

# Commentary

## Developer's Toolbox: Environmental Insurance

*by David A. Ossentjuk*

Environmental insurance policies are an increasingly common component of many real estate transactions. The reasons for this are simple: land available for development is becoming scarce. Former industrial and oil-producing properties are attractive sites for commercial and residential "in-fill" development. Given the enormous liabilities that can arise from environmental problems, the traditional indemnities between buyer and seller often cannot provide either party, or their lenders, with adequate peace of mind. Sometimes an insurance policy underwritten by a high quality carrier can provide the comfort level necessary to close the deal.

Prior to the events of September 11, 2001, the cost of environmental insurance had been dropping in recent years, primarily because of increased competition as more companies entered the market. The carriers have become more sophisticated in underwriting the policies. They are better able to evaluate properties and determine appropriate risk-based premiums. Changes in regulatory attitudes towards certain types of contamination and cleanup criteria also have enabled carriers to provide more coverage at lower rates. For example, early this year, we assisted a client in obtaining a \$1 million policy with a 5-year term and a \$10,000 deductible on a former gasoline station site. The premium was less than \$25,000. In the wake of the World Trade Center attacks, the costs of all types of primary insurance have increased, primarily because the costs of reinsurance have risen sharply. Environmental coverage is no exception, though there are some carriers who signed long term reinsurance treaties prior to September 11 that are still able to offer environmental coverage at rates close to pre-September 11 levels.

Unlike most standard Comprehensive General Liability policies, environmental policies are individually underwritten and tailored. Prospective policyholders can negotiate the terms and scope of the coverage to fit their needs. There are four basic types of coverage available in the typical environmental policy. A prospective policyholder can choose among the following:

### **1. Pollution Legal Liability Coverage**

This covers the policyholder for claims by third parties arising from the environmental conditions on the policyholder's property. For example, it could apply to a claim by a neighboring landowner that soil or groundwater contamination on the policyholder's property has migrated onto the neighbor's property. It could also cover personal injury or so-called "toxic tort" claims arising from alleged contaminants on the policyholder's property.

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## **2. Remediation Legal Liability Coverage**

This is coverage for the cost of complying with an order from a governmental agency requiring the policyholder to investigate and remediate contamination on, or originating at, the policyholder's property. Coverage usually is limited to the cost of complying with governing environmental regulations. The carrier will pay to clean up the property to the prevailing legal standards, but no more.

## **3. Legal Defense Expense Coverage**

This is coverage for legal expenses incurred by the policyholder in defending itself against claims covered under either the Pollution Legal Liability or Remediation Legal Liability provisions in the policy. Unlike many commercial general liability policies, which obligate the carrier to pay legal defense costs over the coverage limits, legal defense cost coverage in most environmental policies is limited to the amount of coverage purchased.

## **4. Remediation Stop Loss Coverage**

This is cost overrun coverage for situations where the policyholder is performing remedial work on its property. The insurance applies to costs incurred in excess of a self-insured retention, which usually is set at about 110% of the estimated cost of the remediation.

In California, most environmental coverage is presently written by "non-admitted" carriers. Carriers and brokers explain the absence of "admitted" carriers in the California environmental insurance market is based on the difficulty in obtaining approval for standardized policy documentation by the Insurance Commissioner. Only non-admitted carriers have the flexibility to customize coverage. There is some merit to this explanation. However, we expect that admitted carriers will begin to write more environmental coverage in California as the marketplace continues to mature.

Environmental policies are not the "be all and end all" for every sale on impacted property. There are some deals where the costs are too high or the risks are too remote. But, these policies can sometimes be the deciding factor in whether a deal "pencils" or not.

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