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Brownfield redevelopment: A new funding alternative

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Developers with experience redeveloping contaminated sites, or "Brownfields," may be aware of the adage that no good deed goes unpunished.

Their efforts to make productive use of otherwise unusable property may run up against hard reality. That is, cleanup and related costs may be so high that they render redevelopment efforts financially impractical.

It was reported that Toll Brothers recently walked away from a $5.75 million down payment on a promising site along Brooklyn's infamous Gowanus Canal. The Canal's designation as a Superfund site was hailed by some, but was apparently the cause of Toll's decision to shelve its proposed 477 unit mixed-income housing development. The Gowanus property just sold with a 35% discount in the price by some estimates.

The good news is that there may be both public and private assistance available to reduce the cost of cleanup and future risk associated with the redevelopment of Brownfield sites in New York City.

The Mayor's Office of Environmental Remediation recently announced the Brownfield Incentive Grant Program (BIG), intended to encourage the redevelopment of Brownfield sites. BIG offers grants and technical assistance services up to $100,000 for various stages, from information gathering through environmental investigation and cleanup.

Another often overlooked source of potential funding is historic liability insurance.

Where the pollution or contamination dates back to when the property was covered by insurance, old comprehensive general liability insurance policies may be prove valuable — even if property ownership and related corporate succession are complicated.

Photo: California EPA

Corporate successors in the chain of property ownership that may be to subject to environmental liability may also be able to tap historic insurance coverage, especially when the insurance was originally purchased by predecessor owners to cover unknown liability, such as Superfund clean-up obligations.

These policies generally pass via corporate succession or express transfer or sale rather than through transfers of title to the property.

One caution: compliance with BIG and similar Brownfield incentive programs can jeopardize insurance coverage.

Most liability insurance policies include a "voluntary payments" clause, typically stating that, "the insured shall not, except at his own cost, voluntarily make any payment, assume any obligation or incur any expense other than for first aid to others at the time of the accident."

Insurance companies may invoke the failure to comply with this condition when it comes to today's "voluntary" clean-up programs as a basis for denying coverage.

There are effective ways to address these issues. First, it is essential to keep the lines of communication open with an insurance company once historic coverage is located and notice of a potential claim has been provided. Even then, insurance companies are primed to deny coverage on other grounds.

However, given sufficient advance notification, certain insurance companies may waive or agree not to assert a voluntary payments defense with respect to specific actions — for example, if the insurance company values its customer and believes the potential payment or settlement to be reasonable.

Obtaining this level of cooperation and responsiveness generally requires carefully tailored communications as well as an appropriate level of candor when informing the insurance company of the potential for exponentially larger liability if a final agreement to pay for cleanup cannot be reached. Ultimately, it may also require litigation.

Coordination and candor with the appropriate government authorities may also assist in avoiding denial of coverage under any "voluntary payments" clause. Voluntary payments clauses generally have been interpreted to mean that liability is only covered where it is involuntarily assessed.

Given the public interest in promoting remediation, and to avoid the problem posed by such clauses, government representatives have been known to cooperate in documenting that clean-up is not really voluntary. In fact, some jurisdictions recognize that the existence of environmental laws alone is sufficient to give rise to covered "liability because of property damage."

In these jurisdictions, the voluntary payments clause should not be an issue. In other circumstances, it may pay to work with environmental regulators to document required clean-up obligations more formally.

A more formal legal agreement can be an effective way to address many concerns, including potential insurance defenses. In the insurers' view, voluntary payment provisions are intended to prevent prejudice to the insurance company by keeping them in the decision-making loop. However, if coverage was (or would have been) denied for another reason, no prejudice can be shown. In the absence of any prejudice, most exclusions should not apply.

To avoid pitfalls in obtaining funding, Brownfield developers need to carefully coordinate funding sources with the appropriate legal authorities as well as with historic liability insurance companies. A properly coordinated effort will help to maximize the resources available for cleanup — and this may well be a deciding factor in orchestrating a successful Brownfield deal.