

INSURANCE RECOVERY

Legal issues in relation to the buy-back or settlement of insurance policies

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I. Introduction

Over the past several years, a number of Canadian resource oriented companies whose business activities date back to at least the 1960's or 70's have negotiated or attempted to negotiate "buy-back agreements" with the insurers who provided liability coverage during the period prior to the introduction of the absolute pollution exclusion in 1986. The object of the "buyback" is to remove the inherent uncertainty associated with both long tail environmental exposures and the insurance coverage available to cover these risks.

The insured receives the certainty of a cash payment now from an historical insurance asset which offsets some of the costs the insured may incur in relation to its present and future environmental liability exposure for clean up claims, third party property damage or bodily injury.

The insurer receives the certainty that no future claims for coverage will be presented by the insured in relation to the environmental risks.

For the most part, in Canada, these transactions are invisible. The negotiation and the outcome are always kept confidential. To date, there is only one Canadian case which deals with the validity of policy buy-backs and then in a completely different context. Further, we are not aware of any academic discussion in Canada of the buyback or "reverse underwriting" of policies of insurance.

The partial details of one insurance buy-back was revealed in a 2003 judgment from Quebec.² The parties involved in the buy-back were Domtar Inc and certain Underwriters at Lloyd's. The Quebec action did not concern the buy-back itself, however the Court was required to consider whether a portion of the payment made by Lloyd's to Domtar should be deducted from the amount claimed by Domtar in the action. The court described the buy-back arrangement as follows:

The discontinuance was prompted by a letter in October 2001 to Domtar from an American attorney acting on behalf of Lloyd's which referenced a Confidential Settlement Agreement and Release entered into between Domtar and Lloyd's in June 2001 under which Domtar was paid a total of U.S. \$10,500,000. Pursuant to the agreement, this sum was said to comprise U.S. \$9,500,000 "for the settlement of all past, present and future Canadian pollution claims", and U.S. \$1,000,000 "for the settlement of all past, present and future claims of any and all other types", excepting only a certain type of claim that is not relevant for present purposes.

In the U.S. a small but active industry of "insurance recovery" specialists (mostly lawyers and environmental consultants) has emerged to provide services to mostly large, resource oriented companies who prefer to take the "bird in the hand", rather than the "two in the bush" of extensive environmental coverage litigation in relation to long tail exposures. These American firms have been marketing their services to Canadian resource companies who then embark upon environmental insurance recovery projects. To our knowledge, Canadian law firms have not lead these efforts.

² *Domtar Inc v Abb Inc, Alstom Canada, and Chubb Insurance* [2003] Q.J. No. 9442, Quebec Superior Court, Hilton J., rev'd 2005 QCCA 730; [2007] 3 SCR 461

Accordingly, the purpose of this paper is to throw some light on the insurance policy buyback phenomenon, to identify some of the important legal questions to be considered, to suggest some potential answers, and to create a foundation for further analysis and discussion.

II. The key elements of an insurance recovery project

The starting point for all insureds is to develop an historical understanding of their liability insurance coverage. This involves identifying the policies of insurance available to the insured at primary and excess levels on a year by year basis, the insurance companies or their successors who underwrote the policies, the limits of the available insurance, the deductible amounts or self insured retentions which apply in relation to each policy or year, and the relevant conditions, exclusions, definitions, and endorsements.

The historical policy analysis is nearly always depicted in a coverage chart which shows the total liability coverage available, the insurance companies responsible at primary and excess levels, and key developments in the timeline such as insolvencies, the introduction of pollution exclusions and other relevant policy provisions. For insureds with a long history of business activity, the coverage chart will begin with the first known liability policies. Often insureds have a difficult time reconstructing the coverage that was available to them 30 to 40 years ago. Typically, the insurance recovery portion of the coverage chart ends with the 1986 year since most insurers adopted the absolute pollution exclusion at that time. Environmental liability exposures allocated to the years after 1986 will be the responsibility of the insured.

Once the available sources and amounts of liability insurance coverage have been identified, the next step is to develop a comprehensive understanding of the actual and potential environmental liability exposures. This involves the insureds typically making a significant effort to review all of their business activities and sites over the past 40-50 years to identify incurred costs in relation to environmental exposures as well a potential environmental claims relating to clean up costs, third party property damage or bodily injury that may be advanced against the insured in the future. Undoubtedly a good due diligence exercise in any event, the insured essentially builds the theoretical worst case scenario for its environmental liability exposures. Environmental consultants play a key role at this stage in reconstructing the incurred costs, estimating the costs associated with investigation of potential environmental claims, feasibility studies to assess damage and determine remediation, the remedial work itself, and the defence and payment of third party damages claims.

Once the total potential liability is estimated it is necessary to allocate this potential liability to the available insurance coverage. Essentially this process applies sets of alternative assumptions to the factors relating to a particular risk both in relation to the liability exposure and the available coverage. There are a multitude of factors to be considered including the likelihood of the environmental liability materializing, its magnitude, the appropriate response, and the validity of the evidence supporting the cost assumptions. On the coverage side, there are assumptions to make in relation to trigger theories, allocation methods, pollution exclusion applicability, occurrence definitions, exclusions and conditions.

In reality, there is a continuum of risk for both the insurer and the insured that runs from zero to tens or hundreds of millions of dollars depending upon the circumstances. It is important to keep in mind that the entire exercise is based on a series of significant assumptions in relation to the likelihood of claims, the costs associated with investigation, remediation, defence, and indemnity, and the strength or weakness of various coverage positions. It is an exercise where the participants can get to almost any position they like simply by changing the variables.