

Pollution events-an insured peril in property insurance?

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Mary is risk manager for ABC manufacturing company (ABC) and a member of the company's emergency management team. An incoming email immediately captures her full attention: "A fire has occurred at Plant 2. Several large storage tanks of solvents have ruptured due to heat from uncontrolled fire. Fire damage to machinery and equipment is extensive. Over 1,000 square feet of manufacturing space may be contaminated by corrosive solvents and toxic gas; some solvents have leached onto the pavement at the truck loading area at south end of plant. Work has stopped. All employees have been accounted for and non-critical employees have been sent home. EPA has been notified." One minute later Mary receives an email from the CFO: "Mary, please give me a summary of insurance coverage for this fire. I know we have insurance for the UST (underground storage tank) at Plant 2. I am concerned about contamination of ABC manufacturing property and our possible shut down by EPA."

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The risk management community has for many decades been concerned about pollution incidents and resulting financial responsibility. Bring up the topic of pollution and most people talk in terms of third party liability: above or below ground storage tanks, contaminants leaching into public water supplies, superfund sites and joint and several financial responsibility for clean-up costs. *If you were Mary how you would start your response to the CFO?*

Pollution is a first party exposure that may become a third party exposure. Risk controls for pollution such as dikes, berms and segregated storage may be the same whether the exposure is first or third party but insurance treatment is different. When was the last time you thought of a pollution incident in terms of *your organization's* exposure to direct property damage and resulting business interruption? Does your organization's property insurance provide adequate coverage for damage and suspension of operations due to a pollution incident? If not, is coverage available in another type of policy? These are important questions and each should be thoroughly reviewed and understood prior to an incident, not when preparing to answer a CFO at time of incident.

Instead of an actual incident at ABC let's change the story. Mary as risk manager is concerned about pollution exposures and potential first party damage and resulting business interruption. She seeks input from operations staff by asking for possible loss scenarios: incidents that could lead to pollution and resulting direct damage and business interruption. Mary uses these scenarios to test current insurance coverage *before* an actual incident. Test scenarios will allow her to consider and implement *proactive* changes to ABC's insurance program.

Property insurance policies often differ by insurer. For our purposes we assume ABC has direct damage and business interruption coverage from an insurer that uses Insurance Services Office (ISO) policy forms: Building and Personal Property Coverage Form CP 00 10 04 02; Causes of Loss-Special Form CP 1030 04 02; Business Income and Extra Expense CP 00 30 0402 and Ordinance or Law Coverage, CP 0405 0402. How will Mary respond to a pollution incident if ABC is insured by these forms? She must review coverage implications by peril, type of damage, and by amount of expense. Thus each policy form will have a bearing on overall coverage and must be reviewed carefully to determine if ABC can be made whole after loss event.

Pollutants

What is pollution in a property policy? ISO defines "pollutants" in its property policy forms as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals, and waste. Waste includes materials to be recycled, reconditioned or reclaimed." This definition is a key to understand direct damage and business interruption coverage that may be included or excluded in the ISO property policy forms.

Perils

ABC covered property is insured for direct physical loss or damage caused by or resulting from a covered cause of loss. Since ABC has the Causes of Loss-Special Form it has coverage for loss or damage from "direct risks of direct physical loss" unless otherwise excluded or subject to other policy limitations. The proximate cause of loss is fire and is understood to be a covered cause of loss within this ISO policy form.

Are there any coverage restrictions since damage has also occurred from pollutants? Coverage for release of pollutants is excluded unless the discharge, dispersal, migration, release or escape is from a "specified cause of loss". This means that the Causes of Loss-Special Form will have some coverage limitations as "specified cause of loss" is limited to the named perils of fire, lightning, explosion, windstorm or hail, smoke, aircraft or vehicles; riot or civil commotion, vandalism; leakage from fire extinguishing equipment; sinkhole collapse; volcanic action; falling objects, weight of snow, ice or sleet and water damage. What perils may not be "specified" and therefore not subject to coverage? Mary determines that pollution incidents such as accidental spills from manufacturing error or seepage from a corroded pipe are not insured in the ISO property forms. While these incidents may be fortuitous, have the potential for significant damage and result in extensive clean up expense neither is insured in ABC's property insurance.

ABC is located in a city known for building ordinances that require demolition of damaged property. Mary understands these ordinances may require demolition of certain portions of ABC's contaminated building, foundation and parking area. Does ABC have Ordinance and Law coverage for this type of enforcement of building laws? No. Ordinance and Law coverage specifically excludes coverage for costs from enforcement of law which requires demolition and removal of property due to contamination of "pollutants". There is no exception made for proximate cause of loss or in this case-fire.

Direct Damage

Damage has occurred to Plant 2 building, its machinery, stock and the loading area at the south end of the building including the adjacent parking lot. These items are insured, correct? Partially as certain items fall within "Property Not Covered": roadways, other paved surfaces, land and foundations. Direct damage is a requirement to trigger business interruption. This issue concerns Mary; if certain ABC property is not insured for direct damage will ABC business interruption coverage still apply? She makes a note to make sure she checks this out.

After the fire there will be extensive clean-up and debris will need to be taken away. Coverage for debris removal applies only to only "covered property" and does not apply to extract "pollutants" from land (i.e. parking lot paved over ABC land located at South end of Plant 2). This means cost to remove contaminated foundation and paved parking lot debris is not subject to coverage. The ISO Building and Personal Property Coverage Form provides coverage of \$10,000 to extract "pollutants" from water and land (parking lot) if the pollution is caused by a covered peril. Since fire is the proximate cause of loss, and a specified peril for pollution, ABC has "extraction" coverage, although \$10,000 may not be sufficient for a catastrophic loss. Mary makes another note to seek assistance on how to quantify clean-up costs for a pollution event-whether the event is caused by an insured peril a property insurance policy or not. She knows it is better to quantify exposure to set a coverage limit than to simply "pick" a limit.

Business Interruption

Plant 2 is shut down as a result of the fire which is later extended by EPA due to extensive contamination. ABC finds that some business interruption is a result of direct damage by fire as covered peril to its building, machinery and equipment. What about business interruption as a result of damage to "property not covered"? Mary looks closely at the ISO Business Income (And Extra Expense) Coverage Form. Coverage is triggered by suspension of ABC operations caused by direct physical damage to *its* property at a premises described in the policy Declarations and for which a business income limit is also shown. She determines that coverage is not limited to *damage to insured ABC property* but to *damage to any ABC property*-insured or uninsured by policy conditions. She concludes that while some property is not insured for direct damage (foundation, paved surfaces) the resulting suspension of operations is insured. Thus ABC has business income coverage for its suspended operations as a result of direct damage whether the direct damage is covered by the policy or not.

What happens if ABC is able to repair all damage and resume operations but must remain closed by order of EPA for further monitoring of toxic substances? The ISO policy form states ABC business income coverage ceases when its property should be repaired or rebuilt. The "period of restoration" in the business income coverage does not apply to any increased period when required by enforcement of any ordinance or law to test or monitor the effects of pollutants.

Will ABC have coverage for business interruption from suspended operations as a result of an EPA directive to demolish contaminated portions of Plant 2? No. The Ordinance and Law coverage endorsement specifically excludes coverage for damage resulting from enforcement of any ordinance or

law which requires demolition of property due to contamination by pollutants. Business income coverage is not triggered as the EPA directive does not fall within a “Covered Cause of Loss”.

Next Steps

Certain pollution clean-up and extraction costs do not appear to be sufficiently covered by ABC’s property insurer’s use of ISO policy forms. Mary asks for assistance from operations staff to quantify the potential costs associated with debris removal and extraction of pollutants from land and water. Mary reaches out to other risk managers and insurance brokers to conduct a policy review to determine coverage terms offered by other insurers that may not use an ISO filed policy. She learns that some insurers do provide broader pollution coverage for direct damage and business interruption than that provided by ABC’s insurer. But even the other insurers use sublimits for debris removal and extraction of pollutants that may be much less than actually needed by ABC. The consensus is property insurance policies are not designed for pollution exposures especially that which arises out of other than an insured peril such as fire. Mary understands a sublimit or exclusion in one insurance policy does not necessarily mean that no other coverage is available; it means more appropriate coverage may be provided by other insurer using a different policy form. She learns that direct damage and resulting business interruption from a pollution event is available in a pollution liability policy.

Pollution insurance: stand alone policy

ABC has a pollution legal liability policy for a UST located outside of Plant 2. Mary reviews this policy to determine if this policy may provide coverage to dovetail with the limited pollution coverage provided by ABC’s property insurance. When ABC analyzed its UST pollution exposure its concerns were in terms of an underground leak that required extensive land clean-up expenses and its more significant third party exposure since the tank is proximate to a public water supply located near the ABC manufacturing facilities. There was no concern at that time for clean-up costs and related expenses from a pollution incident *within* an ABC building as is assumed in this scenario regarding Plant 2. Seepage from a corroded pipe within Plant 2 is deemed by Mary and the operations staff to present a serious exposure from both clean-up expenses and lost income and increased operating expenses from business interruption.

The ABC pollution policy provides coverage for “on-site clean-up of new conditions”. ABC can expand its existing coverage to include discovery of a new condition as a result of a pollution incident in Plant 2 as well as the other ABC manufacturing facilities. The business interruption exposure from suspended operations can be insured by this same policy. The catastrophic nature of a pollution incident whether caused by fire or spill within Plant 2 is deemed appropriately insured by the pollution policy.

Conclusion

Exposures must be thought of in terms of cause (peril) and effect (direct damage and suspension of operations) not in term of simply policy specific coverage. While the underlying story is fictional risk management professionals must continually test insurance coverage prior to a loss event. If Mary had not considered all first and third party pollution exposures then ABC may experience a significant uninsured or underinsured pollution event if the fictional incident at Plant 2 had actually occurred. How do you want to respond to a CFO at time of pollution event?

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