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ACE Progress Report℠:

Contractors and Consultants Face Increasingly Strict Environmental Laws

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By Barbara Deas and William P. Hazelton

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Protect Against Environmental Liabilities

Environmental insurance for contractors and consultants is not just a safeguard against massive lawsuits linked to clean-up operations at toxic waste sites. Today, virtually any contractor or consultant faces a growing array of environmental risks and liabilities due to increasingly strict environmental regulations. As a result, more and more contractors and consultants are vulnerable to both new and newly enforced regulations, and potentially costly liabilities, all stemming from pollution incidents at job sites. Given the expensive remedial work, project delays, and lost revenues that could result, there is a growing trend in both public and private projects to require substantial environmental insurance coverage – even on jobs for which it was not previously required in the past. In addition to this scenario, many contractors are looking for work in a weak economy, particularly in the area of infrastructure projects, and that leads them to venture into areas outside their proven expertise – areas where they may not be aware of the potential liabilities.

Work by a contractor that creates pollution, or exacerbates an existing condition, may create liabilities stemming from injured parties and necessitate an extensive remediation effort. For a small to mid-sized contractor or consultant, these liabilities can be severe enough to jeopardize the existence of the company itself.

But, as regulations have evolved, so have the insurance coverages available for contractors' pollution liability. These coverages provide vital insurance protection against liability from pollution incidents for which contractors, subcontractors, and consultants may share legal responsibility.

The Environmental World

Over the last four decades society as a whole has become very environmentally conscious, and environmental concerns play an integral role in countless aspects of business, as well as everyday life. From recycling to clean energy, the imperative to reduce the environmental footprint resulting from human activities is growing. The construction industry, as well as environmental contracting and consulting specialists, play major roles in this process. Even as they assist in reducing our environmental footprint, they face potential environmental impacts as part of their jobs.

Projects must pass a series of regulatory hurdles before gaining local, state, or federal approval. These hurdles range from air quality issues, to riparian concerns for projects bordering streams and waterways – in other words, soil and run-off issues where grading is involved. Environmental specialists face even greater challenges with projects that involve so-called "brownfield" sites, where hidden pollutants may be present, as well as operations at sites that are known to be contaminated.

Before a construction project begins, environmental concerns should be addressed with thorough pre-planning. While a project is in progress, environmental impacts should be mitigated by taking the correct steps to manage and lessen the impacts. Even when a project is finished, environmental concerns are likely to remain.

Because of all these exposures, the environmental impact of a project should be considered at every phase, from start to finish. Contractors and consultants that ignore these concerns can expose themselves to significant legal risks and large fines.

Historical Evolution of Environmental Laws

During the last five decades, public concerns about the environment and ensuing regulations have grown because of large-scale pollution events that have gained widespread notoriety. Among these events were the discovery of toxic waste at the Love Canal site in the late 1970s; the spread of contaminants at Times Beach in the early 1980s; the Santa Barbara oil spill in 1969; the Exxon Valdez oil spill in Alaska in 1989; and the 2010 oil rig blow-out in the Gulf of Mexico. In addition, the use of once-common materials in the construction industry, such as asbestos insulation and lead paint, have been banned since the adverse health impacts of those substances were discovered.

In the case of asbestos, the costs have been staggering. Until the late 1970s, asbestos was used in many types of residential and commercial building products and insulation materials. Tens of millions of people have been exposed to asbestos in the United States, and hundreds of thousands of people have filed lawsuits. The total cost of the litigation through 2003 was estimated at $70 billion, and the total eventual cost is estimated to be more than $200 billion.[1]

Love Canal and a separate incident at Times Beach, Missouri both illustrate the potentially high costs of pollution for communities and businesses. The Love Canal site in upstate New York was used as a dump for chemical wastes for several decades, before the waste drums were covered over and the land sold to the city for one dollar in 1953 by the Hooker Chemical Company.[2] About a hundred homes and a school were later built on the site. When toxic chemicals were discovered leaching into yards and homes, more than two hundred families had to be relocated. Occidental Chemical Corporation, which had acquired Hooker, agreed in 1995 to pay the federal government $129 million to cover the costs of the clean-up.[3] The Love Canal incident resulted in the implementation of the federal Superfund law in 1980.

At Times Beach, Missouri, roughly two thousand residents were relocated after wide-spread dioxin contamination was discovered following a flood. The dioxin stemmed from a combination of waste oil and chemical wastes that were sprayed on dirt roads in the area, beginning in the 1970s, to keep dust down. The federal government spent about $30 million to relocate nearby residents and businesses,[4] and later reached a $10 million settlement with one of the companies involved.[5] The town itself no longer exists.[6]

> During the last five decades, public concerns about the environment and ensuing regulations have grown.

The Evolution of Environmental Laws and Insurance

As the above incidents led to a greater awareness in our society, environmental laws and regulations were introduced and have continued to evolve, addressing everything from large scale concerns, such as smokestack emissions, to residential issues, such as household mold. The year 1970 was a landmark for environmental legislation. It marked the first Earth Day, as well as the establishment of the Environmental Protection Agency (EPA). The Clean Air Act of 1970, later revised in 1990, launched the serious nationwide effort to combat air pollution from both mobile and stationary sources. The Clean Water Act of 1972 authorized the federal government to limit pollution from point sources, including pipes flowing into waterways. Over the last 30 years, regulators have also begun paying greater attention to issues involving water run-off from streets, construction sites, and other sources.

In 1976, Congress passed the Resource Conservation and Recovery Act, which gave the EPA the power to regulate toxic waste. Four years later, the Superfund law was enacted following the Love Canal incident. That law set up a mechanism to pay for the cost of remediation and took a strict "polluter pays" approach for clean ups. The law also established retroactive liability, so companies may find themselves liable for the cost of cleaning up sites that had not violated then-existing laws, or may face legal liability following an acquisition, also known as legacy liability – such as the situation between Occidental and Hooker Chemical. These basic environmental laws have undergone numerous additions and updates in the ensuing years, in response to specific incidents and the growing general awareness about the hazards of toxic pollution.

As the legal and regulatory landscape has evolved, so too has the insurance industry. When the Superfund law was proposed and enacted, insurers were faced with a flood of claims for new-found environmental liabilities, under commercial general liability, umbrella, and excess policies that had not been designed or priced to cover such claims. Insurance companies began to use specific pollution exclusions in those policies around the time of the 1973 revision of the Insurance Services Office (ISO) standard Commercial General Liability (CGL) policies, which included the first attempt at such an exclusion on an industry-wide basis. The exclusion was revised in 1986 and again in 1988. Once the specific exclusion of pollution coverage in these long-standing coverage lines became commonplace, the insurance industry began developing specialized, stand-alone environmental insurance coverages. These policies have become increasingly popular since the mid-1980s, due in part to the exclusion of such risks from commercial general liability policies, but also because they provide coverage for specific environmental risks. Contractors pollution coverage provides insurance for environmental risks at job sites owned by another entity, whether it be a government body or a private company.

> Today, environmental laws apply to an even larger range of activities, and affect a far greater number of companies than when they were first implemented.

Originally, demand by contractors for environmental insurance was largely driven by the desire to protect against the risk of lawsuits and legal judgments, tied to pollution caused by an accident, or as protection against previously unregulated practices. Over time, many commonplace practices have become subject to regulation, and environmental laws have become an additional driver in the purchase of environmental insurance by contractors and consultants.

After the passage of the 1980 Superfund law, also known as CERCLA, the courts began to hold contractors liable for spreading hidden contaminants at work sites through such routine activities as grading and filling. In one notable case, a construction contractor excavated, graded and filled land to build apartments on the site of a former trucking terminal where a variety of chemicals and pesticides had contaminated the soil. The residents were later relocated and the apartments demolished. More than 20,000 tons of sludge, contaminated soil and debris were removed from the site. At trial, the court held that the dispersal of contaminants through construction work could be construed as disposal under the Superfund law, in a ruling that ultimately cost more than $4 million.

In other cases, a utility contractor was held liable for transporting hazardous waste by unknowingly moving dioxin-contaminated soil. Another contractor was held liable for moving contaminated soil from one area to another within the boundaries of a work site. The courts have also held that companies that conduct soil testing can be held liable for disposal of hazardous wastes that occur during testing.

Today, environmental laws apply to an even larger range of activities, and affect a far greater number of companies than when they were first implemented. For instance, EPA regulations effective April, 2010, concerning lead paint, require contractors renovating or repairing homes built before 1978 to obtain certification and take measures to reduce the spread of lead paint dust.[7] The EPA has also been actively addressing the problem of water run-off from industrial and construction sites. In August of 2009, for instance, the EPA fined a ready-mix concrete company $2.75 million for storm water run-off violations at 23 sites in Massachusetts and New Hampshire, under the Clean Water Act.[8] Earlier this year, the EPA announced the first expansion of its Toxic Release Inventory list of reportable chemicals in more than a decade. Under the proposal, the agency would add sixteen chemicals to the list of potential carcinogens.[9]

Overall, the Obama Administration has been taking a more proactive stance toward environmental regulation. That more aggressive stance to enforcement has resulted in a significant increase in funding. The EPA's budget for fiscal year 2010, the first new fiscal year under the new administration, was increased by the biggest percentage in more than two decades.[10] The $2.65 billion, or 34.7 percent, budget increase to $10.3 billion was the largest, in percentage terms, since fiscal year 1987. The allocation for enforcement was increased by $32 million, or 5.7 percent, to about $600 million. As a sign of that stricter approach, EPA Administrator Lisa Jackson pledged, in 2009, that under the Obama Administration, "the environmental cop will be back on the beat."[11]

Environmental Coverage Required for Bidding

At the same time that the federal government is taking a more rigid stance toward environmental regulation, government at all levels is increasingly requiring both environmental and non-environmental contractors and consultants to carry pollution liability coverage as a condition of bidding on and winning projects. For instance, the city of Norwalk, Connecticut requires contractors bidding on projects that involve hazardous waste to carry environmental liability coverage, with a single occurrence limit of at least $1 million.[12] In a sluggish economy and a very weak housing and construction market, infrastructure projects and other government-financed work may be some of the few opportunities open to contractors who have seen their other business dwindle. Of contractors surveyed in 337 metropolitan areas, 294 lost construction jobs from May 2009 to May 2010, according to an analysis of federal employment data by the Associated General Contractors of America (AGCA).[13] Chicago lost more construction jobs than any other metropolitan area. In the same time period, private non-residential construction spending sagged 25 percent, while public construction declined just three percent. Areas that received stimulus spending under the $787 billion America Recovery and Reinvestment Act of 2009 showed gains. For instance, highway and street construction rose 5.6 percent, transportation increased 13.8 percent, and conservation and development rose 23 percent, according to the AGCA.[14] With the sharp decline of the housing market in the last few years, the focus in the construction industry has shifted from mixed-used commercial/residential work, to these infrastructure projects, often funded by the government. This increase in governmental job opportunities has continued to influence the need for environmental insurance products.

Contractors who may have specialized in one area, such as condominiums, are now faced with unfamiliar rules and regulations as they compete for business in these new areas – for instance, road and public building projects. While the learning curve can create additional liability exposures, these projects are being funded with federal stimulus money and are likely to require environmental insurance. More and more contractors find themselves in the position of having to acquire environmental coverage in order to bid on government-sponsored projects. This makes it crucial for contractors to understand the coverages that are available.

Projects in the private sector now require environmental liability insurance coverage for work performed under a contract that has traditionally not been thought of as "construction." For example, many of the nationally-known fire and water restoration contracting firms now require their franchisees to carry contractors' pollution liability, with a single occurrence limit of at least $1 million. In the traditional private construction market, stricter environmental laws and more focus on aggressive enforcement have led more developers to require contractors to be insured against environmental risks. Earlier this year, for example, the EPA levied a $1 million fine against a home builder for run-off from construction sites in 18 states.[15] Builders are also subject to enforcement action over air quality issues. In Arizona, the EPA fined a builder in Maricopa County (which includes the city of Phoenix) $106,000 in July 2010, for failing to control dust at its construction sites.[16] Enforcement activities can include relatively small-scale projects. The National Pollutant Discharge Elimination storm water permit program affects construction sites that disturb as little as one acre of land.[17] Discharges of muddy stormwater from a small construction site may seem commonplace, but federal regulators take them very seriously. The EPA estimates that erosion from a one-acre site can discharge as much as 20-150 tons of sediment in a year to streams, ponds, and rivers.[18] If that run-off carries pollutants, such as heavy-metal contamination, the consequences can be even more severe for the contractor.

Along with outdoor polluters, regulators have tightened regulations concerning interior space, particularly with regard to issues such as asbestos, mold, and lead. In April 2010, EPA rules governing renovation, repair and painting in homes with lead-based paint took effect. These regulations potentially affect tens of millions of homes nationwide, and require contractors who work in homes built before 1978 to be trained in

government-approved procedures designed to reduce the spread of lead contamination. Besides painting, the regulations apply to contractors doing any remodeling work, such as the installation of windows that could spread lead paint dust throughout a home, and, as a result, may require the use of specialized air filters and vacuums.[19] The rules apply to remodeling and renovation projects that would disturb more than six square feet of lead-based paint.[20] An exemption that allowed homeowners to opt out of the requirements has now been closed. Beginning fall 2010, the EPA has said that it will delay enforcement measures of the new lead regulations.[21]

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Expanding Environmental Risks

As environmental rules affect greater areas of construction and other service-related activities, contractors and environmental consultants face a growing number of potential environmental liabilities. Practices that in the past had been considered normal – such as allowing muddy water to drain from a construction site, or simply scraping and sanding old paint – can now lead to hefty enforcement penalties. In the face of these new liabilities, contractors need to be aware of the environmental risks they face, whether in their traditional area of expertise, or in a new endeavor. These risks run throughout the project lifecycle and apply indoors as well as outdoors. Inside, for instance, contractors dealing with air ducts need to be mindful of the potential to spread asbestos and mold. For work on pre-1978 buildings, painting contractors will have to sample the paint to determine whether lead is present, and then take adequate measures, including the establishment of containment zones. Water intrusion that allows mold to grow could pose a potentially costly problem for the contractor.

Outside, silica dust from cutting concrete block could be an issue, and would require contractors to take measures to contain that fugitive dust. There may be fueling operations on a job site that carry the risk of spills, and should be addressed with contingency plans for fuel and lubricant discharges. Plans must also be developed for the disposal of other wastes, such as chemicals, which may carry a liability exposure for everyone involved in dealing with or moving the waste. While petroleum and chemical wastes may seem a more likely focus for environmental measures, contractors also have to be concerned with the more mundane issue of how to deal with storm water run-off from a site. Each site and each project will have its own demands, as well as different impacts on the surrounding environment, which may vary from streams, to wetlands, to deserts. All these external impacts have to be taken into consideration, along with the capabilities of the contractor or consultant.

Controlling Environmental Exposures

Broadly speaking, the risk mitigation measures that contractors and consultants should consider include: contractual issues, sub-contractor selection, programs and procedures, environmental regulations, changes in regulations, waste disposal, and adequate insurance protection.

First under consideration are the contractual liabilities assumed in securing the project. The contracts should spell out the liabilities, as well as the insurance requirements. The contract may specify the terms of indemnification and hold harmless provisions regarding environmental liabilities. A general contractor or sub-contractor taking on a job may find themselves the first line of monetary and legal defense, should an environmental issue arise.

By the same token, general contractors relying on sub-contractors to perform critical functions should take the time to do the proper due diligence to make sure the sub-contractor is qualified to perform the work, and confirm that they have proper insurance in force.

Of course, contractors need to be aware of all relevant environmental regulations, obtain all the needed permits, and then comply with mandates. In addition to current regulations, contractors also need to be concerned with any regulatory changes that may arise in the course of a project. Environmental laws and regulations are constantly being updated, especially in response to a headline-generating environmental event. Contractors need to make sure that their procedures stay current.

Finally, waste disposal and waste handling remain critical. The potential liability in this area will extend from cradle to grave – from the company generating the waste, to those removing or containing it, transporting it and, finally, to those disposing of it. In addition to performing the proper due diligence for sub-contractors involved in waste handling, contractors and consultants also need to pre-qualify waste disposal sites, to make sure they conform to all legal and regulatory mandates. If the waste disposal site is not properly permitted, is leaching into the surrounding ground or water, or is in violation of other environmental laws, the contractor could be held liable for very expensive remediation measures at the disposal site, as well as fines.

Consider the examples of the contractors in the case studies shown below. For many middle-market contractors, this level of expense could be enough to threaten not only their financial well-being, but also the very existence of the company.

It Pays to be Covered: Case Studies

Example #1: The insured served as a construction manager for a school renovation project and entered into a subcontract for certain contracting services. The insured was sued for negligence by the subcontractor. The subcontractor alleged that the insured's acts and their omissions in carrying out their duties as construction manager led to significant delays and additional work by the subcontractor, resulting in additional claimed costs in the amount of approximately $500,000. Approximately $200,000 in legal defense expenses were also included as costs covered under the policy. This insured had the appropriate professional liability coverage extension and construction management was identified as a covered professional service under the policy.

Example #2: A fire at a treatment storage and disposal facility ("TSDF") allegedly caused the release of hazardous substances into the air, ground and water. This resulted in the evacuation of 17,000 nearby residents and businesses. The fire was allegedly exacerbated by the shipment of oxidizers to the TSDF. The shipment was allegedly

mislabeled and improperly characterized on the manifest. The insured was responsible for the shipment of the waste, and this activity was considered a covered operation under the policy. A class action lawsuit was filed by the neighbors against the TSDF and the insured, resulting in legal defense expenses and a settlement that exceeded $5 million.

Protection Against Pollution Risks

Because of the legal and regulatory risks discussed above, contractors and environmental consultants should carefully evaluate their exposures, and identify any gaps in environmental coverage. While contractors might assume that they would be covered by their commercial general liability policies, such policies may contain absolute or total pollution exclusions or exclusions with very limited exceptions. For environmental risks at a job site owned by another entity, a contractor should look for a contractor's pollution liability policy that provides coverage against financial loss resulting from a pollution incident, including legal defense costs. This coverage also provides an up-front sales tool to use in the bidding process, and enables a contractor to qualify where such coverage is required. In addition, the contractor should make sure the environmental policy he or she chooses provides protection against exposures due to the actions of sub-contractors.

Environmental activities where such coverage is crucial include: the abatement of asbestos, lead, and mold; restoration work; excavating or treating contaminants; installing or removing storage tanks or pipelines; and building or operating landfills, recycling facilities, water treatment plants, and hazardous waste facilities. For environmental contractors, these policies provide coverage for failing to properly clean up contamination, or for making existing contamination worse.

Contractors pollution liability coverage is designed for general contractors, as well as for environmental contractors and consultants. For general contractors, work that poses environmental and pollution risks includes such common trades as carpentry, painting, masonry, roofing, plumbing, electrical, central air installation, and janitorial services. In addition, excavation, grading and fencing, water and sewer, and street and road projects also carry environmental risks. Contractors pollution liability coverage can protect these contractors if they unknowingly cause contamination or contribute to existing contamination in the course of their operations.

> It is crucial to keep abreast of constantly evolving regulations, and to make sure that their insurance coverage also remains current in the face of changes to environmental laws and regulations.

Environmental contractors and consultants should work with their insurance broker to purchase contractors pollution liability coverage that extends to the professional services they provide as a part of, or in conjunction with, their operations. This coverage extension contemplates a wide spectrum of projects, from investigation and feasibility studies, to remediation and design, laboratory analysis, testing and monitoring, non-invasive geological surveys, training, permitting and compliance services. The policies can protect consultants against potential exposures from failing to assess contamination in the air, soil, or water; for errors in project management; for recommending the wrong course of action; or making mistakes in designing a remediation system.

In addition to the laws and regulations already being considered or in place, there is the certainty that new rules and regulations will be imposed in the future, in the natural course of politics or as new environmental catastrophes arise. Contractors and consultants may find themselves dealing with new regulations in the middle of a project, or they may find themselves facing new liabilities arising from changes in environmental laws. For this reason, it is crucial for contractors and consultants to keep abreast of constantly evolving regulations, and to make sure that their insurance coverage also remains current in the face of changes to environmental laws and regulations.

Conclusion: Managing Changing Environmental Risks

Since the first Earth Day in 1970, the world has become much more conscious of the impact of commerce and human activities on the earth's ecology. This growing environmental sensitivity has been reflected in the evolution of environmental laws. From statutes that sought to provide protection against major sources of pollution to the air and water, environmental laws have come to affect every sector of the economy, even including small building sites, and something as ordinary as painting a room in a house. This change in the legal landscape has had a particular impact on the construction industry, which by its very nature involves changes to the local environment, through building, grading or other activities. Whether dealing with known hazards, such as asbestos or lead, or developing a new housing complex or building roads or bridges, contractors face a wide variety of environmental risks.

A critical attribute of any successful enterprise is a thorough approach to risk management. While contractors may be thoroughly versed in the exposures they encounter in their ordinary course of business, such as personal injury or construction defect issues, too often they don't recognize the risks posed by evolving environmental laws. Environmental exposures, however, constitute a growing area of risk for contractors and consultants. Failure to adequately protect against these risks can result in multi-million dollar legal expenses, and even higher fines or awards that could jeopardize the company's existence. Fortunately, coverage for environmental risks has evolved along with these changes in laws and regulations, offering contractors and consultants crucial protection against constantly changing environmental exposures.

It is a prudent part of any contractor's and consultant's risk management process to review their insurance program with their insurance professional on a regular basis, to understand the actual terms, coverages, and limitations. They can then make an informed decision as to how evolving environmental regulations may impact their coverage, allowing them to maximize the protection afforded by their policies. This is an additional tool that will allow contractors and consultants to adjust to new environmental laws and social strictures, while maintaining their success in a highly competitive and demanding arena.

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