

The Environmental **Advisor**

Environmental Division / Great American Insurance Group

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Divisional President,
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Welcome to the latest edition of
the Environmental Advisor.

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Improving financial forecasts hopefully indicate that the economy has turned the corner and is heading into a durable recovery. A welcome rebound in the real estate and housing sectors will ultimately include renewed interest in the redevelopment of contaminated properties and Brownfield programs.

In this edition of the Environmental Advisor, we will explore some of the unique issues associated with real estate property redevelopment, purchase and sale agreements for real estate transactions, and recovery of distressed assets. Environmental insurance and risk management can be utilized as part of value optimization strategies in all of these scenarios.

Hope you find the articles interesting.

John Reynolds

Brownfield Programs and Great American



Pete Pantalone,
Vice President –
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Effective January 20, 2011 Great American Insurance Group has been designated a Selected Insurance Carrier for the Massachusetts Brownfields Redevelopment Access to Capital (MassBRAC) Program. Great American is excited to be part of this program, which demonstrates our continued support to the Brownfields community.

MassBRAC was created in 1999 by the Massachusetts Business Development Corporation (MBDC) to provide subsidies to Brownfield redevelopment companies to assist in the purchase of environmental insurance in the hope that increased use of environmental insurance will assist in quicker redevelopment of regional Brownfield sites. Since 1999, MassBRAC has enabled more than \$4 billion of investment in the cleanup of 347 contaminated sites. The subsidy level for private owners/developers is 50% of the insurance premium up to a maximum of \$50,000. The subsidy level for public and quasi-public entities is 50% of the insurance premium up to a maximum of \$150,000. An important condition of the subsidy is that the funds are only to subsidize an insurance program for a maximum five year

policy term and only for “historical conditions” coverage. If the insured wishes to purchase a policy longer than five years or a policy offering “new conditions” coverage, the subsidy will only apply to the portion of premium attributed to five years of “historical conditions” coverage. There are four primary requirements to meet eligibility for this subsidy:

1. The property being insured is located in Massachusetts;
2. The property is designated by the MassBRAC Program as a “Brownfield”;
3. A “Qualifying Loan” is being used to fund some other aspect of the project; and
4. The property to be insured is being purchased, developed or redeveloped, in connection with the purchase of the insurance.

When Great American quotes an account that meets the MassBRAC requirements, we will be adding a specific “MassBRAC endorsement” that contains key enhancements that have been pre-negotiated for all eligible accounts.

This marks the second state-sponsored Brownfield insurance program that Great American has participated in. Great American is also an approved insurance carrier for the Ohio Voluntary Action Program (VAP) Environmental Insurance Program. This program allows VAP volunteers to obtain Pollution Legal Liability Insurance at a 10% discount off the standard premium cost. Additionally, effective on January 1, 2011, the Ohio EPA will also be granting a \$10,000 to \$15,000 subsidy to any volunteer purchasing environmental insurance. The program also includes a pre-negotiated endorsement specific for the Ohio VAP Program. Participating volunteers must submit their application and all technical documents to the Ohio EPA, at which point, the Ohio EPA will issue a technical assistance comment letter. The letter will identify if the project has met certain requirements of information needed for the insurance carriers to properly underwrite the risk. All these items are then sent to the insurance company, through their broker, for individual negotiations.

Brownfield Claims Require Special Handling



Bill Hoffman, Esq.
Vice President
and Senior
Claims Counsel

Unlike most traditional claims, there is an immediate and magnified sense of urgency regarding the management of environmental claims. Environmental claims tend to have significant involvement of multiple layers of federal, state and local regulatory agencies charged with the oversight of environmental affairs and some of the most complex of these claims are those confronted during site development of a contaminated or Brownfield property. Given the nature of such claims, it isn't surprising that a growing number of development companies, public agencies and lending institutions recognize the need for, and often times require environmental coverage be placed with a carrier that demonstrates proactive claims management. Prompt and comprehensive claims handling, bringing to bear dedicated and sophisticated environmental

and legal expertise is what we do at Great American and is essential when dealing with complex environmental claims.

Brownfield redevelopment is a voluntary undertaking by the private sector, in partnership with government, which focuses on converting what used to be prime real estate from an idle, polluted state into a cleaner, useful and potentially profitable condition. By definition, then, the process of such redevelopment poses a number of risks not ordinarily encountered in traditional real estate development. Most companies involved in this business are sensitive to the need for strict due diligence to determine a property's condition before the transaction is final. However, there is always the risk that an unknown environmental condition could be discovered later during the course of the project.

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Or sometimes the risk is known, but the extent of the contamination is a surprise. Any one of these circumstances can bring a very expensive redevelopment project to a standstill or stall a required property transfer while the remediation process takes place. And while the government may in fact be a partner in the project, if problems develop during remediation, its representatives will not relinquish their regulatory roles merely to facilitate completion.

Managing any environmental cleanup activity is a complex task in which the goal of meeting rigorous regulatory mandates must be weighed against the cost of achieving those mandates. Technical considerations such as the nature of the contamination, the unique characteristics of the site, the future use of the property, the constraints of available remediation technologies and the mandated cleanup levels must be balanced against such "bottom-line" issues such as the cost

of the recommended technology and the time required to achieve regulatory goals. Even a general overview of the nature and extent of contamination can take months to complete. The results of any subsurface investigation are of course subject to wide variations in interpretation by competing experts, regulators and other environmental consultants. Assigning a reliable monetary value to the remediation project and contaminated property damage claims, while objective in methodology, may still end up to be somewhat subjective in result. Remediation costs can be impacted by many variables, but one which has an immediate and expensive impact is the contaminant levels which the cleanup must achieve. Property damage claims are enhanced as a consequence of stigma and diminution in value allegations. Potential bodily injury claims can present complex and unusual exposure scenarios,



requiring quality experts to sort out and understand the science involved, and to address both causation issues and damages. All of these factors can increase the ultimate cost of these claims exponentially. Effective management of complex environmental claims requires specialized legal and technical expertise.

Legal knowledge is needed with regard to issues such as liability, interpretation of statutes and regulations and handling or supervising negotiation efforts with regulatory agencies involved in the claim. Technical expertise is required to understand and guide remediation efforts, and again, to interface with the regulators and the environmental professionals working to remediate the site. Recognizing

and understanding the unique and complex nature of environmental claims is only the first step toward more effective management of such claims. The more important step is translating that recognition into knowledgeable supervision and cost management of the project. Working with dedicated and sophisticated claims professionals – with Great American’s Environmental Division that specializes in handling such risks – is the most effective means of minimizing the impact of these claims.

Distressed Assets, How to Capitalize on Opportunities



Robert Potter,
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As we slowly come out of the recent economic downturn we are seeing lenders lending again, developers developing again and companies finally peeking out from the dark to see what kind of opportunities exist. Some of the opportunities they are seeing are what are generally referred to as “distressed assets”. Some of these distressed assets are large development projects which were funded before the recession but ran out of money since and have been sitting partially developed for the last few years. These midterm projects often represent some of the best values for money today as the receivers are very keen to offload them to a financially viable developer who can complete the project. However there are many risks inherent to these projects which need to be considered, some of which can easily be handled through some basic risk management including, but not limited to, environmental insurance.

The risks of taking on a project which was left incomplete for a number of years are mostly related to how the structure was managed during the project’s downtime. Incomplete structures are

exposed to the elements in a manner for which they were not originally designed. This type of exposure can lead to a number of problems including general degradation of building components and materials, pest infestations, water intrusion and mold. Obviously a building that was already made water tight before the project stalled tends to fare better than one which was exposed to the elements for a few years. The reality is that the building envelope for many of these projects was not completed before construction halted and was not managed well during the downtime, so interested developers should assume the worst and hope for the best.

There are ways to manage this exposure. The best way to start is to perform adequate due diligence before making a decision on the project. Hire some experts in this type of inspection to get into the structure and really get a sense for not just how exposure to the elements impacted the project, but also to how well the first developer was handling the project before it ran out of money. To the extent possible identify any existing construction defects and how exactly the project was impacted by being abandoned. In addition to construction defects it is crucial to understand the nature of any water intrusion issues, including how far into the building they extend, what materials have been impacted and what are the sources and origins of the water. The water and mold can be removed, but if the source remains they will both come back.

While the risks associated with this type of project can be largely mitigated, the long term exposure to risk remains. Many of these projects are residential condominium or apartment projects so there will likely be numerous third parties inhabiting the space once the project is completed. The long term risk for mold to recur despite best practices is still higher than average for these types of distressed asset projects. This is where environmental insurance can be a very effective long term risk management tool. At Great American Insurance Company we have seen a number of these projects and have had much success partnering with developers to help them manage this long term risk and satisfy lender concerns. Coverage can be structured so that it not only protects the developer but also those lending on the project. As lenders are more risk averse today and have tightened

their underwriting guidelines it can be a tough sell for a developer looking for funding on a project that has burned one lender in the recent past. The lender can be added to the policy (or could have their own separate policy) to mitigate their risk and provide enough comfort to allow them to provide the loan. To highlight how this works I will use a specific example of a policy we recently wrote for a distressed asset project where the lender for the new developer was unwilling to lend without some type of backstop to the developer.

The project in question was a three tower multifamily residential project in California. It was roughly 70% complete when it ran out of funding in early 2008. The roofs of two of the three towers were weather proofed but where vertical components such as elevator shafts or HVAC ducts pierced the roofs the prior developer had failed to seal those areas. As such there was water damage and mold surrounding these vertical structures. The roof of the third tower was unfinished and all three towers had sequencing problems where the previous developer had hung drywall and other internal components prior to weatherizing the entire building. There was significant water intrusion, mold, bird droppings and evidence of squatters. There was also a significant amount of abandoned building material that was infested with mold. The new developer hired an expert to assist them with construction defect and water intrusion/mold evaluation. They were able to provide Great American with sufficient data and evidence of how mold and other pollution conditions would be remediated. We put in



place a Contractor Services Environmental policy in an Owner Controlled Insurance Program (OCIP) structure which would cover them not only for mold or other pollution resulting from work they completed after taking on the project, but also for work the prior developer did since they were inheriting all prior liabilities in taking this asset on. The policy was written for a three year term (the duration of the remainder of the project) followed by a period of ten years completed operations to match the statute of repose in California. The lender was added as an additional insured to the policy which enabled the lender to feel comfortable lending on this higher risk project. We also named all contractors and subcontractors at all tiers treating the project as a wrap up. The policy combined with hiring experts and doing thorough due diligence was the solution needed to bring all parties together and restart the project.

When the Indemnity Fails – Insurance as a Back-Stop

Barry Geisler, Esq.
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In these challenging economic times, there are many impediments for those seeking to acquire properties, especially those with potential environmental contamination. Access to capital and stricter lender underwriting standards are often cited as significant hurdles. Increasingly, environmental impairment liability insurance is being required by lenders as a condition of securing financing. In this Article, we will briefly examine how the allocation of liability for pre-existing contamination can be back-stopped with Great American's Premises Environmental Liability (PEL) insurance to satisfy lender obligations and to provide powerful protection for the Buyer (and its lender) from potential environmental liability, including claims for the costs associated with the investigation, remediation and subsequent monitoring of contaminated properties ("Brownfields").

The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), and its subsequent amendments, commonly referred to as the "Superfund" law, imposes

liability upon the current owner of a contaminated facility. 42 U.S.C. § 9607(a)(1). CERCLA does not require a showing of fault or that the current owner contributed to the pollution in any way. Liability automatically attaches where a release of hazardous substances has occurred at a facility that has or will require response costs. Further, CERCLA liability is joint and several. As such, the buyer may be forced to pay for the entire clean-up, even if there are multiple responsible parties. While the Superfund law does contain some defenses, if the buyer is not careful, it may end up acquiring much more than a piece of property, including substantial CERCLA liability and the potential for third party liability arising from bodily injury and property damage. A secured creditor, such as a bank or other lending institution, can also have CERCLA liability under certain circumstances. 42 U.S.C. § 9601(20).



While CERCLA does not permit a party to absolve its liability through a contract, parties are free to allocate the costs associated with such liability through carefully drafted agreements. Typically, a buyer such as a developer or a Real Estate Investment

Trust ("REIT") will require specific provisions in the Purchase and Sale Agreement that identify environmental risks and set forth which side of the transaction will be responsible for such conditions. Examples of these types of provisions include "as is" clauses, warranties, representations and indemnification provisions.

Generally, an indemnification clause will require one party (typically, the seller) to defend and hold harmless another party (typically, the buyer) from any claims arising from

specified conditions. The language of such provisions is diverse and may contain various limitations including monetary caps, time constraints and limits on the scope of covered claims, such as not covering third party bodily injury matters. While the scope and complexity vary greatly, one thing is for sure; they are not infallible. Indemnification clauses rarely take into account possible changes in the regulatory climate or applicable clean-up standards, remain subject to legal challenges and can be limited by common law doctrines and applicable state statutes. In addition, the indemnitor may be unable, for a variety of reasons, to honor its commitment when a problem arises. Perhaps most importantly, even the most carefully crafted indemnity provision is only as strong as the financial support behind it.

How can the savvy buyer gain protection from costly legal challenges, the unforeseen deterioration of the seller's financial condition or from a simple inability or



refusal of the seller to honor its commitment? Great American offers coverage as a back-stop to the indemnity that will respond when the seller does not abide by its indemnity obligation. An Agreement to Indemnify Trigger Endorsement can be utilized to allow the policy's coverage to be triggered only if the indemnitor does not provide the promised indemnity for a claim falling within its contractual obligation. The effect is that the policy's coverage will step in place of the indemnity obligation, protecting the buyer, and thereafter allowing Great American to seek reimbursement from the indemnitor. When structuring a policy in this manner, Great American can even offer coverage for known contamination, something that is rarely available in today's market. In many cases, similar coverage can be offered to the lender.

Each transaction presents its own challenges. Great American's highly experienced underwriting staff and legal support team are uniquely qualified to evaluate the environmental exposures associated with a property transaction and to provide the insured with creative insurance solutions as part of its overall risk management approach. For more information on back-stopping an indemnity with Great American's PEL coverage, please contact your underwriter representative or Doug Stepenosky, Sr. V.P. at 1-888-828-4320 or dstepenosky@gaic.com.

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