Environmental Risks and Insurance Market Place Update

By

David J. Dybdahl, CPCU, ARM

March 2009

Environmental risks are faced by a broad range of organizations. Because environmental losses tend be very expensive and are not captured in traditional insurance applications environmental risks including those posed by fungus and bacteria are usually excluded from traditional property and liability insurance policies. Environmental insurance policies have been designed to fill the gaps in insurance coverage created by pollution and microbial matter exclusions that appear in virtually all forms of property and liability insurance contracts today.

The need for environmental insurance can usually be determined by evaluating the organization's loss exposure to a release of a "pollutant "either directly from their business activities or vicariously through the strict liability cleanup cost recovery provisions in environmental regulations. Environmental insurance was originally developed for companies that generated hazardous wastes or worked to clean it up. The recent introduction of universal fungi and bacteria exclusions into virtually all forms of property and liability insurance has dramatically expanded the need for specially adapted environmental insurance policies.

The environmental insurance market place continues to experience exceptional organic growth rates averaging between ten and fifteen percent annually which is in sharp contrast to the three percent underlying organic growth rate of the traditional property and liability insurance market. The market capacity for environmental insurance on a single risk exceeds two hundred million dollars. Due to the wide diversity of environmental risks and the non standardization of policy forms, well over one hundred different environmental insurance policies are available today.

Although with endorsements there are thousands of potential coverage combinations in the environmental insurance marketplace, there are just a few basic building blocks of the coverage. These are:

Environmental Impairment Liability/ Pollution Legal Liability

Environmental Impairment Liability policies insure specific locations. The EIL policy covers bodily injury, property damage, cleanup expenses and the costs of defense arising from previously undiscovered or newly created pollution conditions at specific (scheduled) sites. The coverage is triggered by the discovery of a release of pollutants that results in a third party claim for damages or clean up costs. The clean-up cost coverage in a EIL policy can be designed to pay based on liability or on a no-fault basis if pollution is identified at the insured location above the level which would require clean up under a regulation or environmental standard.

Contractors Pollution Liability

Contractors Pollution Liability insurance has its roots in the EIL policy. The major difference between an EIL and CPL policy is the CPL policy insures losses that arise out of the negligent specified operations of the contractor as shown on the application in contrast to insuring a particular site. Like the EIL policy the CPL policy covers liability for bodily injury, property damage, clean up expenses and defense costs arising from pollution conditions the contractor creates during work at a job site. These polices can also be used to fill the coverage gaps created by exclusions for asbestos, lead, EFIS and silica which commonly appear in many contractors' General Liability insurance policies.

Remediation Cost Cap

This policy insures cost over runs that may be incurred in the completion of a specified work plan to remediate a contaminated site. In essence the policy works like a performance bond with no recourse back to the contractor for claims made under the policy. The cleanup cost cap policy begins paying the costs of remediation when the actual cost of completing the insured work plan exceeds 110% to 120% of the budgeted amounts. Once the coverage is triggered, the Cost Cap policy will pay the remaining cleanup costs incurred during the policy term, subject to the policy limit.

Professional Liability

Environmental professional services insurance policies are essentially traditional professional liability policies without a pollution, fungi or bacteria exclusion in the policy form.

Package polices

These basic building blocks of coverage can be assembled together or be combined with traditional Commercial General Liability coverage to create package policies. These packages offer many advantages to insurance buyers in cost and coverage and are the fastest growing sector in the environmental insurance market.

Environmental Insurance Innovations

Package Policies

A number of insurance companies now combine traditional General Liability insurance with true environmental insurance coverage options into one package policy. One innovative approach is to combine GL and EIL together and also insure the environmental loss exposure associated with the firms' products. Package polices are better able to seamlessly close the coverage gaps created by the environmental exclusions in the traditional policy forms. They feature coordinated claims adjusting and the economies of shared limits between the coverage parts. For classes of business where a good quality environmental insurance package policy is available, traditional separately purchased General Liability and environmental insurances are likely to become obsolete over time. Package policies are available for a broad range of environmental contractors, manufactures and restoration contractors.

Fixed Price Environmental Remediations

The US Army pioneered this approach in their procurements of environmental contracting services. In order to facilitate fixed cost remediations the Army specifies and cost reimburses Cost Cap insurance as part of the contractors' fixed price bid to remediate a site. By their own calculations the Army has reduced the costs of their environmental remediations 30% to 40% by enabling their contractors to fixed price bid projects without the need to incorporate prepaid environmental contingency funding into their bid. The environmental insurance packages usually combine Remediation Cost Cap insurance to insure cost over runs in completing the insured work plan with Environmental Impairment Liability policies to insure losses arising from previously unknown contaminants at the site.

Brownfields and Environmental Legacy Costs

Land that has been tainted by environmental contamination is commonly referred to as a Brownfield site. Statutory strict liability to pay for the clean-up of these properties has left many areas of the country blighted with idle property. Environmental insurance packages have the ability to create a sum certain and monetize the potential environmental risks associated with a brownfield property. The insurance can also transfer these risks to a objective third party, which can either be the insurance company or a fixed priced remediation contractor who has purchased the insurance.

Recent changes in the financial reporting rules for environmental legacy retirement costs combined with potentially severe penalties for directors and officers not in compliance with these rules created a new market for environmental insurance policies. Customized environmental insurance packages are able to create financial certainty to a broad range of possible cost out comes for environmental legacy cost obligations. The benefits of the utilizing environmental insurance products to monetize and potentially transfer these liabilities mirror those of the US Army fixed cost remediation insurance designs. In addition the insurance underwriting process provides an objective third party valuation of the potential liability for financial reporting purposes, even if insurance is not ultimately purchased.

Fire And Water Damage Restoration Contractors
Universal fungi and bacteria exclusions essentially void out the GL policy including the defense cost coverage provisions in the policy for any firm that is in any way associated with remediating or evaluating these materials. The irresolvable coverage gaps between separate General Liability and the CPL coverage's for these contractors has created a created a new market need for specialty liability insurance packages that combine specially modified GL and environmental coverage's into a package policy.

Incidental General Contractor Professional And Environmental Liability.
General contractors have long had pollution and professional liability exclusions on their General Liability insurance policy. Many sophisticated contractors moved years ago to fill these insurance coverage gaps with the purchase of separate Professional Liability and Contractors Pollution Liability insurance policies. The introduction of universal fungi exclusions added a second set of pollution exclusions for which environmental coverage is needed. Package policies that combine Professional/ CPL and microbial matter coverage can gracefully close these three coverage gaps in the General Liability policy thru the purchase of one cost effective package policy.

Green Building Insurance Products
Green buildings utilize environmental friendly and sustainable building materials. A green building is also more energy efficient. A certified green building is extensively designed and inspected during the course of construction. In recognition of the lower risk profile of a green building, a hand full of insurance companies now offer various insurance policies with premium discounts for green buildings, discounts for the use of low risk green certified building materials or will pay the additional cost to rebuild to green standards after a loss. One interesting example in practice is the use of green certified mold resistive dry wall in new construction. In one study paper faced drywall accounted for more than 80% of the fungi growth in new building materials. Today environmental insurance rate discounts on specially modified environmental coverage's can largely off set the additional costs of utilizing low risk paperless drywall in a construction project.

Real Estate Environmental Liability (REEL)
These environmental insurance policies have their roots in Environmental Impairment Liability and provide for the clean-up of a wide range of pollutants on and off the insured location on a no fault basis. The polices include provisions to add fungi and bacteria as defined "pollutants" and amend the definition of clean up expenses to include the cost of restoring a property to its pre loss state. In sharp contrast to a CPL policy which is designed to fill the pollution coverage gap in a contractors General Liability policy, a REEL policy is designed to fill the coverage gaps created by pollution and fungi exclusion in both the liability and property insurance policies of all the stakeholders in a specific property. REEL polices can insure extra expense and business interruption, loss of rents and name a lender as a loss payee. A valuable feature of the REEL policy format in new construction is it is able to insure the coverage needs of multiple stake holders in a property over the entire statute of repose period. With its no-fault clean up and restoration coverage trigger and the ability to add multiple stakeholders as named insured's, the REEL policy can supersede the need for CPL on a project. With policies that are assignable to new owners of the property as the first named insured and featuring prefunded building science based water intrusion loss control services, the REEL polices offer many advantages over traditional CPL policies.

The insurance requirements in virtually every loan that is secured by real estate specify that “All Risk” property insurance must be maintained on the building over the term of the loan. Although insurance technicians will be quick to point out there is no such thing as “All Risk “ property insurance today, a property insurance policy with a universal fungi and bacteria exclusion endorsement certainly does not meet the historical intent of this insurance specification. A REEL policy is now needed in conjunction with a property insurance policy and general liability insurance for borrowers to meet the insurance specifications in loan covenants.

Universal Fungi/Bacteria Exclusions Create New Environmental Insurance Needs

The need for environmental insurance and the availability of affordable environmental coverage from multiple vendors has never been greater than it is today. Unfortunately the distance between the firms that need environmental insurance to fill the environmental coverage gaps in their liability and property insurance programs and the firms that have actually addressed their environmental coverage needs has never been wider than it is today. The widening environmental risk coverage gap was caused by the introduction of universal fungi and bacteria *related* loss exclusions into virtually all forms of property and liability policies. These far reaching exclusions adversely affect any party associated with the built environment, including developers, owners, lessees, tenants, building products suppliers, contractors and their lenders. The bacteria exclusions affect parties in the food services industry, healthcare providers and some manufactures.

Fungi and bacteria exclusions were introduced by insurance companies in response to the sudden onslaught of “toxic mold” litigation between 2000 and 2003. Research in 2003 conducted by American Risk Management Resources Network, LLC, concluded that in a likely case scenario, before they were universally excluded, mold related losses in the US, including property damage and “toxic mold” bodily injury claims were mirroring the loss frequency and severity rate of the peril fire.

The introduction of the universal exclusions dramatically decreased the amount of mold claims paid out by insurance companies. However it is very unlikely the amount of actual mold related damages to property has decreased in this time period. According to the IICRC, the leading certifying body for mold restoration contractors, there are actually more trained and certified mold remediators today than there were in 2003, every day they to work. Reconciling these observations would lead to the conclusion that many mold related losses are either uninsured today or are being covered as water damage losses while ignoring the mold component of the loss. The average commercial mold remediation in the US is estimated by restoration contractors to be $250,000, although the costs can be much higher. Improperly installed toilets in an apartment complex caused a $10,000,000 mold related loss last year. Selecting and installing the wrong wall board backing for the showers in a new condo has caused an $80,000,000 “mold related” remediation problem with no insurance recovery in sight for the owners or the contractors. The lender is likely to be very surprised on this loss because the remediation costs far exceed the owner’s equity in the property and the lender had specified “All Risk“property insurance in the loan documents. A property insurance policy with a mold exclusionary endorsement is not “All Risk “ property insurance by any historical definition of what “all risk” may mean within the custom and practice in the insurance industry.

The exclusions for these new “microbial matter pollutants” in property and liability insurance policies are much more onerous than most risk management practitioners realize. The insurance coverage case law is supporting broad interpretations of these new exclusions. The good news for insurance buyers is insurance claims adjusters also have poor knowledge resources available to them to define the meaning of fungi and bacteria exclusions and end up paying related damages that technically would not covered if the new exclusions were given their full literal interpretation.

.

The Universal Exclusions For Fungi and Bacteria

A fungi/bacteria exclusion is basically a total pollution exclusion on steroids because of the anti current causation language in the exclusion. In contrast to the traditional "Absolute" pollution exclusion in the GL policy, a "Total" pollution exclusion eliminates coverage for losses arising from products and complete operations in addition to the excluding pollution losses arising from premises and operations of the insured. These exclusions are not standardized, in practice various modifications are made to make the exclusion more or less restrictive than the wording below. However, most exclusions for these new "pollutants" are based on this language from ISO. (Emphasis added)

This insurance does not apply to:
Fungi or Bacteria
a. *"Bodily injury" or "property damage" which would not have occurred, in whole or* ***in part***, ***but for the*** *actual, alleged or* ***threatened*** *inhalation of, ingestion of, contact with, exposure to,* ***existence*** *of, or presence of,* ***any "fungi" or bacteria*** *on or* ***within a building*** *or structure, including its contents,* ***regardless of whether any other cause, event, material or product contributed concurrently or in any sequence*** *to such injury or damage.*
b. *Any loss, cost or expenses arising out of the abating, testing for, monitoring,* ***cleaning up****, removing, containing, treating, detoxifying, neutralizing, remediating or disposing of,* ***or in any way responding to, or assessing the effects of*** *"fungi" or bacteria,* ***by any insured*** *or by any other person or entity.*

There is usually a provision at the end of the exclusion to exempt products intended for human consumption. However a review of actual insurance policies issued to restaurants in a major mid west city revealed that the GL and/or excess liability policies had this exception removed in 25% of the placements reviewed. In effect without the exemption in place these establishments would not have liability insurance for food poisoning which is clearly caused by bacteria within a building.

The combination of the "threatened existence of" and 'in any way responding to" wording along with the anti concurrent causation clause could void out the GL policy entirely as soon as any amount of fungus or mold, it could be one mold spore, is involved with the loss.

The second part of the exclusion essentially prevents insured's from being in the mold and bacteria evaluation and remediation business. In theory an industrial hygienist would not have GL coverage for burning down a house if they were at the house to assess if mold was present or not. Since the exclusion specifically applies to loss related to be in the assessing business for fungus mold and bacteria, there is technically no GL coverage at a project where the assessment reveals there is no mold or bacteria if the reason for being there in the first place was to assess the effects of fungus or bacteria. The second part of the exclusion does not require actual exposure to fungus or bacteria by a claimant before the entire liability policy is nullified by this common exclusion, simply being in the business is good enough to trigger the exclusion.

Another example of the far reaching consequences of this exclusion is fire and water damage restoration contractors essentially have no GL coverage for responding to sewer and drain backups or flood damages. Since fungi spores and bacteria are present in sewers, drains and flood waters every grey or black (Category II or III) water loss will have the actual presence of these materials associated with it in one way or another. The fungus and bacteria insurance exclusions kick in at the threatened existence of a single cell of bacteria which technically voids out the GL policy at the whim of the claims adjuster. To illustrate the coverage GL – CPL coverage gap, if a restoration contractor burns down a house while responding to a backed up sewer, the GL policy is essentially void out because the job was cleaning up and responding to bacterial contamination. A properly structured CPL policy will respond to claims from bacteria but in this case the CPL claims person will be asking where the pollution event was to trigger the CPL coverage, the fire will not count therefore the CPL policy will not respond either. As of this writing there are no endorsements available that will close this coverage gap between separately purchased GL and CPL policies on a restoration contractor. The only way in 2008 to fill this coverage gap was to place restoration contractors with insurance carriers that offer a combined General Liability and Contractors Pollution Liability insurance package.

Fungus and Bacteria Exclusions In Property Insurance Policies

Property insurance policies have anti concurrent causation exclusionary language similar to the GL for fungus and bacteria related losses. However unlike the GL policy which essentially disappears as soon as mold or bacteria appear in any part of a loss, the property policy provides a token sublimit of coverage for the mold part of a loss if the loss is caused by an otherwise covered peril.

What Do The Courts Say About Fungus and Bacteria Exclusions?

The DeVore family had a shut off valve to a washing machine rupture while they were on vacation. This resulted in water damage to the home which was insured by American Family insurance company.

In the first coverage case in the state of Illinois regarding the anti concurrent fungi exclusion, the appellate court made this decision in June of 2008.

DeVore vs.American Family Mutual Insurance Company,
*The policy language in this case **clearly and unambiguously** excludes coverage for losses that resulted from fungi caused by the water event at the DeVores' home. The policy does not cover "a loss to the property *** resulting directly or indirectly from or caused by *** fungi." In addition,"[s]uch loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss." We do not understand how much clearer American Family could have been in excluding coverage relating to an event such as this one, wherein water caused damage to a home and created fungi in the home.*

American Family had paid the water damage part of the loss but not the ensuing loss for the mold damages.

The Property Loss Research Bureau estimates that 150,000 washing machine hoses rupture each year. There are literally hundreds of thousands of water losses in the US every year. Prior to the introduction of mold exclusions, the resulting mold growth from a broken washing machine hose would have been covered as an ensuing loss from a covered peril. The new exclusions dramatically change how water damage claims are adjusted. Tens of thousands of formerly covered water losses will now be denied under these far reaching exclusions in both liability and property policies.

Managing Environmental Risks in New Construction

When universal fungi/bacteria exclusions were introduced, traditional insurance specifications for the stakeholders in new construction became obsolete. Today this newly excluded omni-present environmental loss exposure needs to be addressed with specific environmental insurances. The chart below details the environmental insurance needs of the major stakeholders in a construction project.

Stake Holder	Builders Risk Insurance	Contractor Pollution Liability Insurance (CPL)	Real Estate Environmental Liability Insurance (REEL)	Risk Drivers
General Contractors	May be purchased by the GC or the owner. Lenders require the purchase of this coverage on all projects to protect their security interest in the loan. Builders risk polices usually have restrictive sub-limits for fungi damages. The fungi coverage gap on the builders risk policy is best filled with REEL insurance.	Usually purchased by the GC, but maybe purchased by the owner under a "wrap up insurance program" to protect the owner and the GC from environmental liability (including fungi) arising from the GC's negligent insured operations. GC's and subcontractors need this coverage to fill the gap in coverage created by the exclusions for fungi and pollution in their GL policies. Liability based CPL does not fill the environmental coverage gap in property policies.	May be purchased by the GC but this insurance is usually purchased by the owner. The GC can be insured under the owner's REEL policy. Generally trade contractors will need to be insured under a CPL based policy which may be written on a wrap up basis. Were available as an option the CPL and REEL polices should be provided by the same insurance company to streamline claims settlements.	GC's have exclusions for pollution and fungi related damages in all of the traditional liability and property insurance policies they buy. They need specially adapted environmental insurance policies to fill their insurance coverage gaps. There is usually no first party clean up coverage in a CPL policy; therefore the CPL policy does not fill the insurance coverage gap in the Builders Risk policy that the lender requires on the project. Where CPL can be adequate to insure the needs of contractors; owners/developers need REEL insurance to fill the coverage gap in their property insurance policies and their liability insurance.
Developers **Owners** **Future Owners**	Same as for the CG discussion above. On occasion the GC may provide the Builders Risk insurance	If a owner/ developer needs to insure against the negligence of the contractor, the developer/owner may pay for a CPL policy	Should be purchased by the owner/developer as the primary source of environmental/fungi risk protection for the project.	Owners/Developers need to fill the coverage gaps they have in both the Builders Risk policy and in their GL insurance on the project. REEL is the only

Condo Associations	on a project. Owners /Developers should pay close attention to the insurance required in the loan covenants and the insurance provided on the project. Most Builders Risk polices today "do not meet spec" on the loan. This coverage gap should be disclosed to the lender.	on the project. CPL polices are protection for the contractor's liability and the vicarious liability an owner may incur for the operations of the contractor. CPL policies are rarely adequate to meet the property insurance needs of the owner for environmental losses to the property itself.	With one of these policies in place there is limited need for the owner/developer to pay for a CPL policy to protect the contractor against the negligence of the contractor.	insurance product that can fill both coverage gaps. REEL policies offer much broader insurance and loss prevention protection than a CPL policy and are a superior value for the owner developer. If a REEL policy is purchased and the General Contractor is a named insured under the REEL there is no need for the contractor to purchase a separate CPL policy. Liability claims made against the insured contractor would also be covered under the REEL policy.
Architects	NA	NA	NA	Architects can still purchase professional liability insurance that does not exclude fungi related damages. This insurance is written on a *claims-made* basis which makes it totally unreliable as a risk management strategy. If a exclusion for fungi related damages is added to the Professional Liability policy at any point in the future, the architect will lose all of their insurance protection for fungi related damages both prospectively and retrospectively. To manage this potentially future uninsured risk, architects should specify the use of fungi resistive building materials and recommend that all of their larger projects purchase a REEL policy to access the water intrusion loss control services offered by the

				underwriters of the REEL policy
Lenders	NA	NA	NA	Lenders require Builders Risk insurance on 100% of their secured loans. By default this insurance policy should cover fungi. Lenders appear to be oblivious to the fact that they are being provided policies with total fungi exclusions. The only policy that fills the gap in insurance coverage for fungi related damages under a builders risk policy is the REEL policy.

Avoiding Common Coverage Pitfalls

The most common flaws in the insurance placements for environmental, fungi and bacteria losses are:

1. Not having any coverage in place for environmental losses is by far the most common coverage flaw.
   Historically hazardous waste loss exposure affected relatively few firms. Today with the fungus exclusions effectively eliminating coverage for the ensuing mold losses from water damages there will be a much greater frequency of unnecessarily uninsured environmental losses.

When environmental insurance is actually procured the following the following flaws top the list:

1. Attempting to insure the property insurance coverage gap with a contractor liability based insurance contract.
   Universal fungi exclusions cut through both property and liability policies. It is not possible to effectively fill the coverage gaps created by fungus mold exclusions in the property insurances with a liability based coverage trigger in the traditional CPL policy.

2. Excluding property damage to the insured's work.
   With its roots in the care custody and control exclusion in the GL policy this limitation has found its way into CPL polices. With the advent of mold and fungi exclusions these limitations in a CPL policy can eliminate major parts of the CPL policy for contractors because the exclusions apply to the building itself which is likely to be the source of a liability claim against the contractor.

3. Excluding impaired property.
   Mold and bacteria related damages will impair the value of a property. These exclusions in some environmental policies eliminate significant coverage.

4. Excluding claims arising from materials and equipment supplied or handled by the insured.
   For a general contractor virtually all the materials at an insured project are supplied by the insured. These exclusions on a CPL policy have the ability to exclude the entire job site for mold related damages.

5. Confusing the need for policy term and the extended reporting period.
   For a loss to be covered under an environmental insurance policy there needs to be a covered release of pollution and resulting damages, during the effective coverage period of the policy. The Extended Reporting Period provision in a Claims Made based insurance policy only provides more time to report an otherwise covered claim after the policy term has expired. The ERP does not extend the coverage period of the policy. An Occurrence based policy simply adds an unlimited time to report a covered loss and also cannot replace the need for a coverage period commensurate with the loss exposure of the insured. Under either claims made or occurrence based policies a policy must be in force when the release of the pollution takes place. This can only be accomplished with longer coverage periods on multi-year policies or thru continuous renewals of the coverage with full coverage for completed operations.

6. Poorly prepared insurance applications.
   All environmental insurance policies refer to the application in their insurance agreements. In effect the application becomes part of the insurance policy. In some policies the application actually defines what is being insured under the policy. Incomplete applications are the primary cause of coverage disputes in environmental insurance policies.

7. Poor matches of environmental insurance policy forms to the customers' needs.
   Environmental insurance policies are not standardized. It is possible in this line of coverage to select the inappropriate environmental insurance policy and have it exclude virtually all of the risks of the insurance buyer. This can take place even when a more appropriate policy form would have actually cost less. It is also possible for an insurance policy that excludes everything one customer does for a living would be the best available coverage match for a customer in a different line of business.

Conclusion

Environmental insurance policies play an essential role in closing the coverage gaps created by pollution exclusions in virtually all property and liability insurance policies. The introduction of fungus and bacteria exclusions with anti concurrent causation language has dramatically increased the need for specially modified environmental insurance today. Coverage for environmental risks is readily available in the insurance market place at affordable prices from top rated insurers. Risk management practitioners should pay close attention to all of the provisions in the policy forms and avoid the common pitfalls.

David Dybdahl, CPCU, ARM is the founder and president of American Risk Management Resources Network, LLC. and the Environmental Risk Resources Association. ARMR.Network is wholesale insurance brokerage operation specializing in environmental risks. He is a university level insurance educator and a licensed excess and surplus lines insurance broker in forty eight states. Internationally recognized his work in environmental insurance, he is also an expert witness, insurance product development specialist, and author. Widely published, his written works appear in the CPCU and ARM text books and in the IRMI, Practical Risk Management text. David can be reached at 608 836 9567 or dybdahl@armr.net.