36th Annual Environmental Superconference
"Happy Days"

Environmental Insurance

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Marsh

Earth & Water Law LLC
SOLUTIONS FOR BUSINESS AND THE PLANET

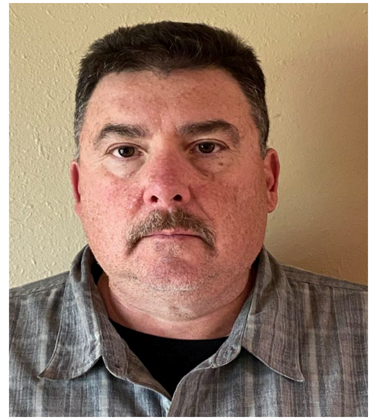
HAYNES BOONE

Introduction

Panelists:

Lindene Patton
Insurance Transactional Attorney,
Earth & Water Law

Andrew Van Osselaer
Insurance Coverage Litigator,
HaynesBoone



James Vetter
Managing Director,
Marsh

Topics:

- Insurance Basics & Insurance Claims – *Andrew Van Osselaer*
- Today's Insurance Market – *James Vetter*
- Integrating Insurance into Business Transactions – *Lindene Patton*

Coverage Basics: Policy Overview

First Party Versus Liability Coverage

General Liability (GL)

- Insures against liabilities due to bodily injury and property damage
- "Occurrence-based" coverage
- Since 70s, have pollution exclusions (more to come)

Property Policies

- Insure against losses to the insured's property
- Business interruption coverage
- All risk versus named peril
- Pollution exclusions (and/or haz. substances exclusions)

Pollution Liability

- Covers liabilities arising out of pollution events
- "Claims-made" coverage

Comprehensive Pollution

- Includes pollution liability
- Includes property component, first-party cleanup component, and often business interruption

Coverage Basics: Policies are Contracts; Extra-Contractual Relief

Policies are Contracts

- Insurers have no authority over whether a claim is covered.
  - *In fact, policy ambiguity is construed in favor of the policyholder.*
- The remedy for disagreement is a breach action (or a DJ).
- State law determines what the policy means, like any contract.
  - *Choice of law is therefore critical in many insurance disputes.*

Extra-Contractual Relief

- Most states award attorney’s fees to successful insureds.
- Many states have bad faith statues—often allowing 3X damages.
- Most states require insured to prove breach before bad faith.

Texas

- Attorney’s fees for success in breach claim
- Bad faith = Up to 3X damages
- 18% pre-judgment interest for first-party claims (which includes unpaid defense costs)

Coverage Basics: Pollution Exclusions

Insurers' response to surge in environmental claims in 60s and 70s.

Mid-1970 – Qualified Pollution Exclusion

- Excludes pollutant releases unless they are "sudden and accidental"

1980s – Absolute Pollution Exclusion

- No "sudden and accidental" exception
- Release must occur under one of a laundry list of locations and circumstances
- Often construed to require injury due to the pollutant

1990s – Total Pollution Exclusion

- Less universally deployed, unlike absolute exclusion
- Removes laundry list requirements
- Sometimes construed to apply when injury is due to the pollution <u>event</u>

A Schism in Scope – Choice of Law is Critical.

- **Camp 1:** Only applies to traditional environmental contamination – air, water, land
- **Camp 2:** No such limitation; "pollutant" construed broadly – *e.g.*, furs ruined by smell of curry from neighbor
- **Camp 3 (the Indiana Rule):** "Pollutant" is ambiguous and therefore has no meaning.

Coverage Basics: Accident Neither Expected Nor Intended

Sometimes framed as a common law issue—the concept of fortuity

Other times based on policy language:

- "*This policy covers occurrences that are **neither expected nor intended** from the perspective of the insured.*"
- *"Occurrence means an **accident** resulting in bodily injury or property damage, including repeated exposure to conditions."*

In most states, the focus is the injurious result; not the conduct.

- E.g., intentionally driving a car and negligently causing a crash poses no issue.
- E.g., negligently designing a product with features leading to injury.

Some courts/jurisdictions, however, have focused on the intentionality of the act—at least when the court deems the result highly certain.

- This theory has reared its head frequently in **climate change** coverage litigation, including recently in Hawaii (*Aloha Petroleum*).
- **Insurer argument:** The knowing emission of greenhouse gasses is sufficient even if the insured did not <u>subjectively</u> know it would lead to climate change.
- Many have concerns this reasoning is a slippery slope, allowing courts to find no coverage for negligence when they feel the insured was particularly negligent.

Claim-Handling Pro Tips

Don’t assume no coverage!

- Policies are governed by their terms, not extemporaneous notions of what they “should” cover.
- Consider a quick policy review by coverage counsel, but at least ask your broker.

The Duty to Defend is Broad!

- In the vast majority of states, it takes only one covered theory of liability to create the duty to defend all claims.
- Do not assume because you believe a resulting liability will not be covered, there is no duty to defend.

Choice of law

- Policies are construed under state law.
- Underwriting: Consider it; Claims-handling: Determine best options.

Notice and proof of loss deadlines

- No benefit in waiting: Notice quickly and document losses.
- Pre-claim: Provide notice of circumstances.
- Rely on broker (or counsel) to determine notice requirements.
- Some policies have strict requirements (nearly always for claims-made policies). These may be conditions precedent to coverage.

A Simple Way to think about it policies…

Unknown Pollution Conditions	Known Pollution Conditions	Green Projects
Contractors Pollution Liability (CPL) Pollution Legal Liability (PLL) Excess of Indemnity Products Pollution	Cost Cap Environmental Liability Buyouts Asbestos Claims	45Q Inflation Reduction Act

Pollution Legal Liability

Core Coverages (new and pre-existing)

- Cleanup
  - *On Site*
  - *Offsite*
- 3rd Party BI-PD
- Natural Resource Damages
- Blanket coverage possible:
  - *NODS*
  - *DIVESTED PROPERTIES*

Program Basics

- 10-year term maximum
- Market Limits:
  $200 MM and higher
  Most primary layers are $10MM to $25MM
  Excess layers can be applied for additional capacity

Applications

- Transactions
- Brownfields
- Operations.

Market Conditions for PFAS

- In short: challenging but still possible
- Some pollution carriers are excluding PFAS for all classes of business due to current / anticipated claim activity and pressure for reinsurers
- Beazley excludes for all risks in NJ
- Many carriers will take a nuanced approach with the right underwriting data and discussion.
- Even if full coverage is not available, we may be able to get coverage with limited restrictions:
  - *Sublimits for Cleanup Costs*
  - *Per Claimant Deductible for Third-Party Bodily Injury Claims*
  - *Government-Mandated Trigger for PFAS Cleanup*
  - *Voluntary Site Investigation for PFAS*

Excess of Indemnity Insurance:
A Counter Party Solution for M&A

What it covers

- Performance failure of **indemnitor** related to environmental indemnity obligations for pollution conditions
  - *Typically, PLL risks like unknown pre-existing pollution conditions*
  - **Most importantly**: can cover KNOWN pollution conditions requiring cleanup

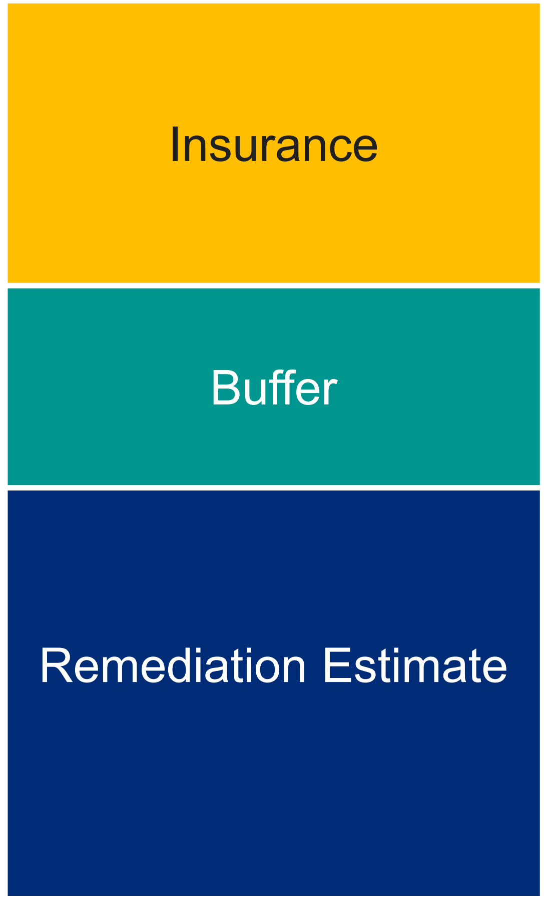
Insurers: limited but sufficient number

Maximum term: 10 years

Remediation Stop Loss (Cost Cap)

Manages Cleanup Cost Overruns:

- Extent of contamination
- Unidentified contaminants (with PLL)
- Increased time for remediation (capital implementation and O&M)
- Changes in Cleanup Standards
- Governmental change in cleanup requirements



Environmental Liability Buyout

- Companies core competencies are products they create or the services they provide.
- A frictional cost of business is managing environmental cleanup projects, including
  - *Cleanup cost uncertainty*
  - *Potential 3rd Party claims*
  - *Management time*
  - *Legal costs*
- Instead of bearing this burden, companies can do an Environmental Liability Buyout
- This solution contractually shifts the obligation from the company to the buyout company in exchange for a one-time payment. Transfer is in-perpetuity
- Commonly done with M&A, Reorganization (e.g. power plants), bankruptcy, Balance Sheet cleanup

Owner → **Buyout Company**

Environmental Liabilities

- **Cleanup**
- **3rd Party Bodily Injury**
- **3rd Party Property damage**
- **Legal defense Expenses**

Carbon Sequestration 45 Q Tax Credit Insurance

- 45Q Tax Credit bolsters/de-risks projects for Carbon Sequestration Projects for investors and project owners.
- Risks for a tax credit carve back (3-year claw back period):
  - *an impermissible leak of CO2 into the atmosphere.; or*
  - *the owner cannot demonstrate the amount claimed has actually been sequestered.*
  - *Error by Geologist/Engineer in original estimates*
- Coverage basics:
  - *10 years from binding with ability to extend annually to eventually provide for 15 years of coverage (12 years of credits plus the three-year recapture period)*
  - *$250K to $500K SIR*
  - *Tax Credit carve Back amount*
  - *Business interruption*
- Exclusion for negligence of the sequestration party.

IRS Direct Pay Tax Insurance- the Inflation Reduction Act

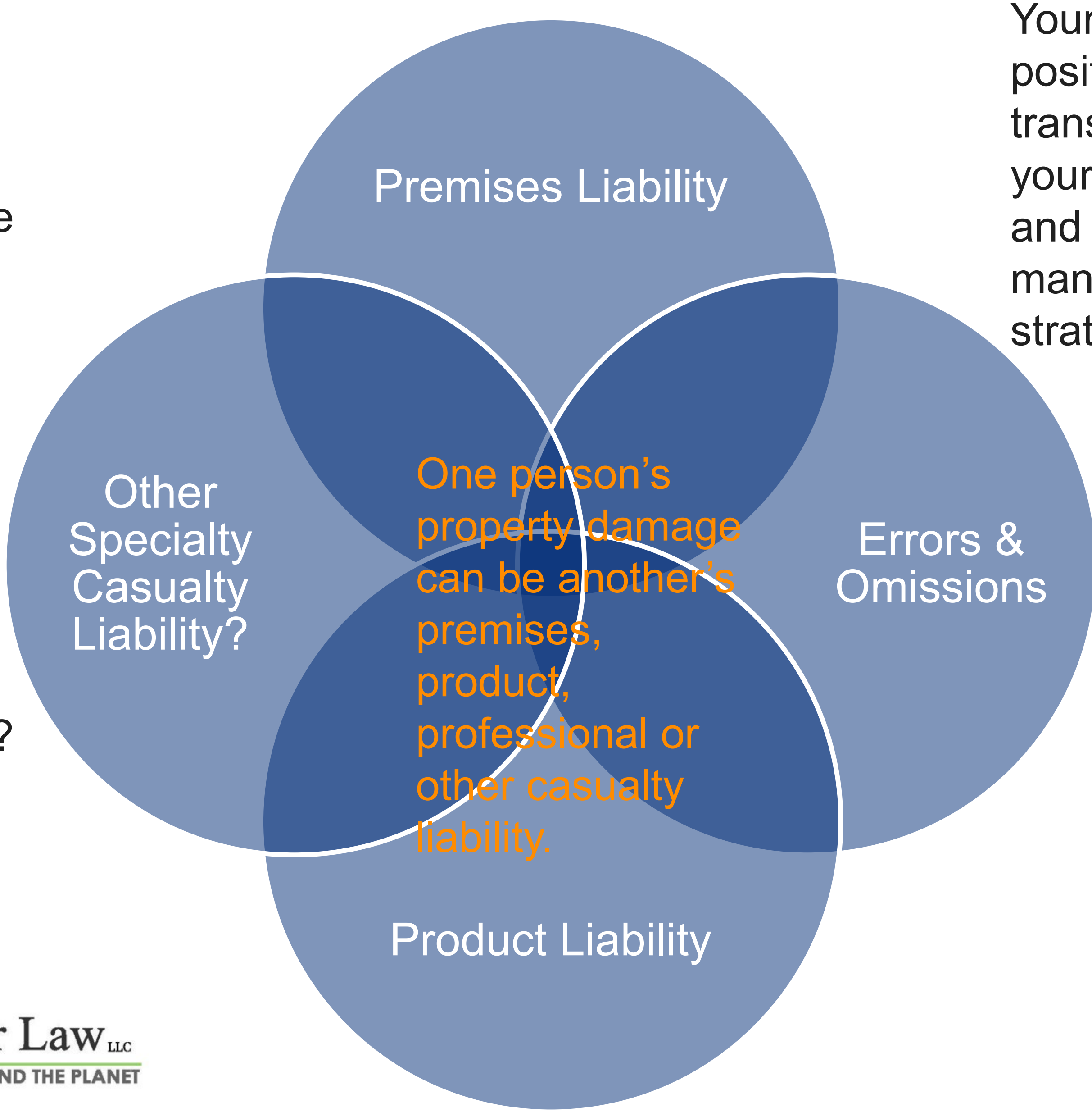
- Low carbon/green energy initiatives often rely heavily on tax credits for viability.
- The "inflation reduction act" allows for direct payment in lieu of a tax credit.
- Direct Payment enhances capital access and full monetization of the benefit without a discount.
- Is now available to a broader range of renewable energy sources, including stand-alone battery storage, renewable natural gas, dynamic glass, and green hydrogen.
- However, here is a risk that the tax benefit could be reduced or eliminated following a successful IRS challenge (a tax credit adjustment)
- And the risk of the adjustment falls on the Direct Pay Eligible Entity ("DPEE")
- Tax insurance can cover "Loss" in the Event of a Tax Credit Adjustment:
  - Traditional: "Additional Taxes" (i.e., lost tax credits), interest, any applicable penalties, a gross up and contest costs.
  - Other: interest on any bridge loan can be included with the definition of "Loss" where such interest accrues as a result of repayment being delayed as a result of the Treasury not paying the direct pay amount in full
- Benefits and Beneficiaries
  - de-risk the Developer/Sponsor's contingent balance sheet exposure
  - Secure commitments from capital providers

Integrating insurance into Business Transactions

Premises, products, D&O and “other liability” should all be considered in transaction wording

Can pollution…

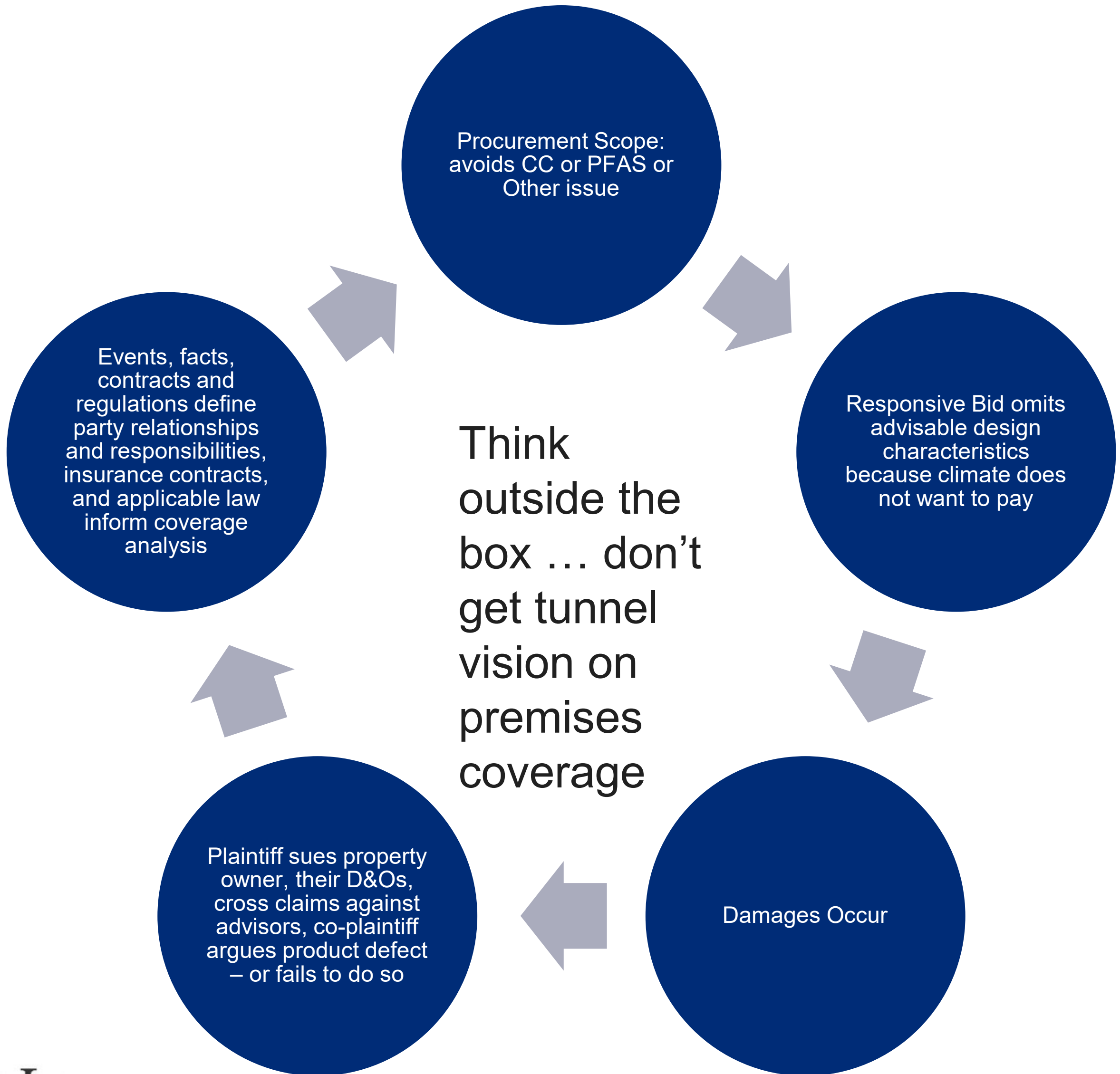
1. Come from your property?
2. Can your decision, advice or omission cause pollution?
3. Can your product cause pollution?
4. Is it a single product or many (e.g. batch process)?



Your role and position in the transaction dictates your potential liability and risk management strategy.

Single Event, Multiple Causations, Multiple Liable Parties

True for Single Sites and Mass Torts



Questions:

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