are standards set for a particular contaminant that you are addressing, say benzene or PCE, you clean up to that standard. If there is no standard, then you do your cleanup until the environmental regulatory authority determines you don’t need to any more, hence achieving No Further Action status.

K. Insured Property: Fixed Site vs. Blanket Coverage

DN: What about a situation where an acquisition is of company stock rather than underlying assets and real estate holdings directly, and the buyer of the company wants environmental insurance regarding any and all properties that the company owns or operates or ever owned or operated in the past. For a major acquisition, records may not be complete and current management may not be aware of all the locations that the company owned or operated historically, yet there may be environmental risk associated with such locations should a claim arise that the company is responsible. Is it possible to buy PLL coverage on a blanket basis, without identifying specific properties for coverage?

CF: No. PLL coverage will always be tied to specifically identified and scheduled Insured Property or Insured Properties. However, we have obtained coverage for non-owned locations on a blanket basis in some instances. You do this by specifying that there is coverage for any facility as long as it was permitted to receive the waste that was sent to it. As long as that is the case, then the policy will respond if an Insured becomes a responsible party at such a facility.

DN: So in order to underwrite facilities without knowing what the facilities are, the insurance companies make permitting the condition of coverage, and that is how they limit their risk?

CF: That’s correct. And that’s the reason they won’t offer PLL coverage for blanket properties. The underwriters cannot limit their risk in the same way for unknown properties in general.

DN: This suggests that environmental insurance may be available for some, but not all, risks associated with acquiring a company with a portfolio of present and past

properties. Where insurance is not available, the seller may be willing to provide an indemnity. If so, would environmental insurance be available to back up the indemnity, with the insurance to be triggered upon failure or exhaustion of the seller’s primary indemnity obligation?

CF: Different environmental carriers have different appetites for providing policies structured around environmental indemnities. Some carriers refuse to write such policies; others will do it very selectively, while some seem more comfortable with this exposure. It would generally depend on the creditworthiness of the entity providing the indemnity. Carriers are likely to be more comfortable with an indemnity provided by a Fortune 500 company rather than one provided by a single purpose limited liability company.

L. Soft Costs

DN: You have mentioned that, in addition to Cleanup Costs, environmental insurance carriers offer Business Interruption as part of their coverages for pollution liability. Are there other forms of losses or expenses that can be covered?

CF: The only other losses of that sort would be what are called Soft Costs. You typically see these offered as part of a policy for a brownfield or redevelopment project. Essentially, if you incur higher engineering or borrowing costs because of a Pollution Condition, you can purchase coverage that would respond to those losses.

M. Naturally Occurring Conditions and Global Warming

DN: Let’s return to the definition of Pollution Conditions. AIG’s policy form contains a carve-out for conditions that are “naturally present in the environment in the amounts or concentrations discovered,” commonly referred to as “background” levels of pollutants. By virtue of



this definitional carve-out, coverage would not apply to require cleanup to a level more stringent than “background” levels. Neither Chubb nor XL has this carve-out, although they do have exclusions to one extent or another for naturally occurring conditions. Is there any way to get coverage for naturally occurring conditions? I am thinking of a case like serpentine rock in California, which is comprised mainly of asbestos.

CF: Yes, this coverage can be obtained. I have actually recently placed a policy that contained coverage for serpentine rock. If you can assess the exposure provided by the naturally occurring conditions and demonstrate the risks associated with those conditions are low, environmental insurance carriers will generally offer this coverage.

DN: What about the spread of contaminants caused by severe weather events or flooding due to global warming? Cleanup may be required, but if the weather event is considered to be a natural phenomenon, the result of a natural cycle in global temperatures, the pollution may be considered a new “background” level not covered by the policy language. An argument could be made that global warming is, at least in part, the result of human activity and is, therefore, not naturally occurring and, hence, coverage should apply under the existing policy language. While the human cause of global warming may be the prevailing view according to media reports these days,¹⁶ scientific opinion is not necessarily unanimous on the significance and extent to which global warming is caused by human activity. Experts may be available on both sides of the issue, and it could theoretically be disputed in a coverage case. To avoid such a dispute, would it be possible to modify the policy language so that coverage would clearly apply regardless of the cause of global warming and resulting damage?

CF: We would have to ask insurers. I know that they are studying the issue of global warming and its impact on insurance risk. For instance, AIG has a Global Warming Group in their New York office, and I have heard that Chubb has had meetings of underwriters to discuss this issue internally. But I don’t know yet what positions they may take as a result.

DN: Actually, I spoke with a Chubb underwriter recently and the indication was that the underwriters would be willing to clarify language so that coverage would apply to Pollution Conditions caused or aggravated by global warming events, even if found to be naturally occurring. Of course, what the underwriters may say does not always get reflected in company policy, so we may get a chance to see what Chubb or other insurers will actually do the next time we negotiate a policy with them.

N. Subsequently Regulated Hazardous Substance

DN: What about a material that might not be considered a pollutant currently, but is determined to be a hazardous material at a later date? Is coverage available for that?

CF: PLL forms are already designed to cover this risk. MTBE is a great example. When pollution liability coverage became widely available in the early to mid-1990s, MTBE wasn’t foreseen as a potential exposure for remediation and bodily injury. Now carriers are dealing with MTBE claims on a regular basis on their policies. And a material doesn’t necessarily have to be hazardous to be a pollutant. A great example that demonstrates this is a claim a dairy business brought under its policy for a spill of milk from one of its milk bulk transport trucks. The spill entered a waterway and caused a fish kill, resulting in a seven-figure fine for the insured.

DN: That is another reason why clients should be considering these policies.

O. Definition of Property Damage

DN: Now I would like to turn to the definition of Property Damage. It covers strictly third party property damage, correct?

CF: That’s correct.

DN: When we look at the definition of this term for each carrier, XL’s definition expressly excludes coverage for third party real property. Is it XL’s intent not to cover these claims for real property, for instance the release of pollutants causing damage to neighboring real property?

CF: That is an ambiguity that we would have to clarify with the carrier. I am not sure what the coverage intent is with that phrase.

DN: Do you think XL would modify its definition of Property Damage to remove the phrase “real property”?

CF: Since neither of its competitors has that provision, I suspect the answer would be yes. But it would have to be clarified with the carrier.

DN: How about first party property damage coverage over and above Cleanup Cost coverage. Is it available?

CF: I have seen it done, but it is very, very rare. In my many years of experience as an underwriter or broker, I have only seen it done maybe once or twice, with neither case very recent.

P. Definition of Responsible Insured

DN: That brings us to the definition of Responsible Insured, and an issue related to one we discussed earlier dealing with Named Insureds. What happens if you have more than one Responsible Insured on a policy?



CF: Environmental insurance carriers want to identify who is going to be the Responsible Insured under its policies, so that they know who is responsible to disclose environmental information, for premium and retention payments and for reporting claims. All employees are essentially considered Insureds under the policy. So if a janitor dumps materials in an effort to get rid of them and causes a Pollution Condition, that situation would be covered, as long as the action was not taken at the direction of a Responsible Insured, who is the person who knows or should know about potential conditions that could give rise to a Claim.

Q. Contractual Liability Exclusion

DN: Now let's talk about Contractual Liability. Where an insured has assumed environmental liability by contract (for example, in a purchase and sale agreement or a lease), the contract must be disclosed and scheduled onto the policy in order to have coverage. Otherwise, contractually assumed liability is generally excluded. Sometimes, however, those contracts won't be entered into at policy inception. Can they be added later?

CF: Generally, insurance companies will add these contracts after inception, as long as they have had a chance to review and underwrite the contracts. It is possible that after such a review, an underwriter might not be comfortable scheduling a contract, but I have never seen it. In situations where you have an insured that might be leasing to an entity, we like to structure the scheduling of these leases as automatic, as long as the lease is similar to a form preapproved by the insurance company. Also, where approval is not automatic, it is possible to obtain an endorsement committing the insurance company not to unreasonably withhold or delay its approval.

R. Owned Property Exclusion

DN: Now let's skip down to the Owned Property exclusion. AIG doesn't have this exclusion, but Chubb does. Why is that?

CF: It goes back to the nature of these policies being liability policies rather than property policies. Chubb includes the Owned Property exclusion to emphasize the fact that there is no first party property coverage on its policy.

DN: But they are providing Cleanup Cost coverage that is supposed to apply to first party property, right?

CF: Yes they are.

DN: Do you see any potential for conflict because of this exclusion? Would the exclusion swallow the coverage?

CF: If you ask the underwriters at Chubb, they will tell you "no," that their intent is to provide coverage for remediation, as specified in its coverage grant.

DN: So Chubb's argument is that they can give it and then take it away, and you should feel comfortable that you have the coverage?

CF: They state that the Owned Property exclusion would not pertain to coverage claimed for remediation.

DN: In my opinion, this provides some potential for mischief. I am not concerned with Chubb's underwriters as much as with their general counsel back in New York who may look for grounds to deny a claim, and the Owned Property exclusion may do that. If the intent is to provide coverage for first party remediation costs, this exclusion should be eliminated. The definition of Property Damage states that it does not apply to remediation costs. Does this help to save us?¹⁷

CF: I think so.

DN: I still think Chubb could try to use this to wiggle out of a large claim if it felt so inclined, so the exclusion should be eliminated. Do you think Chubb would delete this exclusion?

CF: It has never been deleted to my knowledge. I should also add that I am not aware of any claims that have been denied based on this exclusion.

DN: Still, in my opinion, it should be clarified, even if you don't think it necessary. We disagree on that. I am concerned not only with first party remediation coverage but also with third party Property Damage or Bodily Injury coverage where it could be argued that, in the chain of causation, the release of pollutants first damaged the soil (which is property owned by the insured) and then damaged neighboring property or groundwater and perhaps then exposed someone to tainted water. The third party damage or injury arguably arose from the initial damage to owned property and, therefore, the Owned Property exclusion would apply, negating the coverage. After all, Chubb's Owned Property exclusion expressly excludes claims "[a]rising from property damage to property owned, leased, rented, occupied or loaned to an insured," and the words "arising from" have been construed broadly in case law.¹⁸

Also, I don't think I am being overly concerned about what position general counsel may take in order to deny a claim. In fact, this point has already been the subject of litigation in Wisconsin where several insurance companies took exactly the position I am concerned about and they prevailed due to the "arising from" language in the Owned Property exclusion in their CGL policies.¹⁹

Chris, why don't we have this problem with AIG?

CF: I think that AIG's position is that their coverage grant does not extend to first party property damage to begin with, other than the intended Cleanup Cost coverage, so that there is no need for an Owned Property exclusion.

DN: The same should be true of Chubb's policy form. In the context of a PLL policy, the Owned Property exclusion is an



unnecessary and problematic vestige of CGL policies. So, the next time we have the opportunity to negotiate a Chubb policy, Chris, I am going to seek deletion of the Owned Property exclusion. For cases where that exclusion is contained in a PLL policy, I would join you regarding the intent of the coverage. We do agree about that. I would contend, as you have, that the exclusion does not apply to defeat the coverage grant. Otherwise, the exclusion could virtually swallow the entire policy, and one can argue that it is an ambiguity that should be construed against the insurer.²⁰ But one of our objectives in policy negotiation is to avoid potential disputes by clarifying the language. I would have a problem with placing a policy with Chubb if it were to refuse to delete the Owned Property exclusion or to modify it to limit its effect appropriately.

III. CONCLUSION

DN: There are more issues we could discuss, but I think we have touched on the highlights. I want to thank you, Chris, for sharing your experience and insights from the trenches negotiating and placing environmental policies every working day for many years. Ultimately, one may have to prioritize the changes to seek given the nature of a specific transaction, the risks to be covered and how transaction and premium costs may be affected. The objective is to be sure, as much as is feasible and cost-effective for the deal, to obtain the desired coverage and to avoid or minimize the gaps, ambiguities and areas of potential coverage disputes.

¹ That is the title used by AIG for its policy form. Other insurers use different titles, such as Chubb's Environmental Site Liability policy form. For ease of reference, we will refer to all of these policies as PLL forms.

² See, e.g., *State of California v. Underwriters at Lloyd's London*, 146 Cal.App.4th 851 (2006) (review granted). Fortunately, disputes over what is a Sudden and Accidental Occurrence should not arise under

new environmental policies that do not use that term. If it does happen to be included in an offered policy form, it should be deleted or another form used.

³ Qualified Pollution Exclusions were subject to a Sudden and Accidental Occurrence exception, where pollution would be covered if caused by a "sudden and accidental" event.

⁴ Absolute Pollution Exclusions contain no exception for sudden and accidental events and, therefore, exclude coverage regardless whether the pollution occurred gradually or suddenly and accidentally.

⁵ *Frazier-Exton Development, L.P. v. Kemper Environmental, Ltd.*, 2007 WL 756494 (S.D.N.Y. Mar. 13, 2007) (No. 06 CIV. 14228 HB DFE). See also, *Frazier-Exton Development, L.P. v. Kemper Environmental, Ltd.*, 153 Fed.Appx. 31, 2005 WL 2850247 (2nd Cir. 2005).

⁶ *Denihan Ownership Company, LLC vs. Commerce and Industry Insurance Company*, 37 A.D.3d 314, 830 N.Y.S.2d. 128, Slip Op 01417 (NY App. Div. Feb. 20, 2007).

⁷ These are: AISLIC Pollution Legal Liability Select 76391 (0804) C12427 [AIG], Environmental Site Liability Policy Form 70-02-0501 (Ed. 5-01) [Chubb] and Indian Harbor Pollution and Remediation Legal Liability IHIC-PARL5CPr (9-04) [XL]. Specimen policies can be obtained readily from the carriers or from insurance brokers. It helps to have the policy forms at hand to compare language. A spreadsheet prepared by Mr. Falbo and Mr. Nanney comparing policy language from the AIG, Chubb and XL forms, annotated with comments, was included among the program materials for their panel presentation: *Environmental Insurance: The Top 10 Changes in Policy Terms That Insured Should Seek and Insurers May Give*, 26th Annual Retreat, Real Property Law Section, State Bar of California, April 28, 2007. The program tape and materials are available for purchase

from the Real Property Law Section. Some of the discussion in this article is based on that panel presentation.

⁸ Claims Made and Reported forms require that a covered claim be made and reported to the carrier within the policy period in order to be covered. This is much more restrictive than CGL occurrence-based policies under which a claim made long after the expiration of the policy period may still be covered as long as the "occurrence" took place during the policy period. Subject to certain retroactive policy commencement dates and extended reporting periods that can be arranged, PLL policy forms available on the market today are of the Claims Made and Reported variety.

⁹ The Lawsuit Trigger gap is discussed more in depth in an article by Mr. Nanney and Mr. Falbo that is included in their program materials referred to in endnote 7 above.

¹⁰ *Certain Underwriters at Lloyd's of London v. Superior Court (Powerine Oil Company)*, 24 Cal.4th 945 (2001). Under this case, administrative orders by regulatory agencies are insufficient to trigger coverage because they are issued out of court. In contrast, where the coverage language is triggered by a "claim" or by "expenses," a lawsuit is not needed in order to trigger coverage. *Powerine Oil Company v. Superior Court (Central National Insurance Company of Omaha)*, 37 Cal.App.4th 377 (2005). These cases interpreted the coverage under CGL policies, but the meaning of the term "damages" as ruled by the Court should be the same under other insurance policy forms as well.

¹¹ For ease of reference, we will use the term Pollution Conditions to describe this aspect of the different policy forms. In addition, we have capitalized that term and other key policy terms (Bodily Injury, Property Damage, Cleanup Cost, Loss,



Insured, Insured Property, Responsible Insured, Claim, etc.) to highlight them throughout this article. Such terms may be defined differently in different policy forms. They may also be highlighted differently (e.g., capitalized or in bold without capitalizing). Except where quoting policy language (see endnotes 14 and 17), such terms are capitalized in this article for convenience and consistency. Note, however, that other terms are capitalized for emphasis or as shorthand for concepts (Discovery Trigger, Lawsuit Trigger, Soft Costs, etc.) even though not policy terms.

¹² *London Market Insurers v. Superior Court (Truck Insurance Exchange)*, 146 Cal.App.4th 648 (2007).

¹³ *Sunoco, Inc. v. Illinois National Insurance Company*, 226 Fed.Appx. 104 (3rd Cir. Jan. 31, 2007) (not published) (Nos. 05-4992 and 06-1295) (applying Pennsylvania law).

¹⁴ *Compare*: “**Pollution incident** means a discharge, dispersal, seepage, migration, release or escape of any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals, and waste into or upon land, or any structure on land, the atmosphere or any groundwater, watercourse or body of water”; the “deductible applies to all **loss** arising from the same, continuous, repeated or related **pollution incident**”; where a claim is made during a policy period, “all **claims** arising out of the same, continuous, repeated or related **pollution incidents** shall be deemed to have been first made and reported during the policy period”; and subject to the aggregate limit, “the most we will pay for all **loss** ... arising from the same, continuous, repeated or related **pollution incident** is the Each Pollution Incident Loss Limit” (Chubb Environmental Site Liability Policy Form 70-02-0501 (Ed. 5-01), *with*: Occurrence means “an event, or continuous or repeated exposure to conditions, which unexpectedly and unintentionally causes personal injury and/or property damage

during the ... policy period,” but the insurance “does not apply to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water; unless such discharge, dispersal, release or escape is sudden and accidental” (language from a typical, old CGL policy with a Qualified Pollution Exclusion). Thus, the PLL policy covers what the CGL policy excludes, in much the same language, and both forms treat a “continuous or repeated” event or condition as a single occurrence or pollution incident. What is the “same, continuous, repeated or related” and therefore a single pollution incident rather than separate incidents or conditions could give rise to disputes under PLL policies like the disputes under CGL policies. The question is whether alternative language could be developed to clarify this and avoid or minimize this kind of dispute. Given the narrower scope of the coverage provided by PLL policies, it might be possible.

¹⁵ Under that hypothetical, the older PLL policy would not apply because the Pollution Condition would have been discovered and reported or the claim would have been made after that policy had ended. Thus, the policies would not accumulate. The issue would be limited to which policy applies where the Pollution Condition is a “continuing” one.

¹⁶ This seems to be the popular view given the Oscar and Nobel Prize garnered by Al Gore in 2007 based on his work in this field.

¹⁷ The argument here is that the Owned Property exclusion applies to losses “[a]rising from **property damage** to property owned, leased, rented, occupied or loaned to an insured,” and where Chubb excludes remediation costs from its definition of property damage, then the Owned

Property exclusion should not apply to defeat remediation cost coverage.

¹⁸ “California courts have consistently given a broad interpretation to the terms ‘arising out of’ or ‘arising from’ in various kinds of insurance provisions.” *State of California v. Underwriters at Lloyd’s London*, 146 Cal.App.4th 851 (2006) (review granted).

¹⁹ In *State of Wisconsin v. City of Rhineland*, 2003 WI App 87, 263 Wis.2d 311, 661 N.W.2d 509 (Wis. Ct. App. 2003), the court ruled that “the owned property exclusion unambiguously exempts coverage for property damage that arises out of property damage to property owned by the insured. We conclude that any off-site damage that the City must remediate would fall under this exclusion. The policy defined ‘property damage’ as ‘injury to or destruction of tangible property.’ The term ‘arising out of’ in an insurance policy is very broad, general, and comprehensive, and is ordinarily understood to mean originating from, growing out of, or flowing from [citation omitted]. When ‘arising out of’ is used in an exclusion, all that is necessary is some causal relationship between the injury and the event not covered.” The court held that damage to off-site property and groundwater was excluded due to the Owned Property exclusion. A subsequent Wisconsin case reached the opposite conclusion where the policies in question had no similar “arising out of” language, so that the damage to the owned property was excluded but the damage to ground water was not excluded. *United Cooperative v. Frontier FS Cooperative*, 738 N.W.2d. 578, 2007 WI App. 197 (Wis. Ct. App. July 12, 2007). Thus, the “arising from” language should be carefully considered and modified where appropriate.

²⁰ The Wisconsin cases cited in endnote 19 could be distinguished on the ground that they involved CGL policies that still provided significant coverage even with the Owned Property exclusion. On the



other hand, PLL policies have a narrower scope to begin with, so if that exclusion applies as broadly in a PLL policy, the intended coverage may be essentially negated, making the policy worthless, which cannot be the case. This argument could be avoided with a clarification of the policy language when obtaining a PLL policy.