

**Environmental Liability & Insurance:
Hidden Risks and Unforeseen Exposure—
Taking Stock of a Changing Physical and Political Environment**

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Given the turmoil in the economic marketplace and change in U.S. political leadership, now is a good time to take stock of change that has occurred—and changes likely to emerge—that impact commercial pollution liability. Specifically, commercial insurance brokers and customers are advised to examine their preparedness, or in many cases vulnerability, when it comes to emerging and unforeseen pollution risks.

As environmental liability has evolved over the last decade, so has business' general awareness of these risks and the propensity of plaintiffs to press claims for environmental damages. In response to these pressures, developments of science and other social dictates, the legal system's interpretation of what constitutes pollution and the rules for who bears the burden of responsibility has also changed and become refined over time. However, recent developments in all of these areas may create an immediate environment for rapid change in this specialized area of environmental risk which may require greater vigilance and additional immediate assessment to manage risks.

Commercial General Liability (CGL) policies carry exclusions, in addition to the pollution exclusion, for an increasing number of environmental risks, such as biological contaminants including mold, mildew and virus; asbestos; lead; radon; and silica. The case law that has developed with respect to what set of facts fall within the pollution exclusion, and therefore not covered under the CGL policy, has been inconsistent from jurisdiction to jurisdiction, and in a majority of the situations customers and insurance carriers are given no alternative but to litigate such intent. These exclusions leave corporations with large defense and transactional expenses in determining the

applicability of insurance and inadequate or no coverage for judgments that could prove threatening to the long-term viability of their enterprises. The issue is not frequency, but rather the reality that one unforeseen catastrophic claim could put a company out of business.

Adding complexity to the uncertainty created by the courts is a new administration in Washington that has, through its cabinet-level and other appointments, signaled that it will be more vigorous in enforcement and application of environmental standards now in place, and may introduce additional standards, rules and guidelines than prior administrations.

In light of these developments, companies would be wise to assess their environmental risks, regardless of their industry or current insurance coverage, and to consider the solutions that best address their needs. Fortunately, there are options. For industries as varied as agribusiness, construction, non-retail manufacturing, professional services, technology and warehousing—many of which do not have pollution coverage because they may not realize they have pollution exposure—there is environmental liability coverage that is available as a specially created insuring agreement to a combined CGL and pollution policy. For others, there are stand-alone, highly customizable environmental liability policies that allow customers to tailor coverage to their unique fixed-facility exposure.

Equally important, given the current and perhaps persistent turmoil in the financial services sector, is an assessment of the relative financial strength and stability of insurance providers. Brokers and customers should also gauge the global strength, longevity and customer service of their insurer, as well as the knowledge and experience of its environmental underwriting team. This paper outlines some emerging issues of concern in the environmental area and identifies potential risk management solutions.

Understanding Environmental Risks

A Wider Definition

When executives in charge of risk management think about the day-to-day operations of their business, environmental or pollution exposures may not be apparent or recognized as material. What is critical to understand, however, is that in today's marketplace, insurance policy definitions of pollution are generally not limited to regulated hazardous or toxic substances, but also include broadly defined irritants, contaminants or pollutants.

Pollution events involving industrial chemical releases are no longer the only risks to manage. Liabilities associated with damage to neighboring properties due to activity, renovation or construction are now creating liability for property owners who never imagined they could be held accountable for environmental liability in such circumstances. In some cases, even if a property owner did not directly create a pollution event itself, if the owner's property is impacted by an event that occurs upstream or next door, that owner could face liability and expense.

The reality is that nearly any enterprise can be at risk for environmental claims. To illustrate the range of potential exposures, consider the following scenarios:

- Discharge of treated water from a manufacturing site into an adjacent river altered the PH level of the water, killing fish;
- Milk released from a tanker into a water system exposed to high temperatures caused the milk to spoil and smell, and further caused damage to the aquatic environment;
- A catering hall that had a problem with its refrigeration unit released Freon and refrigerant gases into structures and the atmosphere requiring air monitoring and

remediation, and resulting in violation of environmental laws and public health rules;

- A vacation resort was cited by the local public health authority for exposing a patron to the legionella virus via its water system, causing his death from legionnaires disease, and the environmental regulators required a complete investigation and cleanup of the water delivery and filtration systems;
- A university was improperly storing and disposing of animals used for laboratory research dissection and its related chemicals, exposing the university to cleanup orders from the environmental regulators, and fines and penalties for violations of law;
- Sediment consisting of dirt particulates when introduced into water systems changes the turbidity of water disrupting PH balances and creating a murkiness to the water resulting in non compliance with environmental standards and disruption and/or death to aquatic life;
- Naturally occurring materials, such as serpentine rock, when disturbed during excavation, demolition or grading can increase the levels of such naturally occurring materials in the environment above acceptable background levels, requiring engineering controls and monitoring;
- Materials brought on to a site or commercial operation can be released to the environment as a result of terrorist activities or vandalism and can cause both injury to persons and the environment, and business interruption;
- Certain pressed wood products, building materials and carpeting can be sources of emissions;

- Water intrusion events can result in mold and mildew growth that can affect the health of sensitive individuals, resulting in claims for bodily injury to third parties and employees, property damage and business interruption.

Research Suggests Potential New Risks

New studies and scientific research¹ are providing examples of the environmental health and safety impact of substances found in the air and in many products.

A study supported by the National Institute of Environmental Health Sciences asserts a direct causal relationship between exposure to fossil fuel emissions such as diesel soot and cellular damage that may lead to strokes and other neurological impairments.

Researchers at the University of Montana recently released a preliminary study asserting that exposure to air pollution at a young age may predispose people to develop Alzheimer's or Parkinson's disease. The study's author suggests that the findings may indicate that people with a genetic susceptibility for Alzheimer's disease might have a higher risk of developing the disease if they live in a highly polluted environment.

The use of chemicals, not just in an industrial context but in the home, office and in the production of personal care products, have prompted studies to assess the impact on an individuals' long-term health and the quality of the environment as a whole.

The Environmental Working Group, a Washington, D.C. - based nonprofit research organization, published a report on chemicals found in wastewater samples in the San Francisco Bay area². Eighteen of 19 samples contained at least one of the following unregulated, widely used chemicals: phthalates, Bisphenol-A and triclosan. These

¹ It is not the author's intention to endorse scientific analysis, but it is to suggest that such studies have an influence on the public's perception of what constitutes environmental damage and injury.

² *Sources of Hormone-Disrupting Chemicals in San Francisco Bay*, by Rebecca Sutton, PhD, July 2007.

chemicals are used in everyday products such as cosmetics, antibacterial soap, perfumes, food and plastic bottles.

These studies will require further research and confirmation to indicate a direct causal connection to bodily injury or property damage serving as basis for compensable claims, nonetheless, such studies may inspire claimants to make allegations of bodily injury and property damage which at a minimum will lead to costly defense and transaction expenses.

Climate Change—An Emerging Risk

A consensus of scientists agree³ that emission of greenhouse gases (GHGs) from industrial and natural processes can result in an accrual of GHGs in the atmosphere and are likely to impact climate change. The risks of climate change have caught the attention of the Obama Administration. Unlike prior U.S. Administrations, the Obama Administration will likely pay more attention to climate change and take precautionary and directed actions. As such, greater enforcement and regulation of climate related exposures through environmental agencies, including evaluation of GHGs, may be expected from this Administration. The regulation of greenhouse gases could have far-reaching consequences for commercial buildings and manufacturing operations, as well as any stationary facilities and mobile sources that emit GHGs.

Moreover, the stated positions of the Obama Administration, along with its appointment of a former EPA administrator as a climate and energy “czar,” add to the emphasis many states may put on broader and more vigorous enforcement of climate and environmental regulations.

Another sign that “climate change” claims are on the rise in the legal system comes from national law firms, who are beginning to form new “climate change” practice groups. A key area of their focus is directors and officers liability. There is some speculation that the failure to disclose climate change risks could leave directors and

³IPCC, 2007. It is not the author's intention to endorse IPCC's scientific analysis, but it is to suggest that prudent businesses will take the data and predictions seriously.

officers in violation of Securities and Exchange Commission rules and therefore vulnerable.⁴

As such, companies may be faced with a possible increase in climate related claims.

Environmental Judgments—Lasting and Potentially Catastrophic

Environmental claims can be catastrophic in terms of the amount of damages awarded and the cost of defending against claims. Often less appreciated are the possible impacts to a company's balance sheet or a diminution of property or other asset values or loss of reputation and the diversion of management's attention from the core business that can result from such claims and / or associated litigation.

Legal and Regulatory Scrutiny, Standards and Enforcement

Legal and regulatory trends are raising the importance of adequate and effective environmental liability coverage. Changing scientific, evidentiary and legal standards are making it easier for environmental claims to be made and to survive motions to dismiss. Concepts like "duty of care," "fear of future injury" and "damage at the cellular level" are expanding both the range and possible duration of environmental liability claims. A judgment may find that no immediate damage or injury may have been sustained as a result of a claim, but may all the same impose on the defendant the burden of paying for a lifetime of medical tests and monitoring should any medical condition emerge as the result of an event or sustained exposure.

The short-term and lasting effects of environmental claims can be costly and distracting to a company, at the least, and at the worst catastrophic and enterprise threatening.

⁴ *How to Mitigate the Effects of Climate Change Disclosure Requirements on D & O Insurance*, by Rachel S. Kronowitz, Andrews Insurance Coverage Litigation Reporter, October, 2008.

Managing Environmental Risk in a Changing Environment

Despite the emerging risks described above, the insurance market has responded with solutions for individual companies that provide coverage for environmental and pollution claims. There are actions that can be taken now to substantially assess risks and to design appropriate and affordable coverage packages to mitigate long-term or lethal damage to an enterprise.

The first step is to assess a company's risk profile. Organizations that are not aware of potential environmental risks or liabilities are advised to re-evaluate both their environmental risks and existing coverage in light of the current state of the market.

Armed with a better understanding of environmental risks, brokers and risk managers can make sure they have policies better tailored to a particular business's needs. In that regard, there are more and better options available today.

Combining CGL and environmental liability coverage into one policy is one approach to manage environmental risk and claims. Integrating CGL and environmental coverage can be a good strategy for enterprises that face environmental exposures as a result of their operations, raw materials, products, disposal practices, waste streams or location. A combined policy also offers a solution for CGL customers who want limited environmental coverage. Such an approach can be more cost-effective, depending on the circumstances, and may even enhance efficiency by avoiding multiple carriers or policies. This solution may appeal to CGL customers who in the past never thought they had environmental exposures or do not see a substantial or immediate risk, but believe they need to broaden coverage to accommodate emerging risks.

Also available are stand-alone, customized environmental liability policies tailored to specific exposures. These policies provide flexibility, enable customers to pay for only the coverage needed and chosen, and yet can be written to help provide comprehensive protection to address a company's full range of needs.

Businesses that present risk to the environment or adversely impact environmental health as a result of their operations typically benefit from this type of tailored environmental coverage. Risk classes for which these stand alone pollution liability policies may provide significant risk management value include agriculture, bulk storage, chemical manufacturing/blending/distribution, apartment buildings, light to heavy manufacturing, medical laboratories, retail operations, offices, gas stations, schools/universities, garage and vehicle maintenance sites, hospitals, hotels, warehouses/public storage, treatment, storage, disposal and landfill facilities.

The Time to Act is Now

Environmental risks are real, growing in magnitude and frequency, often unseen and potentially catastrophic—even for companies that may have never thought they had such risks. General liability policies should be reassessed in the context of existing and new regulations, law and legal liability that could impact the policies' effectiveness. Pollution related exclusions must be carefully examined and companies must assess their overall vulnerability to claims and liability given changes to the physical, legal and political environments. Only then can management make informed judgments about how best to protect their business going forward.

There is one final risk to be assessed, and that is the risk associated with the insurer and underwriting team selected. The global financial meltdown has had deleterious effects on some insurers. In choosing the company that will be called upon for support when there is a claim, consider the following criteria:

- Financial stability—Does the company still have the balance sheet to survive and perform?

- Breadth of coverage—Does the insurer provide a wide range of products? Can it provide multiple lines to cover businesses in multiple locations and in different lines of business?
- Experience—Does the insurer have a track record that indicates it has performed as promised for other clients? Does it understand the changing industry and emerging risks and offer innovative solutions?
- Expertise—Is the insurer keeping up with the legal and regulatory trends in the areas where you do business? How much experience and what science specialty degrees do its environmental pollution underwriters possess?
- Responsive—Does the insurer provide regional and local service contacts and technology solutions to effectively manage claims? Can you count on them when the need arises?

For more information, visit www.zurichna.com/environmental



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