Module 9

Environmental Loss Exposures

Environmental Loss Exposures and Insurance

Module 9
Chapter 9

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Objectives

- Obj I: Legal Foundations for Environmental Liability
- Obj II: Environmental Statutes
- Obj III: Environmental Risk Management
- Obj IV: Environmental Insurance

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Legal Foundations for Environmental Liability

Objective I

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Legal Foundations

- Almost every organization has environmental loss exposures.
  - Can result from pollutants being released into the environment.
- Environmental liability can be incurred under:
  - Tort liability.
  - Contract liability.
  - Statutory law.

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Tort Liability

- Tort liability for pollution can be based on negligence, intentional torts, or strict liability.
  - Negligence – may result in pollution.
    - Organization can be held legally liable to pay claimant's damages.
  - Intentional torts – nuisance and trespass.
    - Nuisance – interference with another's peaceful enjoyment of their property.
    - Trespass – physical deposit of pollutants on the property of another.

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Tort Liability

- Strict liability – when manufacturing operations use inherently hazardous materials or processes, courts may impose strict liability.
  - Eliminates common-law defenses normally available to the defendant in a negligence suit.
  - No degree of care is considered to be adequate for ultrahazardous activities.

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Contractual Liability

- An organization can assume liability for environmental losses under a contract.
  - If contract contains a hold-harmless agreement.
- Example – contractor agrees to indemnify project owner for claims made against the owner.

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Environmental Statutes

- Many environmental laws do not require fault on the part of the responsible party.
  - Creates strict liability by statute.
  - "Let the polluter pay" principle.
- Federal statutes provide the baseline standards for state and local environmental laws.
  - Local governments can impose more strict requirements.
- Statutes can result in injunctions, fines, and even criminal penalties.

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Environmental Regulation

- Traditionally, environmental regulation involved physical inspections.
  - EPA set standards, counted contaminants, and enforced statutes.
  - Risk managers were rarely involved.
- Enforcement model for environmental laws has changed dramatically.
  - Now involves both a review of the physical facilities and control of the processes that pose a threat to the environment.

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Environmental Regulation

- Enforcement model now evaluates:
  - Accountability of the board of directors.
  - Assignment of environmental responsibility within senior management ranks.
  - Effective dispersion of responsibility through all levels of the organization.
  - Day-to-day operation of the system in controlling activities that involve hazardous materials.

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Practice

- As part of their day-to-day operations, Scott's Sandblasting, Inc. regularly releases dust and sand particles into the air. They take precautions to control these releases, however, air quality on a neighboring restaurant has become so poor they are unable to use their outdoor patio for customer dining on most days. The restaurant could sue Scott's Sandblasting for damages based on which of the following?
  - A. Trespass.
  - B. Nuisance.
  - C. Negligence.
  - D. Strict Liability.

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Environmental Statutes

Objective II

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Clean Water Act

- The Clean Water Act seeks to improve the quality of surface waters.
  - Prohibits/regulates the discharge of pollutants into navigable waters.
  - Restores them to fishable and swimmable quality.
- Also mandates a Spill Prevention, Control, and Countermeasure Plan for certain regulated facilities.

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Clean Air Act

- The Clean Air Act seeks to improve the quality of ambient air.
  - Regulates emissions from both mobile and stationary sources of air pollution.
  - Parties that intend to construct or operate sources of air emissions must obtain permits.
- Zones where air quality fails to meet requirements are "Nonattainment Areas."
  - Regulators can curtail new commercial development by denying required air permits.

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Toxic Substance Control Act

- The Toxic Substance Control Act regulates the chemical manufacturing industry.
  - Prevents the import or manufacture of dangerous chemicals without safeguards.
- Manufacturers must provide extensive information to the EPA.
  - Regarding formulation, use, and risks of each substance manufactured or imported.

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Resource Conservation Act

- The Resource Conservation and Recovery Act imposes strict waste management requirements.
  - Imposed on generators and transporters of hazardous wastes and on disposal facilities.
  - Provides "cradle-to-grave" regulation.
- One of the first environmental Acts to require proof of financial responsibility.
  - Owners of facilities must show they have the resources to clean up any material that causes environmental damage.

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Motor Carrier Act

- The Motor Carrier Act of 1980 established minimum levels of financial responsibility for carriers of hazardous materials.
  - Protects the environment from releases of harmful materials during transportation.
- MCS 90 endorsement is required of any carrier subject to the Motor Carrier Act of 1980.
  - Pays for damages resulting from negligence in the operation or use of any vehicle subject to the Act.

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Superfund Act

- The Comprehensive Environmental Response, Compensation, and Liability Act facilitates the cleanup of any abandoned or uncontrolled sites containing hazardous substances.
  - Strict and retroactive liability.
    - Many sites subject to Superfund Act were legal at the time they were accepting waste.
  - Joint and several liability.
- Potentially responsible parties (PRPs) are responsible for remediation costs.

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Superfund Act

- PRPs can include:
  - Current owners and operators of a site.
  - Prior owners and operators who may or may not have been involved during the disposal of hazardous materials.
  - Generators of the waste materials disposed of at the site.
  - Transporters who hauled waste to the site.
  - Anyone who arranged for the disposal of materials at the site.

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Oil Pollution Act

- The Oil Pollution Act (OPA) seeks to reduce spills of hazardous materials into U.S. coastal or navigable waters.
  - Mandates technical standards for facilities and vessels operating in or near such waters.
- Imposes requirements on owners of vessels.
  - Must prevent releases and to pay for the costs of releases that are not prevented.
  - Liable for removal costs and damages.

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Practice

- Which one of the following Acts was enacted to facilitate the cleanup of abandoned or uncontrolled sites containing hazardous substances?
  - A. Clean Air Act.
  - B. Resource Conservation and Recovery Act.
  - C. Comprehensive Environmental Response, Compensation, and Liability Act.
  - D. Toxic Substance Control Act.

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Environmental Risk Management

Objective III

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Identifying Loss Exposures

- Process to identify environmental exposures:
  - Identify what materials are present and the quantities of those materials.
  - Identify potential routes those materials could take if they were released.
    - Sewers and air ducts are examples of routes that contaminants can follow.
  - Identify target populations of living entities that could be affected.

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Unique Characteristics

- Characteristics of environmental exposures:
  - Difficult to identify – many arise from activities conducted many years ago.
  - Tend to elude traditional exposure identification methods – physical inspections of facilities do not always reveal damage.
  - Amount of loss may be difficult to measure.
    - Often, no relationship is apparent between exposure to a substance and injury.

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Unique Characteristics

- Characteristics of environmental exposures:
  - Claims may result from a perceived, rather than real, exposure.
    - Or from a fear of future injury.
  - Environmental losses are often very severe.
  - Many remediation laws impose a "let the polluter pay" funding concept.
  - Technology can change the loss exposure.
  - Loss can increase over time as contamination spreads farther from its source.

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Overcoming Difficulties

- The difficulty of identifying exposures can sometimes be overcome by the effective use of internal and external resources.
  - Compliance personnel within the firm are often familiar with the laws that apply to the operations of the firm.
  - Legal counsel is another source of expertise.
  - Operational personnel may be familiar with environmental loss exposures.
  - Environmental consultants can also be used.

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Overcoming Difficulties

- Risk manager should attempt to distinguish between loss exposures resulting from:
  - Prior activities.
  - Those that could result from future activities.
- An essential element in controlling losses is to have a contingency plan in place.
  - Plan should address the procedures to follow in the event of an environmental contamination incident.

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Overcoming Difficulties

- Insurance agents and brokers contemplating working with environmental insurance should seek specialized assistance.
  - Environmental insurance policies are complex and are not standardized.
  - Expertise can be found in consultants, wholesale insurance brokers, or some of the specially trained underwriters.

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Practice

- Derek has recently joined Mira Bella Development Company as their Chief Risk Officer. Mira Bella is a developer for senior living communities in the Florida panhandle. Derek quickly identified several potential environmental liability issues with one of the company's new communities. Which one of the following would be the best strategy for Derek to implement to control environmental losses?
  - A. Avoid building new structures near water management districts.
  - B. Instruct their insurance agent to add an MCS 90 endorsement to their policy.
  - C. Put a contingency plan in place.
  - D. Join a Superfund group to reduce their risk.

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Environmental Insurance

Objective IV

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Environmental Insurance

- Environmental exposures may be covered in some cases through endorsements to existing liability policies.
  - However, coverage may be inadequate.
- Major categories of environmental insurance:
  - Site-specific.
  - Operations-specific.
  - Professional liability.
- Environmental policies are not standardized.

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Site-Specific EIL Policy

- Site-specific environmental impairment liability (EIL) policy.
  - Type of site-specific policy.
  - Covers third-party claims arising from sudden or gradual releases of pollutants.
  - Typically sold to factories, golf courses, waste disposal sites, oil refineries, farms, and municipalities.

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Site-Specific EIL Policy

- Insuring agreement obligates insurer to pay a loss for bodily injury, property damage, cleanup costs, and defense expenses.
  - Loss must result from pollution beyond the boundaries of the sites listed in the policy.
  - On-site cleanup can be added by endorsement.
- For coverage to apply, the bodily injury or property damage must result from pollutants emanating from an insured site.

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Site-Specific EIL Policy

- Site-Specific EIL policies respond to losses arising from "pollution conditions."
  - Pollution conditions follows definition of pollutants in CGL and other policies.
- Provide coverage on a claims-made basis.
  - Often have no retroactive date.
  - Contain extended reporting period provisions.
    - Typically 1-3 years.
- Defense costs are typically payable within policy limits.

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Site-Specific EIL Policy

- All claims arising from a pollution incident are treated as a single loss subject to one limit of liability and one deductible.
- Example – a manufacturing company determined that 500 gallons of chemicals seeped into a stream due to a leaking pipe. EIL policy covered the cleanup, after the deductible.
  - Three years later, some fishermen filed a class-action suit against the company. If company is found liable, the damages will be considered part of the earlier loss.

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Site-Specific EIL Policy

- Typically contain most of these exclusions:
  - Known preexisting conditions.
  - Deliberate noncompliance with laws.
  - Punitive damages.
  - Sold or leased premises.
  - Nuclear liability, acid rain.
  - War, terrorism.
  - Contractual liability.
  - Damage to the insured site.

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CGL/EIL Combination Policies

- CGL/EIL Combination Policies produce seamless coverage.
  - May be lower premium than separate policies.
- Combination policies are offered with EIL coverage on a claims-made basis.
  - CGL coverage is offered on either an occurrence or a claims-made basis.
  - Both coverages are subject to a single aggregate limit and deductible.

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CGL/EIL Combination Policies

- CGL/EIL combination policies may also be endorsed to provide products liability coverage.
  - Includes protection against pollution claims resulting from failure of insured's product.
- Advantages over buying separate policies:
  - Combination policies can eliminate coverage disputes.
  - Combination policy is typically less expensive than if the forms were purchased separately.

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Underground Storage Tank Compliance

- Underground storage tank compliance policies.
  - Provide proof of financial responsibility required under RCRA.
- Most UST policies do not provide the full scope of coverage granted by full EIL policies.
  - UST policy does not insure all releases of contaminants from the insured site.
  - Some policies respond only to a "corrective action" and not to other environmental damage claims.

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Property Transfer Policies

- A property transfer policy is purchased in connection with the sale of property.
  - Transfers potential pollutant cleanup liability to an insurer.
- Essentially an EIL policy that has been amended to cover on-site cleanup on a first-party basis.
  - Can be written to provide remediation and third-party liability coverage.
  - Policies are usually assignable to new owners.
  - Commonly written for terms of 7-10 years.

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Property Transfer Policies

- Policy typically has two insuring agreements:
  - Third-party liability.
  - On-site cleanup required under environmental protection laws.
- Coverage for cleanup is usually triggered by the discovery of contamination in excess of baseline cleanup levels.
  - Baseline levels are set forth in laws.
- Exclusions closely match those found in Site-Specific EIL policies.

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Remediation Stop-loss Policies

- Remediation stop-loss policies are designed to facilitate real estate sales.
  - Used when a property contaminated but cost of remediation is uncertain.
- Used to close the gap between low and high estimates of cleanup costs.
  - Insures costs that exceed the projected or anticipated cleanup costs.
- Typically contain relatively few exclusions.
  - Written on a first-party coverage basis.

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Remediation Stop-loss Policies

- Example – a grain elevator worth $2,000,000 is on land that is contaminated. The seller's estimate of remediation costs is $500,000, but an environmental consultant believes the costs could be as high as $3,000,000.
  - Remediation stop-loss policy could be purchased with a limit of $3,000,000 and a $500,000 deductible.

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Secured Creditor Policies

- Secured creditor policies were developed to protect a lender's security interest in property.
  - For those with uninsured environmental loss exposures not severe enough for EIL policy.
- Pays for cleanup that a borrower is unable to perform without involvement of the lender.
  - Borrower must be in default on the loan.
  - Borrower receives no protection under policy.
  - Pays lesser of cleanup costs or loan balance.

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Operations-Specific Policies

- The second major category of environmental insurance policies is operations-specific policies.
  - Contractors pollution liability policies.
  - CGL/CPL combination policies.
  - Asbestos and lead abatement contractors general liability policies.

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Contractors Pollution Liability Policies

- Contractors pollution liability (CPL) policies address the needs of contractors performing environmental remediation services.
  - Cover operations at project sites.
  - Policies are available with either a claims-made or an occurrence coverage trigger.
- Emergence of mold as a contaminant has expanded the need for CPL coverage.

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Contractors Pollution Liability Policies

- CPL policies often exclude these exposures:
  - Asbestos abatement operations.
  - Radioactive matter.
  - Claims arising out of the insured's products.
  - Damage to sites owned by or leased to the insured.
  - Professional liability.

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CGL/CPL Combination Policies

- A CGL/CPL combination policy combines a CGL policy with a claims-made or an occurrence-based CPL policy.
  - Originally designed to provide seamless CGL and environmental coverage for environmental remediation contractors.

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Asbestos and Lead Abatement

- Asbestos and lead abatement contractors general liability policies.
  - Essentially a CGL policy that amends the pollution exclusion, deleting asbestos from the definition of pollutants.
  - Usually includes defense costs within the general aggregate limit.
  - Deductibles are typically higher than those found in most contractors' CGL forms.

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Professional Liability Policies

- Environmental professional errors and omissions (E&O) liability policies.
  - Resemble the coverage of traditional engineers' professional liability policies.
  - Do not contain pollution exclusions.
  - Written on a claims-made basis.
  - Usually subject to a retroactive date and a substantial deductible.

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Professional Liability Policies

- Professional liability/CGL/CPL combination policies.
  - Can save the insured premium dollars.
- Combines components of:
  - Environmental professional E&O liability insurance.
  - CGL insurance.
  - Contractors pollution liability insurance.

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Practice

- C&C Factories has a factory that is adjacent to a fuel storage facility. They are concerned about potential liability from any pollution that may occur from the underground storage tanks on the adjacent property. Which of the following would be the most appropriate policy to mitigate this loss exposure?
  - A. Remediation stop-loss policy.
  - B. Site-specific environmental impairment liability policy.
  - C. Property transfer policy.
  - D. Underground storage tank (UST) compliance policy.

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Practice

- ABC Company is considering the purchase of a large tract of land in Texas. ABC Company has been made aware of the need for some environmental clean-up of the property after the purchase. The costs of the clean-up are unknown and cannot be precisely estimated at this time. Which of the following policies would be most appropriate for ABC Company to purchase to cover clean-up costs in excess of preliminary estimates?
  - A. Contractors pollution liability policy.
  - B. Property transfer policy.
  - C. Site-specific environmental impairment liability policy.
  - D. Remediation stop-loss policy.

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