

**Real Estate Environmental Liability Insurance
Highly Protected Risk / With Mold Coverage**

**A Superior Approach to Insuring
The Environmental Hazards
Of
New Commercial Construction Projects**

March 2006

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Introduction

Universal Mold exclusions in all forms of business insurance policies have left developers, owners, lenders and contractors uninsured for mold related damages. Advances in mold loss prevention engineering and building products have enabled the development of specialized insurance products that can help manage the mold and other environmental risks associated with new construction. The introduction of Real Estate Environmental Liability insurance with highly protected risk loss control services built into a multi year insurance policy that matches most project finance terms promises to revolutionize the way environmental loss exposures are insured on new construction projects in the future. This innovative insurance product will be referred to as a REEL/HPR/Mold policy in the rest of this paper. The acronym stands for Real Estate Environmental Liability insurance with Highly Protected Risk engineering services supporting a Mold coverage element.

Insuring pollution and mold claims arising from the property itself on an Environmental Impairment Liability (EIL) based policy form instead of only insuring claims arising from the contractor's described operations on a Contractors Pollution Liability (CPL) policy produces many benefits to the insurance consumer. These benefits include; broader coverage, lower total cost of risk, prefunded ongoing building science based loss control services, fixed cost non-cancelable policies, and streamlined claims handling. A REEL/HPR/Mold policy (an expanded form of EIL insurance) on a new construction project will usually cost considerably less than the separate environmental insurance policies that would have to be purchased by the developer, and eventual owners of the project to duplicate the coverage provided in the REEL/HPR/Mold policy for the same coverage term. In addition the real estate based environmental insurance on a new construction project will normally be a better insurance investment for the insurance consumer because the policy has been crafted specifically for the purpose of insuring new construction. In contrast CPL policies were originally developed to insure contractors cleaning up Superfund hazardous waste sites and are not as well suited to address the long-term environmental loss exposures including the indoor air quality of new habitational construction. A specially tailored CPL policy can protect the interests of a contractor but provides inadequate coverage for developers, owners and lenders.

This paper compares and contrasts these two different coverage options to insure the environmental hazards associated with new construction. All factors considered, purchasing Contractors Pollution Liability (CPL) insurance is still preferable to going bare, and may be the only coverage option for a general contractor if all of the subcontractors are to be insured under a wrap up. However when compared to CPL coverage options, insuring the environmental loss exposures associated with new construction on a single real estate based environmental insurance policy that offers specialized building science based loss control support over a long policy period is a superior over all risk management approach for developers, general contractors, owners and their lenders.

Background

When mold launched onto the scene as the “pollutant” of the new millennium, the stigma associated with “toxic” mold alone was enough to stop construction projects in their tracks if a water intrusion problem developed. But mold has a lot more bite than stigma. Mold related claims on new construction projects measured in the tens of millions of dollars are not rare. There are even a handful of toxic mold lawsuits on new construction projects with alleged damages in the billions of dollars. Toxic mold claims were once insured in standard general liability insurance policies. Today with universal mold exclusions in place it is very unlikely there is any coverage for mold related claims unless everyone associated with the project has purchased a separate environmental insurance policy and expanded it to address mold related claims. REEL/HPR Mold is specifically designed to address this exposure to loss for the developer and owners. CPL coverage’s were never intended to address the first party insurable interest of lenders and developers and therefore do a poor job in doing so.

Universal mold exclusions and limitations in addition to the pollution exclusions on insurance policies carried by virtually everyone associated with a new construction project have created a need for special insurance treatment of the “environmental” loss exposure on new construction. In the simplest terms, mold exclusions are really just another form of pollution exclusion for the specific pollutant mold. Pollution exclusions have been in insurance policies for thirty years. However no one really knows for certain what the effect of a pollution exclusion on an insurance policy will be until a loss is reported. The facts associated with an individual loss including what state it is in will dictate how a pollution exclusion and mold related claims exclusion will be applied in a coverage determination. The coverage ambiguity associated with these exclusions makes relying on the remnants of insurance coverage not eliminated by total or absolute pollution exclusions and now universal mold “related” claims exclusions in a standard insurance policy very dangerous. Because of these exclusions separate environmental insurance needs to be purchased to fill the coverage gaps created by pollution and mold exclusions.

Pollution exclusions have the distinction of being the most litigated words in the four hundred year history of the insurance business. With courts split after twenty-five years of continuous litigation on the meaning of various terms within pollution exclusions, it is safe to predict that no one knows what the effects of mold exclusions will be either. However it is easy to forecast that “Absolute “ or “Total” pollution exclusions combined with universal “mold related claims ” exclusions that are now standard additions to General Liability, Umbrella Liability and Builders Risk insurance policies leave all of these policies with totally inadequate coverage for the environmental loss exposures associated with new construction projects. Lenders in particular have been slow to come to this realization and continue to fund high-risk projects that are uninsured for mold related damages.

Historically, the environmental loss exposures associated with construction operations were insured under a Contractor’s Pollution Liability or Contractor’s Environmental

Liability policy form. These are different brand names for the same type of insurance coverage. A Contractor's Pollution Liability policy insures "pollution" claims for Bodily Injury, Property Damage, Clean Up and Defense arising directly out the negligent Described Operations of the insured contractor. When the environmental loss exposure of concern involves the emission of a pollutant from the job site, Contractor's Pollution Liability policies are a good way to fill the gap in liability coverage created by "absolute" or "total" pollution exclusions on all traditional liability insurance policies. Because of the far-reaching effects of pollution exclusions contractors are well advised to carry CPL coverage as part of their annual "practice" insurance packages. However, for a number of reasons that are detailed latter in this paper, off the shelf Contractor's Pollution Liability policies do not provide sufficient coverage for mold related damages and are not the best insurance coverage choice to insure new habitational construction projects.

Mold has created a new risk management paradigm for new construction projects. Unlike the release of toxic substances due to contractor negligence, mold in the built environment can arise from ongoing operation of the building after the contractor has left the project. Managing the ongoing loss exposure from mold for owners, developers and lenders requires a different kind of environmental insurance that is not dependent upon the general contractor's "negligent operations" during construction as a coverage trigger. The developer, owner and their lender all have insurable interests in the long-term management of water intrusion/mold risks in new construction. Where each of these entities have different types of environmental insurance coverage available to them, if each buys their own project specific insurance to address this loss exposure, the environmental insurance costs on the project will likely be triple the cost of a single policy that insures them all. The REEL/HPR/Mold is the wrap up policy form that can insure the interests of the developer, owner and lender on a new construction project. A unique feature in REEL/HPR/Mold insurance is the subsequent owners of a project for example a condominium association can have the REEL/HPR/Mold policy assigned to them for the remainder of the policy term one the property has been transferred to them. This transfer of the insurance protection is done without additional premium.

The remainder of this paper will highlight some of the differences between using a "contractor's negligence" based environmental insurance policy or using a real estate based environmental liability policy to insure the environmental loss exposures associated with new construction projects.

Contractor's Pollution Liability

A Contractor's Pollution Liability (CPL) policy insures against liability claims caused by the release of "pollutants" from the described operations of the first named insured. CPL policies are sometimes sold on an owner-controlled wrap up basis. However, even the CPL policies sold to owners refer back to the negligent operations of the contractor at the job site in the insuring agreement. In contrast, a real estate based environmental liability policy insures pollution loses arising from the site without a negligence requirement. This fundamental difference in the insuring agreements of the policies

permeates throughout the coverage provided in the two policy forms and makes the real estate based coverage's a superior coverage form for insuring new construction.

Pollution losses that are not a result of the contractor's (the insured's) negligent work are not covered in the CPL policy form. Therefore there is usually no provision for no-fault, on-site clean up of pollutants in a CPL policy. In contrast, real estate policies (REEL) have first party no fault on site clean up coverage built into the policy or available as an option. For example if the contractor discovers a toxic waste dump in the excavation of the building foundation, the cost to clean this up to regulatory clean up levels would be a covered claim in a REEL policy but would not be covered in a CPL policy because the contractor was not negligent.

It is common for CPL policies to exclude property damage to the insured's work. Where this provision is not of major concern for an environmental contractor digging up a Superfund hazardous waste site, this exclusion creates a major coverage deficiency for any contractor putting up a building and trying to insure against the mold hazard. Since the entire building is the "insured's work" this exclusion could make the policy considerably less valuable by excluding all property damage claims to the building. In contrast, real estate based policies do not have an "insured's work" exclusion.

Due to their relatively narrow insuring agreement, CPL policies usually have lower self-insured retentions than real estate based policies with long policy terms. The first named insured (the contractor) in a CPL is always responsible for paying the self-insured retention. In contrast, responsibility for paying the self-insured retention actually shifts to the project owner in a REEL policy when the policy is assigned to the owner upon project completion.

Contractors Pollution Liability policies are usually written for a policy term equal to the length of time actual construction operations are being performed. This initial coverage term is supplemented by adding either extended discovery clauses (these provide inadequate coverage for owners and developers because the pollution event would have to take place during the original policy period to be covered) or completed operations coverage for a period of time past job completion. It is important to note that for CPL coverage to apply to a claim, the origin of the pollution event had to be from the contractor's described operations during the policy period or completed operations coverage period. CPL policies do not provide any protection for pollution related losses that are not directly related to the described operations of the first named insured on the policy. For example improper maintenance would not be covered under a CPL policy, which could cause an uninsured loss and the resulting diminution in value for the owner and the lender.

CPL policies do not provide ongoing loss control services. To complicate implementing an over all risk management strategy on a construction project, the insured contractor and their insurers lose access to the building once the property is sold. Ongoing access to the property is not critically important to a CPL underwriter since they are only insuring claims arising directly from the work of the first named insured under the policy. Future

pollution events that are not caused by the original work of the first named insured are not covered under a CPL policy. However the contractor has an ongoing loss exposure at the project even if the CPL insurance will not cover the claim. If the building owner creates a mold condition at the project years after the contractor has completed their work there is nothing to stop the owner from bringing a legal action against the contractor alleging something from the original construction lead to the loss. Without ongoing access to the building the contractor is powerless to avoid these kinds of problems in the future. The REEL/HPR/Mold insurance product was developed specifically to address this situation by providing ongoing building science based loss control services over the course of the policy term. Through this unique feature the developer and contractor are able to access the benefits of ongoing loss control services at the building for their entire statute of repose period.

Usually to obtain CPL insurance, construction supervisors must have mold awareness training and the underwriter must review this training prior to binding insurance. If the supervisors have not been trained this training can be purchased from various underwriter-approved firms. The costs of these training services are not included in the CPL premiums.

The application process for CPL insurance is easier than Real Estate Environmental Liability based insurance products. However, even the application process for Real Estate Environmental Liability insurance provides powerful risk management tools for the insured to use with or without the purchase of insurance. The building science-based engineering services performed during the application process of a REEL/HPR/Mold policy provides helpful insight into managing the mold risk at the property even before, and in addition to, the purchase of insurance.

Aware of the glaring gaps in insurance coverage created by universal mold exclusions, lenders, owners and developers of construction projects are increasingly asking contractors for CPL policies with coverage for mold. There is one coverage gap in this request that is not well understood. If the owner wants to sue the contractor because the building has a mold problem, the CPL policy the owner paid for is first going to defend the contractor so that the owner cannot recover for their loss. This is probably not the outcome an owner or developer envisioned when asking for (and most of the time paying for) the CPL insurance. CPL forms do a good job however in defending the contractor and owner of a building if a third party claim is made against the contractor and the owner is on the contractor's policy as an additional insured.

Real Estate Based Environmental Insurance Highlights

The main difference in the CPL versus the REEL/HPR/Mold policy form is that the real estate based policy insures against pollution claims from the insured property and CPL only covers pollution claims from the insured operations.

The Real Estate Environmental Liability (REEL) policy features ongoing proprietary loss control engineering, a longer policy term, alignment of all interests to prevent losses, the ability for the developer or contractor to completely off load to the future owner of the building the responsibility to pay the self-insured retention and provides first party no-fault clean up coverage for regulated hazardous materials or mold over the course of the entire policy term. In contrast, a CPL policy will typically not have any of the above features.

In the proprietary real estate based environmental insurance/loss control engineering product offered through American Risk Management Resources Network, LLC, the underwriter pays for building science based water intrusion and mold loss prevention engineering services over the entire policy term to help avoid third party environmental claims under the policy. The proprietary engineering services that support the REEL/HPR/Mold insurance product took years to develop and included input from eighteen different specialty firms. The actual water intrusion loss control inspection services that support the REEL/HPR/Mold insurance product are provided by a national network of building science based engineering firms. In contrast, CPL based policies offer little or no current or going loss control service.

A long term REEL/HPR/Mold policy may allocate up to 25% of the premium for loss control engineering expenses over the course of the policy term. This engineering service provides a direct benefit to all of the insureds under the policy because environmental losses can be avoided through ongoing access to the building and the active cooperation of the building owner over the course of the policy term. For this reason compared to a CPL policy, the ongoing loss control support provided in the REEL/HPR/Mold policy would be a superior value even if the premiums for the REEL policy were significantly higher in comparison.

The REEL/HPR/Mold policy offered by ARMR.net is typically first issued to the developer or contractor at the beginning of the project and then is assignable to the final owner of the project without additional premium. At the assigning of the policy the new owner assumes responsibility for the self-insured retention as the first named insured and must provide ongoing access to the building for the loss control engineering that has been prefunded in the premium. The developer and contractor continue to be named insureds under the policy but are not responsible to pay the self-insured retention. The self-insured retentions on a REEL policy are substantial in order to encourage the property owner to implement the loss control recommendations from the engineers over the life of the policy. The assignability feature of a REEL policy to the future owner of the project is not an available option under a CPL policy.

The insured developer, general contractor and lender all benefit in three significant ways by the assignability feature in the REEL policy. First, the responsibility for the deductible is completely eliminated for the developer or contractor during the time a mold liability claim under the policy is most likely to be incurred, after the building is completed and occupied. Second, the developer and contractor benefit from the ongoing building science-based loss control services during the entire statute of repose period. Third,

faced with a significant deductible on their environmental liability insurance the new owner should be very committed to maintaining the building and cooperating with the building science loss control engineers.

Clean Up coverage under the REEL/HPR/Mold policy is provided on a no-fault basis. There is no similar no-fault clean up coverage provision in a CPL policy.

A REEL/HPR/Mold policy covers environmental claims at the insured location. This includes new pollution events during the policy period unrelated to the insured operations of the first named insured. To illustrate this coverage difference, assume the air conditioning contractor misadjusts the humidity control system four years after a condominium was completed. During a series of hot humid days the misadjustment leads to the complete failure of the building envelope because of water accumulation in the walls. As a result, the individual condo owners sue the condo association, the air conditioning contractor, the general contractor that built the building four years earlier and the developer. The original CPL policy on the project could deny this claim because the air conditioning contractor had nothing to do with the initial construction of the building, only claims arising out of the general contractor's described operations during the course of construction would be covered. The REEL/HPR/Mold policy would respond to this loss for all of the named insureds (not the air conditioning contractor) including the developer and general contractor because the coverage in the REEL policy is not restricted to the described operations of the general contractor.

The REEL/HPR/Mold policy can be adapted to "wrap up" the insurance protection for the developer, general contractor and owner. There is a separation of insured coverage provision and the REEL/HPR/Mold policy used for new construction deletes the typical insured versus insured exclusion found in EIL policies. Therefore a developer could recover from the general contractor for contractor negligence under the REEL/HPR/Mold policy form. This design feature eliminates the need for all of the insured parties including the owner to obtain their own environmental insurance for the project.

A REEL policy typically has a higher self-insured retention than a CPL policy. But it is important for insurance buyers to remember which party has to pay the deductible. The first named insured is responsible for the deductible in both CPL and EIL based policies. However, when the REEL policy is assigned to the owner, the owner assumes responsibility for the deductible when they become the first named insured under the policy. Under the REEL/HPR/Mold approach the contractor and developer are able to off-load the responsibility for the deductible altogether. From the owners perspective they are being given free insurance protection in exchange for picking up the deductible and gaining access for ongoing loss control on the building. From the perspective of the developer/contractor, a high deductible on the part of the owner is a good thing since it encourages the owner to maintain the facility and follow the loss control recommendations of the building science engineers. This ongoing loss control activity lowers the chance that the contractor and developer will ever be involved in a toxic tort lawsuit for mold in the future.

There is an additional risk management benefit gained by the contractor and developer by assigning the policy and the deductible to the owner. If the owner seeks recovery for a loss through a legal action against the contractor and developer the owner would be responsible to pay the deductible on the REEL policy covering the contractor and developer. In effect the owners would be suing themselves for the amount of the deductible. This feature in the REEL/HPR/Mold insurance product is designed to eliminate frivolous insured versus insured cost recovery actions under the policy.

All ongoing engineering costs under the REEL/HPR/Mold are incorporated into the premium and the underwriter will provide for the ongoing loss control engineering without additional cost to the insured's. A possible benefit from this insurance program design is that since the premium incorporates ongoing loss-control engineering services, the insurance premium may be a capitalized asset in conjunction with the building. As a result, the insurance premium for a REEL/HPR/Mold policy can potentially be funded as part of the original project financing program.

The Application Process For REEL/HPR/Mold

The application process for the REEL/HPR/Mold is not the same as a CPL policy. A CPL policy typically only requires only a completed insurance application to get a quote from a number of different underwriters. Quotes for CPL insurance on projects can usually be obtained within hours, which is reflective of the differential in the coverage provided between the two coverage forms.

In contrast, the highly protected risk engineering approach to underwriting a new construction project under the REEL/HPR/Mold insurance product begins in the application process. In addition to a specialized insurance application that must be completed and signed by the applicant, a complete insurance submission for a REEL/HPR/Mold quote will include a review of the building plans by the underwriter's preapproved engineers. The applicant must agree to pay for the building plan review and also receives the completed report, which is in of itself a valuable risk management tool. These plan reviews typically cost one to three cents per square foot to complete and are fully cost reimbursable through premium reductions if insurance coverage is bound.

To assist applicants in determining if the REEL/HPR/Mold product is the right insurance product for their project, American Risk Management Resources Network will provide a pricing benchmark for the insurance premium and the plan review costs on a project based on the completed application or an executive summary of the project. This process is designed to give the potential insurance buyer a realistic view of what the entire insurance transaction will cost including engineering expenses.

When coverage is bound, the premium will be reduced by the amount the applicant has already paid for the building plan reviews. In effect, the cost of the plan review is already incorporated in the rates being charged for the REEL/HPR/Mold policy. However, if coverage is not purchased, applicant will still be responsible to pay for the review of the



building plans. The turn around time on these building plan reviews is usually about two weeks but can be finished within days in emergency situations.

The building science based engineering services that support the REEL/HPR/Mold insurance product are proprietary and are available only through the ARMR.Network.

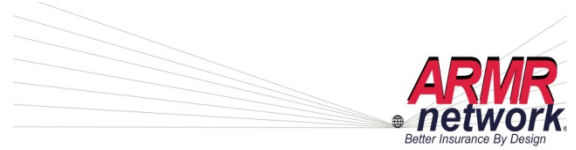
How To Obtain a REEL/HPR/Mold Policy

American Risk Management Resources Network, LLC a specialty environmental wholesale broker has pioneered the specially modified Real Estate Environmental Liability (REEL) policy for new construction. As discussed above, this policy is specifically designed to address the environmental insurance needs including mold of the developer, general contractor and owner in new commercial construction projects. Lenders can also be insured under these policies as loss payees.

Maximum Limits	\$25,000,000 with additional capacity available \$10,000,000 on habitational risks
Maximum policy term	10 years
Minimum premium	\$100,000 for a 10-year term Lower limits and policy terms have lower minimum premiums

This product is available through insurance brokers in the US and Canada. The product description, this white paper, the customized insurance application and policy forms with endorsements for the REEL/HPR/Mold insurance product are available on the web at www.armr.net.

ARMR.Net is a full service environmental specialty wholesale insurance brokerage firm with access to the full range of environmental insurance products including wrap-ups for Contractors Pollution Liability insurance products. All of our brokers have more than ten years of experience in environmental insurance and advanced technical degrees in related fields.



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