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What's New in the Real Estate Field(s)?

By: John G. Nevius

Brown fields, 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.

What Are Brownfields?

What's a property owner 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. What are Brownfields?

> "'Brownfield site' [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 "Small Business Liability Relief and Brownfields Revitalization Act" effective January 11, 2002. This is virtually identical to the definition found in CERCLA/Superfund, although sites with more serious environmental problems currently subject to specific CERCLA activity or other specific environmental requirements generally cannot qualify for Brownfield programs.

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, various environmental insurance products such as clean-up cost cap or environmental impairment liability ("EIL") insurance can be

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Insurance Coverage for Zero-Sum and Other Net Settlements in Construction Defect Litigation

By: Robert E. Frankel

Architects, engineers, contractors, and others in the construction trade profession are sometimes involved in disputes with their clients (who, for purposes of this article, are referred to as the "owners") concerning allegedly defective construction. These disputes can involve claims of strict product liability, breach of warranty, and negligence, including professional negligence. Often, the owners withhold payment of moneys owed to these building professionals until the defective construction disputes are resolved.

Are Zero-Sum or Other Net Settlements Covered "Damages"?

These construction defect claims are generally covered under various types of liability insurance policies, including comprehensive general liability, professional liability, or errors and omissions insurance policies held by the building professional. An interesting issue arises when the insurance company refuses to defend its policyholder in an action

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involving a construction defect claim that is arguably or potentially covered, and without insurance company participation the parties enter into a settlement agreement in which the building professional agrees to forego a claim it has against the owner for unpaid fees. Is the entire settlement, including the portion representing the unpaid fees that are waived by the settlement agreement, covered under the building professional's relevant liability insurance policy?

The question presented involves two types of settlements. First, a "zero sum settlement" results if no money changes hands in the settlement because the parties value the policyholder's claim for unpaid fees equally with the owner's claim. Alternatively, an "other net settlement" results if some money changes hands in the settlement, but the amount of money that changes hands is less than the value of the owner's claim because the parties value the owner's claim as greater than the policyholder claim for unpaid fees.

The Zero-Sum Game Played by Insurance Companies

The insurance coverage analysis is the same regardless of the type of settlement. Insurance companies have universally treated such zero-sum and other net settlements as a zero-sum game, to which it refuses to be the net economic loser. In particular, insurance companies typically take the position that the waiver of unpaid fees is not covered because it represents the outlay of no new value.

However, such settlements should be fully covered because there is no functional difference between paying cash or foregoing a valid contract right. In fact, the few cases that have addressed the issue have unanimously determined that the portion of a settlement constituting the waiver of the unpaid fees or a valid contract right is covered. Despite the unanimity of result in the reported decisions, insurance companies continue to take the position that such unpaid fees are not covered, arguing that the settlement of unpaid fees is excluded from the definition of damages, that the settlement represents a collusive attempt by the policy-

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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.

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 thirty 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.

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. Often, however, considerable information is available for free from state and federal environmental agencies and databases maintained under various environmental laws. A Freedom of Information 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. 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. For these reasons, state and federal employees generally are very enthusiastic about working with prospective 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 such risks and see a business opportunity. Certain companies are even marketing emerging environmental insurance products to the United

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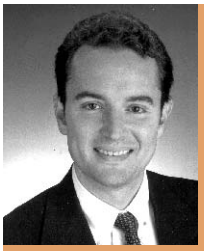
States Environmental Protection Agency. One company has signed on as a party to a complex Superfund clean-up agreement with the State of California. Several companies also sell environmental insurance policies designed exclusively to indemnify lenders and that may reduce the time necessary to obtain financing and allow buyers to lock in interest rates.

These types of insurance policies also 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. Qualified technical and legal advice is essential. Anderson Kill & Olick, P.C. made its reputation, in part, on addressing environmental liabilities. Contact us and find out more. ■



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holder, with the assistance of its client, to obtain an unwarranted insurance recovery, or that the settlement is unfair or unreasonable.

Non-Collusiveness

First, the insurance company might argue that the settlement is collusive or that the definition of "damages" excludes claims for unpaid fees. These arguments are related. The liability insurance policies generally define "damages" as any amount that a policyholder is "legally obligated to pay" for any covered claim, including judgments, settlements, and interest on judgments. In some professional liability insurance policies, "damages" may expressly exclude the "return or withdrawal of professional fees." This provision has been construed to prevent a policyholder and its client—the claimant—from colluding and obtaining an unwarranted insurance recovery. Thus, as long as the settlement is not a collusive effort by the policyholder and its client to extract the payment of unwarranted fees from the insurance company, the "withdrawal of fees" exclusion should not operate as a bar to insurance coverage for the portion of the settlement that includes the waiver of the unpaid fees.

Fair and Reasonable

Additionally, the insurance company might argue that the settlement is unfair and unreasonable. The rules are relatively clear, although they may vary slightly depending upon the jurisdiction whose substantive law is deemed to govern the insurance coverage controversy. In particular, an insurance company that breaches its duty to defend bears the burden of proving that the claims that were settled were outside the policy's coverage. If the insurance company fails to meet this burden, the insurance company is liable for a fair and reasonable settlement.

Thus, zero-sum and other net settlements should be fully covered. Accordingly, as long as the settlement is fair, reasonable, and non-collusive, the agreement to forego the collection of fees should be recoverable under the indemnity provisions of the relevant liability insurance policy. ■

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