Environmental Risk Transfers

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What are Environmental Liability Transfers?

- A private contract which provides:
  - Transfer of some or virtually all environmental liabilities to a third party
  - Cost certainty
  - May be insurance or be backed up by insurance
  - May be limited in duration, scope, or by exclusions

Sources of Liability

- Comprehensive Environmental Response Compensation and Liability Act ("CERCLA"), including NRD.
- Resource Conservation and Recovery Act
- Other Federal Law
- State law, including common law
- Contracts/Indemnities

When Are Liability Transfers Used?

- Superfund or CERCLA
- Sales/Divestitures
- Mergers
- Acquisitions
- Brownfields

Stricter Environmental Accounting Standards

- FASB Interpretation 47, Accounting for Conditional Asset Retirement Obligations
  - Seeks to foster uniform accounting and disclosure of environmental liabilities, clarifying FASB Statement No. 143
  - Liabilities must be disclosed when they can be reasonably estimated, even if asset retirement date is uncertain
  - Result: it is vastly more difficult to maintain ownership of contaminated properties without disclosing them as liabilities

Stricter Environmental Accounting Standards (continued)

- FASB Statement No. 143 provided: "An entity shall recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made."
- FASB Interpretation 47 clarifies that a liability must be reported even if the "timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity."

Comparison With N.Y. Brownfield Program

- A Certificate of Completion includes a Covenant Not to Sue from the State (includes Attorney General). Does not include federal government or private parties
- Runs with the Land
- Does Not Include Third Party Claims for Personal Injury or Federal Claims for Natural Resources Damages (for PRPs)

N.Y. Brownfield Program

- A Certificate of Completion is subject to several "re-openers"
  - the remedy is no longer protective of public health or the environment;
  - there is noncompliance with the brownfield cleanup agreement;
  - fraud has been discovered;
  - a factor or criterion upon which the remedial work plan or no further action determination was based is no longer protective of public health or the environment;
  - there is a change in the site's use;
  - the applicant fails to make progress on the development within five years

N.Y. Brownfield Program

- A Certificate of Completion may be modified or revoked if:
  - The applicant has failed to comply with terms and conditions of the cleanup agreement
  - The applicant misrepresented a material fact
  - There is good cause for such modification or revocation

Regulatory Background

- Historically EPA and states have resisted letting PRPs “off the hook” for contaminated sites
- When available, cash-outs required significant multiples of the anticipated costs
- Why?
  - Risk of failure transfers to agency
  - No agency incentive to take risks
- Today, regulators are more open to innovative solutions with PRP remaining “secondarily” liable

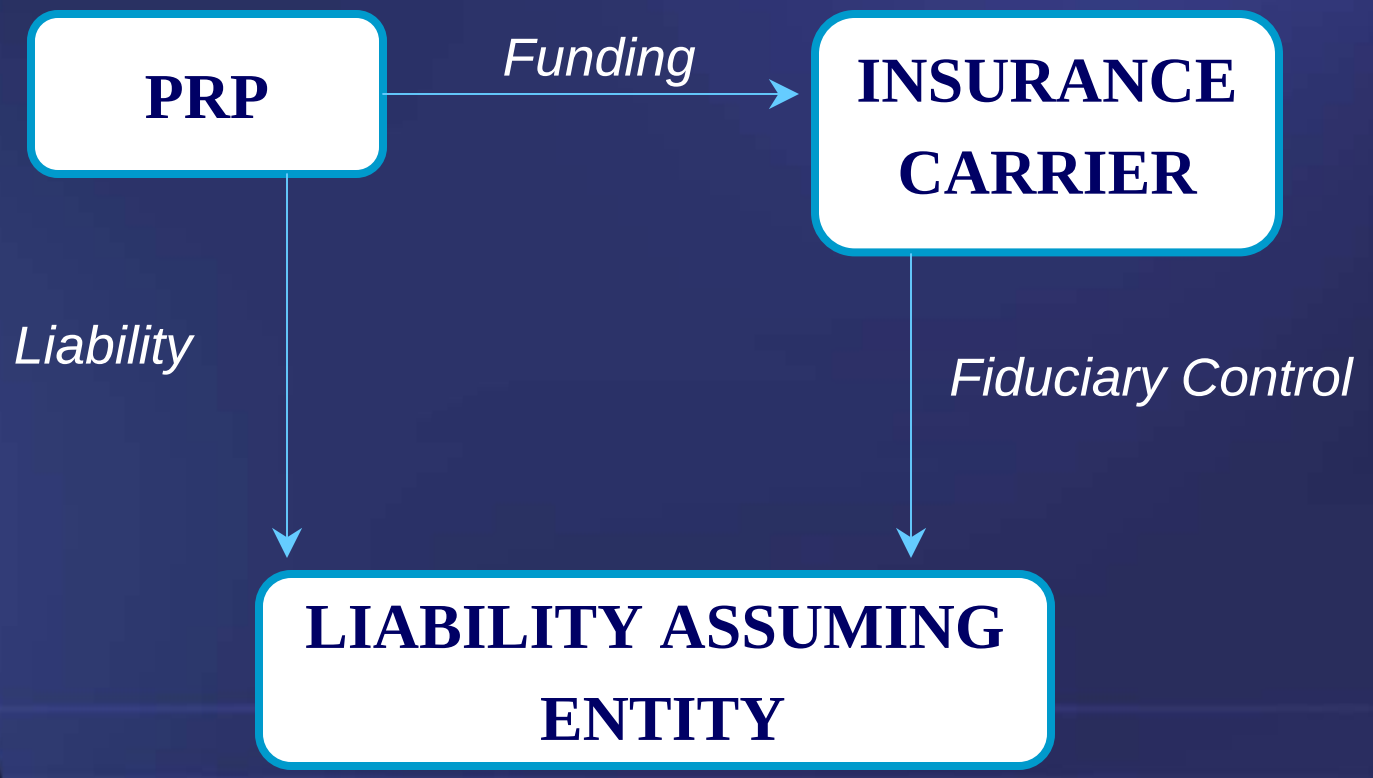
Insurance Background

- Historically insurance carriers resisted environmental coverage
  - Releases were not “sudden and accidental”
  - Cleanup costs are not “occurrences” or “damages”
  - More recent pollution exclusions bar coverage
- Today, many insurers desire to provide site-specific environmental coverage for known/unknown contamination

Comprehensive Liability Transfer

- Broad indemnification (but usually no governmental release)
- Immediate “walk-away” for firm fixed price
- Protection against allocated share exposure/NRD
- Protect against tort litigation
- Assign rights to pursue others (e.g. historical insurers, other PRPs, etc.)

Deal Structure



CERCLA and Liability Transfer Agreements

- CERCLA § 107(e): Indemnification, hold harmless, etc., agreements or conveyances; subrogation rights.

  (1) No indemnification, hold harmless, or similar agreement or conveyance shall be effective to transfer from the owner or operator of any vessel or facility or from any person who may be liable for a release or threat of release under this section, to any other person the liability imposed under this section. ***Nothing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this section.***

  (2) Nothing in this [title] including the provisions of paragraph (one) of this subsection, shall bar a cause of action that an owner or operator or any other person subject to liability under this section, or a guarantor, has or would have, by reason of subrogation or otherwise against any person.

Courts and Liability Transfer

Mobay Corporation v. Allied Signal, Inc., 716 F. Supp. 345, 355 (D.N.J. 1991): "as between private parties, CERCLA liability can be transferred by contract…parties remain liable for response costs in a government-initiated cleanup. However, private parties may contractually transfer to or release another from CERCLA financial responsibilities…."

- However, "courts have required an express statement in a contract in order to transfer CERCLA liability"

Who Offers Such Contracts?

- Many private/public companies including:
  - Pollution Risk Services, LLC
  - TRC Companies, Inc.
  - ARCADIS
  - Weston Solutions, Inc.
- How do they make money?
  - Cleanup Costs
  - Land Value/Development Rights
  - Commutation Account
  - Other fees from the PRP

Deal Structure

- Liability assuming entity ("LAE") assumes responsibility for cleanup obligations, whatever they may be
- "Cleanup" insurance secured to collateralize deal at appropriate multiple of costs (e.g., 2x)
- Third party liability insurance also available
- Majority of PRP group buy-in may be required to secure policy
- LAE assumes cost recovery responsibility from remaining parties or orphans

Deal Structure (continued)

- Indemnification typically includes
  - All environmental liabilities
  - Known (pre-existing) and unknown contamination
  - Changing environmental regulations
  - Remedy failure
  - Bankruptcy, etc. of consultants/contractors/LAE
  - Excludes criminal fines and penalties

Funding

- Client funds
- Supplemented by:
  - Cost Recovery/other PRPs
  - Historical or existing insurance policies
  - Property can be sold (if not needed for operations)
  - Risk sharing
  - Grants/Tax Incentives

Consent Orders

- Mattiace Petrochemical Superfund Site in Glen Cove, Consent Decree, 2003, U.S. District Court
  - "TRC has been retained by the Group A Settling Parties to perform the Work and satisfy other obligations…The Work Settling Parties recognize that their obligations as referenced in [the agreement] are joint and several…Nevertheless…EPA will initially seek corrective measures, in its enforcement discretion, only from TRC…If despite those efforts by EPA, TRC does not remedy noncompliance, EPA may direct the Work Settling Parties to remedy the noncompliance." (Consent Decree at 10)
  - "To ensure the fulfillment of TRC's primary obligations under this Consent Decree, the [settling parties] have paid for a policy of insurance…in the amount of $25,000,000…." (Consent Decree at 3)

Consent Orders

- Amended Consent Decree for the Upper River Work on the Sheboygan River, January 2006
  - "EPA acknowledges that the Work Party [e.g., Pollution Risk Services LLC] will be the party primarily responsible for the performance of the Upper River Work…and in its enforcement discretion, will initially seek performance, corrective measures, and stipulated penalties…" from PRS. (Consent Decree at 18)
  - Remediation Cost Cap insurance policy from Chubb with "an overall coverage limit of $100 million" (Consent Decree at 53)