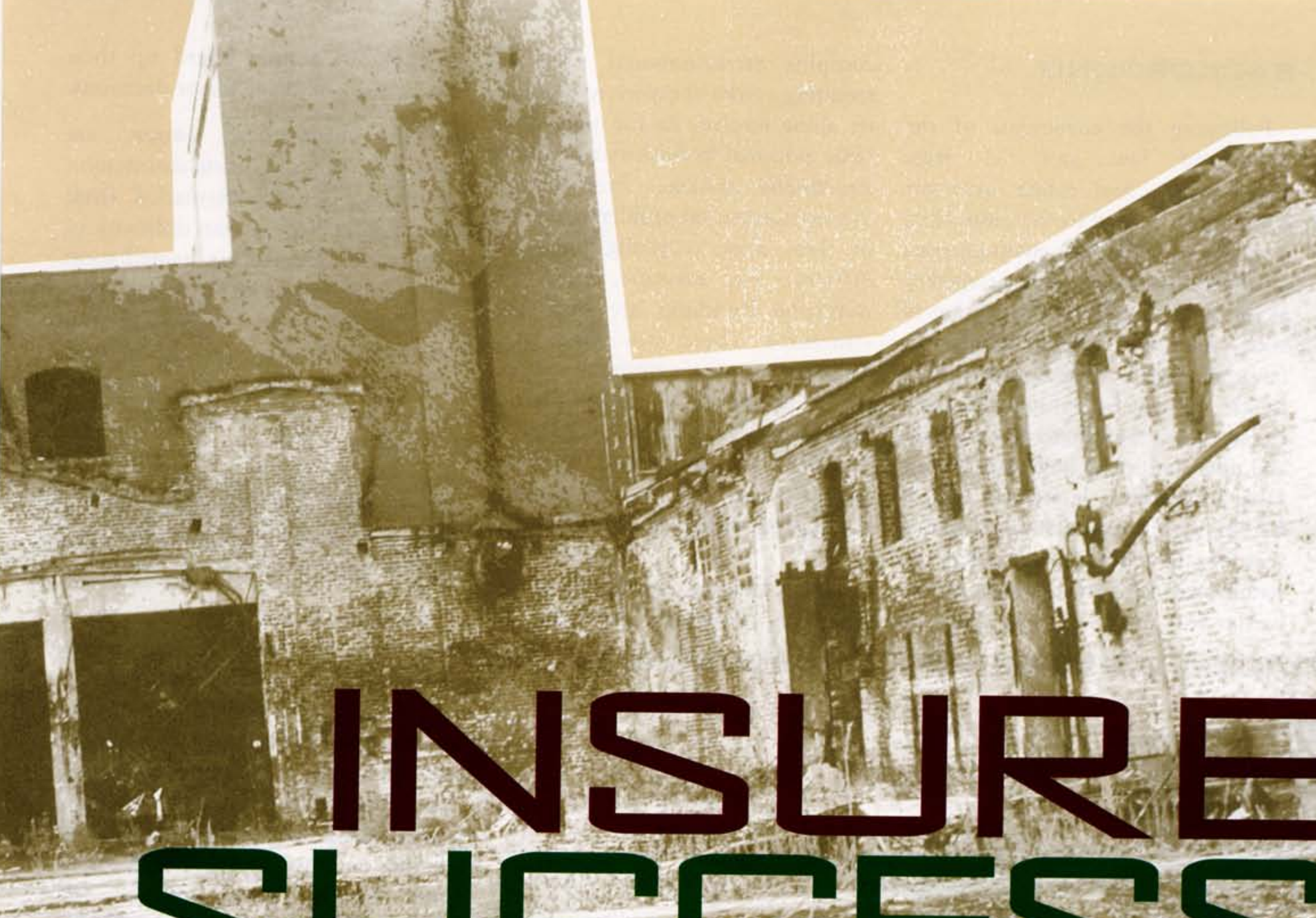

INSURE SUCCESS

SELL BROWNFIELD SITES WHILE ELIMINATING LIABILITY

BY RANDALL L. AIRST, ESQ., LLM

Many of America's largest corporations mothball brownfield properties — a strategy used for various reasons, including the desire to limit liability. Although this corporate objective is laudable, a mothballed brownfield leaves the owner responsible for recurring expenses such as property taxes, maintenance, security and liability insurance. Moreover, owners whose shares are publicly traded are also responsible for compliance with securities laws, including disclosure requirements.

Brownfield sites are distinguishable from Superfund sites in that the environmental problems are much less severe. A growing number of stakeholders are focusing on brownfield revitalization. This was not always the case.

BACKGROUND

Following the enactment of the Superfund law and its state counterparts, real estate investors and lenders tended to shy away from properties saddled with environmental problems. This stance was not surprising as the statute imposed the burden of strict, joint and several liability on innocent parties. Furthermore, those caught up in Superfund litigation reeled under the weight of expensive and time-consuming litigation. Among other objectives, legislators sought funding for the remediation of orphan sites. Instead of a source of funding, the statute provided potentially responsible parties with motivation to focus on litigation rather than remediation. The high costs of cleanup encouraged many potentially responsible parties to prepare for civil trials rather than endure the trials and tribulations associated with the imposition of Superfund liability. With average cleanup costs exceeding $30 million, many property owners felt they had no alternative but to vigorously contest liability. Cleaning up in court took precedence over cleaning up contamination.

The mere specter of contamination was enough to scare off many prospective purchasers. After all, millions of acres of pristine greenfields were awaiting development, free from complex environmental problems requiring a cadre of experts to diagnose, let alone resolve. At the same time, older industrial facilities were becoming structurally obsolete. Even without the environmental problems inherent in these sites, recycling them was difficult. For example, many old industrial buildings are multistory structures. These structures are a nuisance to manufacturing companies, which prefer single story structures with dedicated drive-in and loading facilities. Furthermore, investors generally did not have the tools to manage brownfield risks effectively.

More recently, advances in due diligence, insurance coverage, and regulation have opened the door for the revitalization of many more sites. Despite recent advances, hundreds of thousands of brownfield sites across the country continue to sit idle, producing no new jobs, and only meager tax revenue. Instead, they languish as visual blights and impediments to redevelopment.

UNCERTAINTY

One reason that brownfield owners mothball their properties is fear of the unknown. Unfortunately, the resolution of brownfield problems is often complex and requires the input of a broad spectrum of skilled professionals. Owners are often tempted to simply board up their properties and delay major decisions.

Some brownfield owners are initially willing to perform remediation activities, but are dissuaded from doing so because of the difficulty in accurately anticipating remediation costs at the outset of a project. Other brownfield owners would prefer to sell but confront a pool of purchasers who are equally concerned about uncertain remediation costs and contingent liability.

THE FIRST STEP: CHARACTERIZING THE BROWNFIELD

Many brownfield properties have not been thoroughly characterized. Characterization entails the performance of that due diligence required to ascertain the environmental condition of a property to a reasonable degree of certainty. Insurance underwriters will demand that sites are characterized before coverage is provided. Without this characterization, coverage will either be unavailable or will be prohibitively expensive. Once a brownfield has been characterized, owners can make their properties much more marketable by examining insurance options before beginning to market their brownfields. Two insurance products in particular can be very helpful to brownfield vendors: Cleanup Cost Cap and Pollution Legal Liability.

CLEANUP COST CAP

Brownfield owners can purchase coverage which caps environmental remediation costs. This Cleanup Cost Cap Policy provides protection for both known and unknown pollution. The insurance underwriter and the insured agree on a cap for the remediation of known environmental problems. The insurer will be responsible for costs which exceed the agreed upon cap. Cost Cap Coverage also protects against undiscovered contamination. The underwriter provides the brownfield owner with protection against previously undiscovered environmental problems. With this protection in place, disclosure obligations can be met with greater precision, and the outer limits on remediation expenses may be stated with confidence. This will help public corporations meet their disclosure requirements, without providing either an unjustified sense of confidence or instilling undue concern in existing or prospective investors, bond holders, securities analysts, or others.

Placing a cap on cleanup costs removes the possibility that remediation expenses will spiral out of control. With a clearly delineated ceiling on remediation expenses, the owner can follow the most prudent course of action. The owner can begin by comparing post-remediation returns from the sale, rental and mothballing of the property. The investment in due diligence often provides an excellent return as the cap on clean up costs should increase the pool of prospective purchasers. Furthermore, prospective purchasers can no longer claim the need to cushion their rate of return because of the risk that cleanup costs will be higher than initially anticipated.

POLLUTION LEGAL LIABILITY

Another policy is known as Pollution Legal Liability Insurance. The protection available under this policy is triggered by any one of the following: 1) discovery of an environmental problem by the insured; 2) a third-party claim; or 3) government mandate. PLL provides the insured with two types of protection: 1) indemnification against liability; and 2) funding for those legal costs necessary to defend against the covered actions. The indemnification component of the policy guarantees that the insurer will step in to cover legal liability which arises at the covered property. These policies do carry limits and the risk manager should be careful to match coverage limits and risks. The duty to defend constitutes the second major component of this policy. Legal costs can quickly mount in complex environmental cases. Owners whose legal costs are covered should feel much more comfortable whether they retain their brownfields in an inactive state, market them for lease, or attempt to sell them.

BROWNFIELDS MARKET

Brownfield properties are owned by a diverse group of parties. These groups include sole proprietorships, limited partnerships, limited liability companies, governmental entities and public companies. Some brownfield properties are owned by large corporate entities who have decided that it is in their best interest to leave their brownfield properties idle. These decisions are not made lightly, and are certainly not without some justification.

There is a limited market for brownfield properties. One part of the market is composed of purchasers who either cannot or will not invest the funds necessary to deal appropriately with environmental problems. Responsible brownfield owners will not sell to this group for a variety of reasons. One is that responsible owners feel a sense of stewardship towards their brownfields and the communities which host them. These owners do not want to place their brownfields in the hands of parties who will exacerbate existing problems or jeopardize human health or the environment. Another is that selling a brownfield often increases the risk of litigation, adverse publicity, as well as higher legal and other professional expenditures. For many brownfield owners, these risks outweigh the potential monetary gains of a sale.

Another part of the market consists of brownfield purchasers who recognize the potential pitfalls inherent in brownfield redevelopment and are committed to conducting due diligence required to ascertain the problems at a property. Due diligence must be conducted prior to settlement, as it often uncovers additional environmental problems not previously known to the vendor. Depending on the language of the agreement of sale, discovery of previously unknown problems can delay settlement, scuttle the deal, or trigger abatement in the purchase price. Vendors and purchasers must tailor contractual terms to suit the property in question, as well as the parties to the agreement. All of the expertise, expense and effort required to reach an agreement for the sale of a brownfield constitutes a barrier many owners are unwilling to surmount.

FULL AND FAIR DISCLOSURE

The diverse nature of brownfield owners is reflected in the divergent array of disclosure triggers to which they are susceptible. Private property owners may be required to disclose environmental problems to investors, lenders, prospective lessees and others. Environmental problems must be taken into account in situations ranging from estate planning and divorce settlements to the distribution of assets to private shareholders or partners.

The shares of public companies are available to the broadest possible array of investors, the public. Legislators and securities regulators take great pains to assure the integrity of securities markets. Public companies (also referred to herein as "regulated entities") are responsible for compliance with various securities laws, including disclosure requirements. Securities laws are imposed by both the federal as well as state governments. The exchanges which list securities impose an additional layer of rules on regulated entities.

Recent accounting and securities scandals have made regulators, securities analysts, and investors more sensitive to any lack of transparency or anything less than full and fair disclosure. Those who scrutinize financial statements (e.g., lenders, investors, due diligence professionals, prospective purchasers, etc.) will be paying increasing attention to contingent environmental liability. Due to the availability of tools such as insurance, the risks and costs of mothballing nonproductive brownfield properties may be growing in relation to those resulting from development or divestiture.

LIABILITY ISSUES AND RISKS

The potential for liability often looms as a possibility for brownfield owners. Concerns about liability dissuade many brownfield owners from actively marketing their brownfield property. These concerns are only

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exacerbated by the discounted price and protracted marketing cycle required before many brownfields can be sold.

While each brownfield is unique, these general concerns are often justified. Once a brownfield is sold, the vendor loses control over the property, any contamination, and the impact on the community.

Concerns about liability are not restricted to vendors. Prospective purchasers must factor concerns about liability and cleanup costs into their estimate of market value and potential. These and other risks and uncertainties lead many investors to require a higher rate of return than they would on nonbrownfield transactions. The result is that many companies with strong environmental records simply allow brownfield properties to accumulate in their portfolio.

This corporate strategy can be consistent with the duty of care owed to shareholders. However, holding contaminated properties can be risky as well as expensive. While a brownfield is being mothballed, the company still remains responsible for recurring expenses such as property taxes, maintenance, security and liability insurance.

Although they can certainly add up, these expenses are relatively minor. Potentially much more damaging is the ongoing threat posed to: 1) human health and the environment; 2) the host community; as well as 3) the owner's reputation and finances. Companies work hard to build and maintain brand images. Decades of successful branding can be permanently damaged by a single environmental incident at a brownfield property.

As discussed above, the act of exposing a brownfield property for sale also entails risk. One risk is that both previously identified and newly discovered environmental problems will be exaggerated in the mind of the public. Increasingly, this risk will have to be addressed by property owners who mothball their brownfields. Environmental issues will have to be disclosed whether or not the property is being marketed. Disclosure can be triggered by any number of events.

Continued on page 46

Insure Success
Continued from page 27

SEC MANDATED DISCLOSURE

The Securities and Exchange Commission imposes disclosure requirements on regulated entities. Public companies are expected to make full and fair disclosure of environmental matters which a reasonable investor would consider to be material in deciding whether to buy or sell a security. Many important regulations were enacted pursuant to two statutes, each of which governs behavior at a different stage of a securities' lifecycle.

The Securities Act of 1933 decrees that companies register their securities before they can be tendered for sale to the public. Registration requires that regulated entities follow a series of rules before their securities may be sold to the public. The registration process is designed to safeguard investors contemplating the purchase of securities.

The Securities Exchange Act of 1934 applies to regulated entities whose securities have already been tendered for sale to the public. The 1934 Act mandates that regulated entities regularly disclose information that would be material to investment decisions. Congress enacted the 1934 Act to preserve the integrity of trading in existing securities, or what is commonly called the secondary market.

Item 101: Material Effects of Compliance

Pursuant to Item 101, under Regulation S-K, registrants must describe material effects on capital expenditures, earnings and competitive position stemming from compliance with federal, state and local provisions which have been enacted or adopted regulating the discharge of materials in the environment, or otherwise relating to the protection of the environment.[1]

The term "material" is critical in deciding whether disclosure is required. The threshold for disclosure is triggered when: 1) a reasonable investor would probably have found the omitted information important; or 2) when the missing facts would have altered the total mix of information available to the investor.[2]

Item 103: Material Legal Proceedings

Pursuant to Item 103, under Regulation S-K, registrants must disclose material pending legal proceedings in which the company or

its subsidiaries are a litigant.[3] However, companies need not disclose legal proceedings which constitute routine litigation incidental to the business. Instruction 5 to Item 103 provides the regulated community with the SEC's position on what constitutes ordinary routine litigation. Specifically, an existing administrative or judicial proceeding or one that is known to be contemplated by the government does not constitute ordinary routine litigation incidental to the business if *any one of three* criteria are satisfied:

1) The proceeding is material to the business or financial condition of the registrant; or

2) The proceeding involves a claim or potential financial consequences that will surpass 10 percent of the collective assets of the registrant and its subsidiaries; or

3) A governmental entity is a party to the proceedings, unless the registrant reasonably believes that financial sanctions will be lower than $100,000.

Item 303: Management Discussion and Analysis

Item 303, more widely referred to as Management Discussion and Analysis, is an important source of environmental information.[4] MD&A requires registrants to provide a narrative report discussing liquidity, capital resources and results of operations. The report must include historical as well as prospective analysis.

At first blush Items 101 and 303 appear to encompass distinct similarities. An important distinction is that Item 303 includes a report on the registrant's future outlook. The SEC provided guidance on complying with Item 303.[5] In it the SEC provided a hypothetical in which a registrant had been correctly designated as a Potentially Responsible Party for the remediation of hazardous waste at three different properties. In determining whether disclosure of the registrant's PRP status was required, the SEC advised that the ability to defray costs through possible sources such as insurance can be considered in deciding whether a material impending impact is likely to be imposed. Based on the SEC's guidance, it appears as though it is the net figure, after calculating in potential contributions from other PRPs and other sources, which the registrant should use to determine materiality.

Section 10(b) of the Securities and Exchange Act of 1934

Section 10(b) of the Securities and Exchange Act of 1934 is broadly considered an anti-fraud provision. Section 10(b) is put into effect through SEC Rule 10b-5.[6] Acting in tandem, Section 10(b) and Rule 10b-5 produce a sweeping ban on false or deceptive disclosures.

Rule 10b-5 does not itself impose a duty to disclose on regulated entities. The provisions of Rule 10b-5 govern two principal types of disclosures: 1) those mandated by the SEC; and 2) voluntary disclosures and statements such as those made to securities analysts covering the company. The voluntary disclosures falling under the aegis of Rule 10b-5 consist of statements received by investors. Section 10(b) and Rule 10b-5 prohibit regulated companies from knowingly making false statements or failing to disclose material information.

ACCOUNTING FOR BROWNFIELDS

Securities laws are not the only rules governing the disclosure of contingent environmental liability. For example, the accounting profession must adhere to specific guidelines when determining how to treat contingent liability. The Financial Accounting Standards Board Statement No. 5 requires that estimated losses from contingencies must be charged to income on the balance sheet if: 1) it is probable that a liability has been incurred; and 2) the amount of the liability is capable of being reasonably estimated.[7] This statement can have a direct impact on a company's bottom line.

THE SARBANES-OXLEY ACT

The Sarbanes-Oxley Act includes the requirement that CEOs and CFOs certify their company's quarterly and annual reports. Certification must include the CEO's and CFO's endorsement that to his/her knowledge the report does not include any material misstatements or omissions. Changes in this area are likely to continue. Prompted by the spate of recent scandals, the General Accounting Office will be reviewing current norms in respect of environmental disclosures.

The Sarbanes-Oxley Act represents one of various important initiatives driving increased disclosure. The spate of scandals at MCI, Enron and elsewhere will ensure that closer scrutiny will be paid to contingent environmental liability. The need for more careful disclosure of contingent environmental liability has been simmering for some time. In 1993 the GAO published a study which discussed the lack of adequate disclosure of contingent environmental liability. Many *right of way* Magazine readers will be familiar with ASTM's E-1527-00 (the Standard governing Phase I Environmental Assessments). An alliance of charitable foundations and investment funds have petitioned the SEC to adopt recently published ASTM standards for estimating and disclosing environmental expenditures and liabilities.

INSURANCE LESSONS FROM THE WORLD TRADE CENTER

Brownfield revitalization often involves demolishing existing buildings, performing remediation activities and then rebuilding. The U.S. Conference of Mayors recently published their 2003 Survey on Brownfields.[8] The lack of demolition monies was listed as the 9th most cited impediment to brownfield redevelopment. Demolition costs were not however a factor at the World Trade Center site. Demolition and remediation was covered by FEMA, not by insurance companies.

Many observers believe that resolution of an insurance dispute will play a central role in the rebuilding of the site. Silverstein Properties secured a 99-year lease on the WTC site just six weeks before the September 11 attacks. Silverstein Properties purchased a $3.546 billion insurance policy for the commercial buildings at the site. The principal of Silverstein Properties is Larry Silverstein. The coverage purchased was "per occurrence." Silverstein's contention is that the attacks constitute two occurrences and therefore the insured is entitled to recover $7.1 billion. The insurers contend that the attacks constitute a single occurrence and therefore the insured is entitled to only the face limit of the policy.

Silverstein said the policy purchased was the, " ... largest property insurance program ever assembled for a single group of buildings." He further noted that because New York law relies on the immediate physical cause of the loss to ascertain the number of occurrences, the two attacks of two different planes entitle the insured to recover for the cost of rebuilding on a two occurrences basis.

The insurance funds represent the sole source of private capital for rebuilding the site. Silverstein's access to this capital, at a time when public funding is strained, has provided him with a great deal of leverage in negotiations over the future of the site. Ultimately, the dispute will be settled in court. The future of the site and possibly its control will only be determined once the issue of one versus two occurrences has been resolved.

Insurers are willing to customize policies. Brownfield owners need not, and should not, accept off the shelf coverage. Customizing insurance coverage can guarantee that adequate funds are available to meet both anticipated and unforeseen contingencies. The availability of insurance proceeds has provided Silverstein with control over the WTC site. Brownfield owners can similarly enhance their bargaining position through the judicious use of insurance coverage.

Companies work hard to build and maintain brand images. Decades of successful branding can be permanently damaged by a single environmental incident at a brownfield property.

CONCLUSION

The insurance coverage can provide brownfield owners, vendors and purchasers with enormous benefits. Using cleanup cost cap coverage, brownfield owners can chart a course for their properties knowing that the cost to cure will not exceed a specific amount. Being confident about the cost to cure provides owners with many benefits. Instead of guessing, brownfield owners will know precisely what their net proceeds from the sale or lease of a brownfield will be. Removing the uncertainty will help owners optimize the selling price as prospective purchasers will react positively to a cap on cleanup costs. The community will also benefit as an increased number of brownfields will be redeveloped once the risks of unpredictable cleanup costs are addressed.

Sophisticated users of financial and securities statements will be comforted by the protection offered by caps and liability coverage. Although only one of many factors which must be considered, this can have a positive impact on a company's stock price or bond rating. Insurance coverage can also help private companies in dealing with lenders, partners, shareholders and other stakeholders. Government agencies which own brownfields will find them more marketable and susceptible to redevelopment after they have been adequately insured.❖

REFERENCES

[1] 17 C.F.R. 229.101 (c)(xii).

[2] TSC Industries, Inc. v. Northway, 426 U.S. 438 (1976).

[3] 17 C.F.R. 229.103

[4] 17 C.F.R. 229.303

[5] Securities Act Release No. 6349 (1981).

[6] 17 C.F.R. s240.10b-5.

[7] Statement of Financial Accounting Standards No. 5 (Financial Accounting Standards Board 1975).

[8] Recycling America's Land: A National Report on Brownfields Development," The United States Conference of Mayors Report, June 2003. Page 14.