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INSURANCE SERVICES

Environmental Risk Transfers for PRPs

Strategies for Managing Substantial Damages Exposure

Deal Structure Issues & Case Studies, March 14, 2007

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Key Deal Considerations

- Selecting the Contractor
- Scope of the Assumption
- Future Buyers/Future Use – Minimizing Exposure
- Financial Structure – Case Studies

Selecting the Contractor

- Experience in Risk Transfer Assumptions
- Remediation Experience
- Project Manager's Experience
- Regulatory Relationship
- Financial Wherewithal
- Insurer(s) Relationship
- Breadth of Risk Assumption

Scope of Assumption

Each liability assumption is unique and the degree and scope of the liability assumed varies from one deal to the next. Below is a discussion of the variables that may be negotiable in the liability assumption agreement.

- Can varies in scope of liability assumed and time period of assumption. Most assumption agreements are in a limited form, generally limiting both scope and time period.
- Scope of assumption may be limited to known conditions or in some cases include unknowns.
- May be limited to on-site cleanup not off-site cleanup
- In some cases assumption of statutory liability where permitted by regulator, is assumed by the third party.
- May be limited to a specified time period and/or specified liability limit (i.e. Insurance policy term and/or Insurance Limits). Many IFC arrangements will be limited to the policy limit and policy term.
- May be limited to achieve closure and not provide indemnification into perpetuity, covering re-openers, etc.
- Typically covers only regulatory cleanup costs, but some times can include natural resource damages as well as bodily injury and property damage claims.

Future Use – Minimizing the Risk

Impact of future owners on the transaction

- Use restrictions to reduce risk that future owner will act to weaken the coverage of the risk transfer
- Contractually bind owner (current or new, if selling) to require in future contract of sale that owner acts consistently with risk transfer

Refinery Company Selling Its Business

Background:

A refinery company was looking to exit the business and cease to exist. It had 12 Terminal in various states that had contamination matters that needed remediation. The terminal assets were all in different phases of the regulatory process, with a number of them with some groundwater matters that would require 10 or more years of monitoring once cleanup had occurred. It was also highly probable that the terminal portfolio assets would be purchased by multiple buyers versus one buyer.

Seller Objectives:

1. Maximize the sale price – find a solution to avoid devaluation of the assets due to the environmental conditions.
2. Preserve Ownership Wealth – find a solution to protect the principal shareholders from future environmental liabilities after they have exited the business.
3. Eliminate or Minimize Future Administration of Environmental Management – the seller wanted to be able to wind down its operation and not have to continue management of the environmental conditions of the terminals on a day-to-day basis until "no further action" achieved.

Refinery Selling Its Business (Continued)

Buyer Entities Objectives:

The multiple buyers had various concerns regarding the environmental liability in regards to purchasing the terminal assets, which collectively fall into the below categories:

1. Greater Environmental Cleanup Liability Than Anticipated –
2. The ability of the Seller to get to "NFA" status in a reasonable period.
3. Toxic Tort Liability
4. Natural Resource Damages for Assets on Major Waterways
5. Financial Wherewithal of Seller to Pay for Remediation Costs
6. Ability of the Seller to Satisfactorily Manage the Environmental Cleanup
7. Financial Wherewithal of Seller to Pay for Self Insured Retentions in Environmental Insurance Program

Refinery Selling Its Business

IFC Environmental Solution:

An IFC solution was structured to satisfactory address the environmental liabilities related to the terminal to alleviate concerns that both the Selling and Buyer entities had regarding resolution of the environmental problems. The sale transaction was able to move forward based on the IFC structure. The key components of the IFC solution were:

1. Single Environmental Consulting Firm assumed environmental regulatory liabilities for all assets and provide indemnification to the various buyers under separate Fixed-Price contract agreements.
2. Environmental Consulting Firm assumed the liability to get to closure, even if the policy term had expired and/or the limits of insurance were exhausted.
3. Finite Cost Cap Insurance was structured to fund for the expected cost of the cleanup over a 10-year policy term.
4. Pollution Legal Liability policy was structured to cover the seller and the various buyer entities with each party having its own dedicated limits of liability. The self-insured retentions that the seller agreed to be responsible were pre-funded in the Experience Account of the Finite Cost Cap to be used in the event of a PLL claim. The PLL addressed the toxic tort, natural resource damages and re-opener liabilities that all buyers had some level of concern.

IFC Structure for Refinery Business Sale

Contractor Liability Assumption:

1. Beyond the policy limit
2. Beyond policy term

Until "NFA" Achieved

Co-Insurance 20 % assumed by Contractor

Cost Cap limit $25 million
(Risk Transfer Layer)

Commutation Account
$15 million
(NPV of cleanup estimate)

Case Study – Fortune 50 Company Sale to Local Developer

New York Brownfield Residential Redevelopment Project

Background

- A Fortune 50 company wanted to divest an industrial property for residential and commercial redevelopment under New York City's revitalization plan for the area. Due to the environmental site conditions from the historical operations, the company was challenged to sell it without a steep discount and potentially still bearing the historical liability.

Business Objectives

- The seller wanted to maximize the value of the property by utilizing environmental insurance to cap historical liabilities.
- The seller wanted a long-term environmental insurance solution that would protect it in the event that the developer who was to assume the historical liability became insolvent.
- Support the transfer of the property to the developer for residential/commercial use to meet the City's overall revitalization plans. The Seller stood to reap special tax credits for donating a portion of the land to City as well.
- The market value of the property was $45 million and the Fortune 50 Company didn't want any environmental contamination to significantly discount the property.

Case Study – Fortune 50 Company Sale to Local Developer

Issues

- Magnitude of cleanup problem was estimated near $10 million – developer (buyer) wanted to discount the purchase price much by significantly greater than $10 million.
- Developer assuming the risk under an LLC company raising the concern for the Seller about solvency issues, and the liability boomeranging back to the Seller in the future.
- Developer had very limited experience with contaminated properties another big concern for the Seller.
- Cleanup would be done under voluntary program that had yet to be negotiated with DEC; the sale would need to occur prior to full site characterization and remedy agreement with DEC.

Fortune 50 Company Sale to Local Developer (Continued)

The Solution

- An insured fixed-price solution was developed which consisted of selecting a cleanup contractor who would assume the regulatory cleanup liabilities.
- The insurance program provides coverage from dollar one for cleanup of known and unknown conditions by pre-funding the expected net present value of the cleanup (contractor's price, negotiated and accepted by the insurer). The insurer held the money for the cleanup in a commutation account (similar to escrow) and would disburse it as the contractor completed the agreed upon work. Therefore, the cleanup funds would be protected in the event of the contractor's bankruptcy or default.
- A 15-year term environmental program was structured to cap known and unknown cleanup liabilities, toxic tort including natural resource damages and new pollution conditions. Additionally, business interruption loss for new pollution conditions including business interruption caused by mold liability was covered– an emerging concern in residential property. The aggregate limits of liability structured for the program were $100 million.
- The developers lender was named on the policy and if the developer would become insolvent the lender would have step up rights to control the policy.