

New Environmental Disclosure Obligations and Market Solutions

By Michael Balmer and Jim Redwine

Public companies' accrual and disclosure practices for their environmental liabilities have long been perceived as inconsistent and in some cases inadequate. Recent developments such as FIN 47 have tightened the disclosure rules, especially in relation to environmental liabilities. While the recent changes follow a long line of accounting pronouncements (including SAB 92, SOP 96-1, and FAS 143) designed to standardize the reporting of environmental liabilities, they also raise many questions and pose a host of new challenges for senior management.

Background

Environmental liabilities are among the significant issues that impact investment decisions. The SEC therefore requires public companies to recognize and/or disclose both current and contingent environmental liabilities in their annual 10-K filings. However, only those liabilities that are considered material are required to be disclosed, and long-standing Financial Accounting Standards Board (FASB) rules such as FAS 5 dictate that a loss contingency should be accrued if it is probable that it will occur and the amount of the loss can be reasonably estimated.

The inherent flexibility of these rules has allowed companies to interpret their disclosure obligations in different ways. This problem is epitomized by how some companies account for potentially contaminated, non-performing real estate assets. Reluctant to initiate investigations that might trigger enforcement actions and remediation expenditure, some companies have adopted a so-called "don't ask/don't tell" policy which involves mothballing potentially contaminated facilities and thereby not reporting future remediation obligations.

Recent Developments

The Sarbanes-Oxley Act of 2002 (SOX) does not specifically address environmental disclosure, but it has changed the legal and political context in which such disclosure requirements must be interpreted. SOX is specifically designed to ensure that companies look beyond mere compliance with GAAP requirements when preparing their financial statements and that CEOs and CFOs personally certify the disclosures made by their organizations.

Further developments in the past 12 months have raised the bar even higher and may combine to change the way corporations report environmental liabilities. Significant changes include new 8-K disclosure requirements which mean that certain environmental liabilities, such as a determination that one of the company's assets is contaminated, will now compel companies to file an 8K, and, the new



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...developments in the past 12 months have raised the bar even higher and may combine [with the effects of Sarbanes Oxley] to change the way corporations report environmental liabilities

FASB interpretation on “Accounting for Conditional Asset Retirement Obligations”, FIN 47, which will require companies to recognize and report an environmental liability even if the enforcement of the liability is conditional upon future events that are not within the control of the reporting company. These developments may well close the “don’t ask/don’t tell” loophole and prevent companies from deferring the reporting of liabilities by mothballing sites.

FIN47

FIN 47, issued in March 2005, addresses Conditional Asset Retirement Obligations (CAROs). CAROs are legal obligations to perform asset retirement activities in which the timing and/or method of settlement are conditional on future events that may or may not be within the control of the entity. Environmental cleanup and disposal obligations in connection with the retirement of contaminated property, plant and equipment are CAROs. Retirement is defined broadly by FIN 47 to include not only demolition of a non-performing asset, but also includes the sale, abandonment, recycling or disposal (but not temporary idling) of a long-lived asset.

The regulatory obligation to remove asbestos on the renovation or demolition of a building is a CARO. The environmental regulation is in force today, but the asbestos will not be removed until the owner decides in the future to retire the building. Since



retirement is defined to include sale and recycling, the building (or parts of it) may be retired a number of times before it is finally demolished. Thus, the cost of the asbestos removal may be incurred long before the end of the building’s useful life (as when the price is reduced on a sale because of the asbestos contamination).

FIN 47 clarifies that companies must recognize liabilities for CAROs if their fair value can be reasonably estimated, and provides guidance for the estimation of fair value.

FIN 47 establishes an order of methods to determine whether the fair value of a CARO can be reasonably estimated. According to FIN 47, a CARO’s fair value can be reasonably estimated if:

- (1) The fair value of the obligation is embodied in the purchase price of the asset, such as if insurance or an escrow is provided for the obligation.
- (2) There is an active market for the transfer of the obligation (as is provided by insured environmental liability transfer transactions).
- (3) There is enough information to apply an expected present value technique.

If there is not enough information to estimate the fair value of the obligation, the company does not have to recognize a liability. However, the company must make certain special disclosures. In these circumstances, companies are required to describe the obligation, state that a liability has not been recognized because the fair value cannot be reasonably estimated, and disclose why the value cannot be reasonably estimated. And, as far as FIN 47 goes, SOX’s certification requirements seem to require more, because the certification that financial statements fairly present the financial condition of the company are not limited to GAAP.

Incentives and Market Solutions

In the era of corporate transparency and heightened investor scrutiny, proactivity is imperative. Environmental risk management should include re-evaluation of the adequacy of existing internal control and disclosure control policies, including establishment of appropriate systems for ensuring accurate data collection and consistent evaluation of environmental liabilities, and thorough assessment of available risk management tools. FIN 47 should add impetus to this process, because FIN 47 requires companies to “identify all [their] conditional asset retirement obligations.”

Once an environmental liability has been identified and determined to be “material,” there are several mechanisms

available to mitigate the exposure and demonstrate that it is thoroughly and adequately managed. These options might include accelerated clean up of a contaminated site, sale of relevant sites or operations, and/or use of risk transfer arrangements such as environmental insurance or liability transfer alternatives. Indeed, two of the three methods FIN 47 mentions for estimating the fair value of a CARO (when the fair value is embodied in the price of an asset through the use of insurance or when there is an active market for the obligation's transfer), seem to provide significant incentives for insured Brownfield and environmental liability transfer transactions.

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Life After BRAC 2005

Background

The Department of Defense (DOD) has excess land capacity for its current requirements. As a consequence, it has been progressively realigning and closing military installations in a rolling initiative known as the Base Realignment and Closure (BRAC) program. There have been four previous BRAC rounds, but BRAC 2005 is considerably larger than previous rounds, and it is the first one in a decade.

The BRAC 2005 round includes the closure of 22 major military bases and the realignment of another 31 major bases. In total, however, BRAC 2005 will involve the closure of over 175 military installations. The final list took effect on November 8, 2005 after Congress passed the BRAC Commission's recommendations into law. Nearly every state has a base that will be shut down. Those communities affected by base closures and/or realignments are charged with facilitating the beneficial re-use and redevelopment of these facilities.

Going Forward

Each individual privatization project presents many challenges, including the management of environmental liabilities and the successful coordination of development time pressures with the slow moving federal conveyance process. Environmental insurance has played a key role in facilitating BRAC development projects.

An example of a high profile success story is the redevelopment of the 1,800-acre Lowery Air Force Base near Denver. Since 1994, residential and commercial redevelopment has provided 3,000 homes for 6,500 new residents while creating approximately 6,000 jobs and yielding around four billion dollars for the Denver metropolitan area.

While the closing and realignment of military bases is generally viewed by local residents as a potentially catastrophic development for their community, the judicious use of environmental insurance can frequently enhance the speed and ease the pain of the transition, helping to turn a devastating event into new life for the area.

More information on the BRAC process will follow in future editions of this newsletter.

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Hot Issue Update: Welding Rod Exposures

Fumes from welding rods constitute the latest hot button toxic tort issue. Such fumes are the cause of much current and ongoing litigation involving welders who claim to have been injured by exposure to the fumes, and companies who manufacture welding and associated equipment, including welding rods. Many of our clients have started to see an impact on coverage and, as a result, have sought information about exposures in this emerging tort area. This article will help frame the issue.

Framing the Health Issues

Welding rods typically consist of metal coated with or containing zinc, lead, chromium, cadmium, copper, manganese, and other chemicals and metals. Manganese, one of the most common elements found in the earth's crust, is also one of the most commonly used metals in the world. Unfortunately, exposure to excessive levels of manganese can cause damage to the central nervous system and has been associated with a neurological disorder called manganism. Symptoms of manganism often

resemble those of Parkinson's disease and can include muscle stiffness and soreness, night sweats, hand shakes/tremors, loss of coordination, memory loss and fatigue. Other illnesses associated with long-term exposure to welding rod fumes include kidney and liver damage, respiratory disease, lung cancer and weight loss.

Framing the Potential Liability

Welding is a ubiquitous industrial operation employed in a multitude of endeavors from building ships, bridges and buildings to the manufacture of electronics, plastics and heavy equipment. To the hundreds of thousands of active welders must be added perhaps half as many retired workers, as well as the far larger number of workers who are likely exposed to welding fumes in the workplace. This makes for a large potential plaintiff's pool and, as a result, dozens of law firms now pursue class action lawsuits against companies who manufactured or distributed welding rods and/or supplied other materials (including gasses) needed to support the welding operation. Target defendants also include several industry groups, and estimates for costs could easily reach many billions of dollars.



Recent Legal Impact

Insurers that currently provide (or have provided) comprehensive general liability coverage to welding rod manufacturers, distributors, retailers and others whose main business activity is centered around welding, will likely incur defense expenses and maybe even indemnity payments depending on coverage and whether or not the lawsuits prove successful. Defense attorneys have argued that because no causal link has been established between exposure to welding fumes and the most serious neurological disorder, those cases involving high potential damage claims from Parkinson's should not be allowed. However, in federal court in Cleveland in July, 2005, US District Judge Kathleen McDonald O'Malley denied a defense motion to exclude testimony that welding fume exposure causes a serious neurological disorder. While this move does not address the

question of whether or not welding fumes cause Parkinson's, it will likely help shape a mass of litigation now poised to move forward in federal and state courts around the country.

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Conclusion: Impact on Insurance

Until now, there has been an ongoing debate as to whether or not the insured who bought a comprehensive general liability policy is entitled to indemnity payments for successful claims brought against them in this area. Since 1986, claims for injuries caused by hazardous fumes have been specifically excluded by the absolute pollution exclusion which was attached to such policies. Some jurisdictions, however, have found that the exclusion does not apply to non-traditional and non-environmental claims or, in other words, if the claim arises out of ordinary workplace exposure to ordinary substances, which in sustained exposure, caused the damage. As a result, many insurance companies now avoid entities primarily engaged in welding operations or the manufacture of welding and related equipment. Others have started putting welding rod exclusions on their policies to avoid the potential for litigation.

For more information, please contact Gary Rodrigues at 617 351 7405 or gary.rodrigues@willis.com.

Events

Willis made a big splash at the annual **Environmental Financial Consulting Group** (EFCG) CEO Conference held in New York City in October. We served as one of six primary sponsors (the sole sponsor from the insurance brokerage community) at this exclusive event whose attendees included more than 250 chief executives from leading engineering and consulting companies, including Bechtel, CH2MHill, CDM, SAIC, Tetra-Tech, Weston, AECOM, Amec, Black & Veatch and Fluor.

Paul Becker, President of the **Willis Construction Practice**, joined **John Reynolds**, Willis Environmental Practice leader, and **Gary Rodrigues**, **Mike Balmer** and **Rick Secchia** of the Environmental team at the event's opening reception at the New York Yacht Club. Paul later presented "Current Insurance Realities Facing E&C Firms in Light of Recent Events, including

Katrina," which generated requests for further information from a number of CEOs.

Rick Craig will be holding a seminar in our San Francisco office on January 26, 2006 entitled "Environmental Insurance: State of the Market, Updates on Carriers, Capacity and Emerging Issues."

Cliff Yeckes was a panel member at the November 1, 2005 session on *Brownfield Redevelopment: Challenges, Solutions, Benefits!*, which was part of the Final Phase III Conference of the US - German Bilateral Working Group, sponsored by the US Environmental Protection Agency (EPA). He offered opinions and comments related to the environmental insurance section for the EPA's SMARTe Internet site. Sustainable Management and Revitalization Tools, SMARTe, is a joint effort of the US-German Bilateral Working Group, the EPA, and the Interstate Technology Regulatory Council (ITRC) Brownfields Team. The tool is intended to be used by Brownfield project stakeholders for assessing both market and non-market costs and benefits of redevelopment options, clarifying both private and public financing options, evaluating and communicating environmental risks, and easing access to pertinent state-specific information related to specific projects. SMARTe will provide the analytical tools needed to implement and integrate each component of the decision process.

On November 8, Cliff gave a talk entitled "A Primer on Environmental Insurance" to the Colorado Hazardous Waste Management Society in Denver. On November 16 he spoke on "Environmental Insurance and Elements of Environmental Risk Management" at the Denver-based Colorado RIMS Chapter.

Robin Kelliher spoke at the NJCAT Innovative Technology Conference in Newark, NJ on October 26, 2005 about environmental and products liability issues involving the use of innovative technologies in remediation projects. She also made a presentation on the use of environmental insurance within the land use / re-use transaction at the Environmental Insurance and Claims Conference in New York on December 5-6.

On October 2, 2005 **Gary Lutz** participated on a panel for the Center for Creative Land Recycling. (CCLR). The session was held in Reno and the panel consisted of Gary, an attorney from Parsons, Behle & Lattimer, a consultant from Kleinfelder, and a representative from the Nevada Department of Environmental Protection. Gary's topic was "Creating Vibrant Communities." The highly technical, interactive seminar attracted many local developers and generated extensive audience participation.

Willis' Radnor Environmental Team, led by **Rich Sheldon**, co-sponsored the Society of Women Environmental Professionals

(SWEP) of Greater Philadelphia's Annual Touchstone Awards reception on December 5. Rich will also be on a panel addressing "Life After the Clean-Up" at the Institute for Continuing Legal Education's January 27 and February 16 continuing education sessions in Mt. Laurel, NJ.

The Georgia branch of the Associated General Contractors of America sponsored a roundtable discussion on December 7, 2005. Among the topics were the application of Environmental insurance to the general contracting and real estate development industries, the strategic use and benefits of project-specific, operational and transactional programs, as well as the construction-related risks these programs are designed to mitigate. **Brian McBride**, who leads the Willis Environmental Practice team in Atlanta, participated in the discussion.

For more information about any of the topics mentioned above, or how they might relate to your company's risk management needs, please contact **Gary Rodrigues** at 617 351 7405.

New Faces

New York Region



Cristin K. Bullen

Cristin Bullen is the New York Regional leader of the Willis Environmental Practice. A Senior Vice President, she is responsible for the New York Environmental team's strategies for new and expanded Environmental insurance sales and servicing, insurer relations, center-of-influence relationships and team training and development.

Joining Willis in 2005, Cristin brings 14 years of insurance experience, both on the brokerage and underwriting sides. She has been specializing in Environmental insurance for more than 10 years and also has considerable experience with architects' and engineers' Professional Liability coverage. Within the

Environmental and Professional Liability niche, industries of focus for Cristin include real estate, construction, architecture and engineering, and petrochemicals. She has worked extensively with M&A transactions and global insurance programs.

Prior to Willis, Cristin was with Marsh for seven years, leading environmental insurance specialist teams in New York and, for three years, in London.

Cristin holds an MBA in Finance and International Business from the Stern School of Business, New York University and a BA in Political Science from the University of Massachusetts at Amherst. She is a matriculated CPCU candidate.

Jessica Plummer

Jessica Plummer is a Vice President and member of the Willis Environmental team in New York. She designs customized environmental insurance programs to meet clients' risk management needs. Jessica is responsible for identifying and analyzing a client's pollution exposures and coordinating the marketing and placement of those programs. Working with attorneys, developers and other stakeholders she has facilitated customized risk transfer solutions for unique and complex risks through the utilization of site, cost cap and contractor's pollution liability policies.

Jessica has served in the environmental field since 1997. Her experience includes law firms and environmental consultant work at ENSR and GaiaTech that involved conducting Phase I environmental site assessments and regulatory compliance for clients nationwide. Additionally, she has more than five years of underwriting experience with AIG Environmental and Chubb Environmental Solutions.

Jessica received her Masters in Environmental Policy and Management from the University of Denver and her BS from Ball State University.

Selina Regan

Selina Regan is a Vice President in Willis' Environmental Practice and a member of the New York Environmental Team. Her responsibilities include generating and marketing new business, prospecting internal opportunities and assisting in strategic business development.

Selina has been involved in the Environmental insurance field since 1998, working at major carriers on both the claims and underwriting sides. Immediately prior to joining Willis, Selina was the Northeast Regional Manager for the Environmental Division of Quanta US Holdings. She has worked with risk managers as

well as attorneys and developers to create unique insurance solutions that utilize a wide range of policy options. Before joining the insurance industry, Selina spent five years as a litigation attorney at New York City law firms specializing in the defense of complex toxic tort/environmental, products liability and E&O cases.

Selina received her BA degree cum laude in Political Science from the State University of New York at Albany and her JD degree from the State University of New York at Buffalo School of Law in 1993. She is a member of the Association of the Bar of the City of New York and the Association of Professional Insurance Women.

South Central Region



Darren Stone

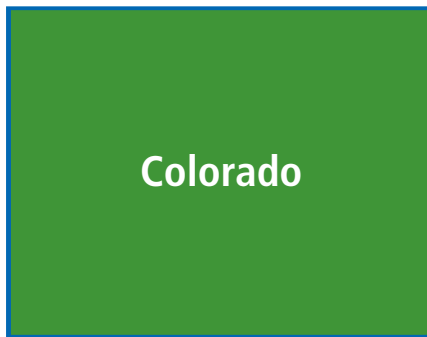
Darren Stone is an Environmental Risk Specialist and member of the Willis Environmental team in Dallas. He has more than 14 years of commercial experience in risk identification, management and mitigation for environmental liability.

His career history includes several years with a specialist London Lloyd's broker and AIG Europe within their risk finance team. In this capacity, Darren dealt with all insurance and risk finance matters relating to long-term environmental risks for leading UK and US based companies. His responsibilities included analysis of liability in property and corporate deals; insurance structure and policy design; and negotiating bespoke policies with leading city lawyers for FTSE 100 companies, major property developers, companies in the chemical, water and waste, engineering and retail sectors.

Darren has worked and consulted in the following countries: Japan, Iran, Saudi Arabia, North America, India, South Africa, Central and Eastern Europe and Scandinavia. As a Project Manager for Ernst & Young (Riyadh, Saudi Arabia), Darren

managed an international team of consultants undertaking a strategic economic and environmental evaluation for a national oil and gas company. He spent five years as a consultant for various environmental services, advising on all aspects of hazardous waste management, handling, transportation and treatment and the European movement of such wastes. While with AIG Europe, Darren assisted in developing market awareness for EIL-based on environmental solutions for contaminated land and cleanup implications for nuclear power stations, asbestos issues, platform decommissioning in the North Sea and AIG's potential involvement.

Darren received his BS in Land Economics from Anglia



University/Writtle Agricultural College.

Cliff Yeckes

Cliff Yeckes, based in Denver, is a Vice President with the Willis South Central Region Environmental Team. Cliff has 23 years of experience as an executive manager and senior technical professional in the consulting, environmental, engineering, retail petroleum and mining industries.

Cliff has been very effective helping our commercial, manufacturing, industrial, and government sector clients minimize their business risk and financial liabilities arising from contaminated media, natural hazards, mining and water resource matters. He has worked extensively in environmental due diligence effecting real property transactions, and mergers and acquisitions. This work has involved measuring and evaluating the regulatory, technical and financial impacts of environmental deficiencies associated with multiple site portfolios and developing approaches for prudently managing the risk, often through insurance vehicles. Cliff also works frequently with the legal profession, providing litigation support and expert testimony.

Prior to joining Willis, he was Environmental Director for Retail Operations for Flying J Inc. Cliff began his career as a mine geologist before entering the environmental sector with emergency response contractor OHM. Since that time he has

held managing principal and vice president positions with such firms as Harding Lawson Associates and Brown and Caldwell. Cliff holds an MBA from the University of Utah and a BS in Geosciences from the University of Arizona. He completed graduate studies in Hydrogeology and Engineering Geology at Georgia State University and the Georgia Institute of Technology. He is a Registered Professional Geologist in Florida, Utah and Tennessee and a Certified Environmental Manager in Nevada.



South East Region

Sarah M. Respass

Sarah Respass is a Senior Client Manager on our Atlanta-based Southeast Regional Environmental Team. Her responsibilities include the marketing and growth of Environmental and Casualty insurance programs for the Southeast Region.

Prior to joining Willis, Sarah managed a substantial Commercial Property and Casualty book of business for J. Smith Lanier & Co. Throughout her internship and two years of service, she was responsible for fielding all coverage inquiries from the client and carrier as well as initiating the renewal process and assisting with new submissions. Because of her involvement in many coverage lines, Sarah has developed and maintained strong relationships in a variety of industries and insurance markets.

Sarah received her BA in Risk Management & Insurance from the University of Georgia in 2003.

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Disclaimer: This update is intended to provide US readers with general information regarding developments on environmental insurance and risk management issues. Please consult your attorney for legal advice on these issues.