Brownfields and Green Insurance

Developing and transferring real estate in the new millennium

By John G. Nevius, Esq., PE

Brownfields, strawberry fields, elysian fields — who cares? You should if you will ever be involved in the purchase or sale of land that has not always been part of a wilderness preserve. Even "virgin" agricultural land may be contaminated by pesticides, weed-killing herbicides, concentrations of animal waste or petroleum from underground storage tanks used to fuel farm machinery.

Brownfields are Everywhere

What's a property owner or buyer to do? Take advantage of an idea that has found new currency in these days of "compassionate environmentalism." Brownfield programs streamline government review and are designed to encourage reuse of land that may be contaminated, in part, by addressing the fear of uncertain, overly strict or prolonged regulatory requirements. The Bush administration has doubled the federal budget for fiscal year 2003 — from $98 million to $200 million — to assist state and local efforts to revitalize brownfield sites.

What are Brownfields?

"'Brownfield sites [generally] means real property, the expansion, redevelopment or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant or contaminant."

Public Law 107-118 (H.R. 2869) — the recently enacted "Small Business Liability Relief and Brownfields Revitalization Act" went into effect January 11, 2002 (the "Act"). This is virtually identical to the definition found in the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA" or "Superfund"). Sites with more serious environmental problems currently subject to specific CERCLA activity or other environmental requirements generally cannot qualify for brownfield programs, in part, because CERCLA and the remedies often imposed thereunder, are not geared to addressing redevelopment of significantly contaminated property as commercial real estate. The new Act, however, created two new defenses and certain additional exemptions to CERCLA liability, which positively affect brownfield redevelopment, but many issues and potential risks remain.

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A raft of state and federal initiatives have been instituted to facilitate cleanup of these brownfields and minimize the expense and effort of returning to beneficial use the approximately 500,000 to one million contaminated parcels of property that are estimated to qualify as brownfields. It makes good business and regulatory sense to reutilize property that may not be completely clean and green, while limiting future liability by taking advantage of state or federal brownfield initiatives. Brownfield programs vary, but generally allow a seller to obtain in a relatively short time a seal of approval from environmental regulators or, at least, a covenant not to sue over existing environmental conditions. Alternatively (or in conjunction with brownfield redevelopment), various environmental insurance products, such as clean-up cost cap or environmental impairment liability ("EIL") insurance, can be purchased alone or in combination to address known or unknown potential environmental liabilities. Not only can these products provide peace of mind, but they also can facilitate making and finalizing timely business decisions. Of course, historic comprehensive-general-liability and other types of insurance may also be available to provide financing for cleanup and redevelopment.

Sellers of industrial property may have no other choices than to take advantage of government initiatives or emerging

environmental-insurance products because lenders, buyers and the general public increasingly are concerned about the various kinds of potential environmental problems. Lenders and buyers usually demand some form of indemnification as part of any real estate transaction, forcing a seller to stay involved — sometimes for years. Buyers and sellers of property need to know how to avoid liability, ranging from becoming the next multimillion dollar Superfund clean-up site to undertaking the 30 years of monitoring typically required for even minor environmental problems that will not go away, but that can wreak havoc on the most well-thought-out transactions.

Recent Brownfields Legislation

The Act attempts to address the fear of CERLCA liability by lightening the load on small businesses and unsuspecting or unsophisticated land owners. The Act combines two proposed bills, one of which provides funding for brownfield assessment and cleanup and addressed Superfund liability and enforcement issues. This portion of the new brownfields law exempts contiguous property owners and prospective purchasers from Superfund liability, and clarifies what sort of due diligence inquiries are required of those seeking to qualify for exemptions from liability as "innocent landowners." This portion of the Act also provides funding for state Superfund programs and limits federal enforcement authority at sites already addressed under a state program.

The second proposed bill, known as the "Small Business Liability Protection Act" exempts so-called "de-micromis" or minimal generators of hazardous substances (no more than a total of 110 gallons or 200 pounds) from liability for Superfund response costs at Superfund sites unless the amounts disposed of were a significant cause of the costs incurred. This portion of the Act also exempts household, small-business and not-for-profit generators of municipal waste with fewer than 100 full-time employees from Superfund liability and provides for expedited CERCLA settlements with entities that qualify based on a limited ability to pay. This exemption, however, does not apply to municipalities or to municipal wastes that significantly contribute to the response costs incurred. Thus, the Act goes a long way toward providing the regulatory relief advertised, but does not come close to eliminating environmental insurance as an important component in many brownfield redevelopments.

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Getting Started

How to get started? Many consultants will assess environmental conditions for a fee and provide other services, including navigation of the brownfields process and referrals to insurance brokers. Often, however, considerable information is available for free from state and federal environmental agencies, databases maintained under various environmental laws and Web sites. A Freedom of Information Act (FOIA) request can be used to obtain a wealth of data on historic activities and potential problems at a site. Similarly, environmental regulators can be good sources of information on the best and most effective ways to take advantage of brownfield initiatives.

Brownfield programs often are designed to pay for themselves by taking in "oversight" costs to review and evaluate proposed work plans and the resulting environmental reports from property owners that apply under these programs. In addition, brownfield programs address potentially hazardous environmental conditions and also are designed to return previously unproductive property to local tax rolls and productive use thereby relieving development pressure and creating jobs. Therefore, not only are these programs popular with government officials because they can generate revenue, they also reflect well on government by encouraging environmental protection and business development (by, among other things, providing substantial tax incentives to brownfield developers). For these reasons, state and federal employees generally are very enthusiastic about working with potential brownfield-program applicants and can provide valuable information on how to apply, what to expect and how to prepare a successful application package.

Environmental Insurance

Similarly, insurance companies that traditionally have shied away from any "environmental" risks with the advent of asbestos and hazardous-substance liability, now believe they have a better handle on underwriting these risks and see a business opportunity. Certain companies are even marketing emerging environmental insurance products to the U. S. Environmental Protection Agency (EPA). One company has signed on as a party to a complex Superfund clean-up agreement with the state of California involving an insurance policy purportedly providing more than $300 million in coverage for clean-up costs and potential cost overruns over a 30-year period.

Most explicitly "environmental" insurance contains standard-form provisions and is "claims-made" in that it only provides coverage for a limited time. Thorough investigation, full disclosure and strict adherence to standard provisions, including providing notice, are essential where insurance is used to address risks associated with existing environmental contamination. In purchasing insurance to cap clean-up costs, "pre-fund" clean-up obligations (aka, "finite risk"), address the risks of: remedy failure; contractor errors or omissions; changing environmental standards and regulations; natural resource damage assessments; or off-site transport and disposal, etc. Policyholders and other environmental stakeholders (e.g., state and federal governments, contractors) may be subject to unexpectedly stringent review of costs and decision-making by an insurance company. In addition, changes in site conditions or the discovery of new contamination may not be covered or may lead to costly and time-consuming coverage disputes. Diligence in investigating environmental conditions before purchasing these types of insurance and qualified advice in obtaining, negotiating and making timely claims under these types of insurance policies also are essential.

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Several companies also sell simpler environmental insurance policies designed exclusively to indemnify lenders with respect to property where there is little or no expectation of environmental liability. These types of insurance policies may reduce the time necessary to obtain financing, allow buyers to lock in interest rates and can obviate the need for environmental assessments under certain circumstances. No matter how environmental risks appear to be transferred via insurance, however, there is no substitute for traditional due diligence in investigating environmental conditions. In addition, lender-only coverage may be penny-wise in the short term, but pound-foolish for property owners in the long term when: environmental liabilities crop up, the bank is the only one indemnified and the deal goes sour.

The recent enthusiasm on the part of insurance companies for new environmental insurance products also has at least two benefits to the potential environmental insurance consumer: 1) insurance companies may be more flexible in working with buyers, sellers, lenders and regulators to address unique factual circumstances and negotiating policy terms and conditions; and 2) in order to develop future business and maintain or increase market share, insurance companies offering these products may be more likely to pay the inevitable claims.

Conclusion

Whether you are dealing with environmental regulators or insurance underwriters, do your homework and disclose everything you know about the real estate involved, including any and all environmental assessment reports. Failure to do so may result in voiding covenants not to sue or insurance-coverage provisions.

Real estate has almost always been seen as a good investment because "they are not making any more of it." Often, the most attractive locations for development involve land with a history of intensive use. It is impossible to reduce potential environmental liability to zero, but brownfield programs and environmental insurance are two more recent and promising ways of managing future risks and allowing business deals involving real estate to proceed with an added measure of assurance for all of the stakeholders involved. EP

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