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Episode 14 Managing Environmental Risk

Sarah Baldys:

Welcome to Powered, where we talk with experts on the front lines of the energy transition to understand what's changing, what's at stake, and what boards and executives need to know now. From emerging technologies to evolving liability exposures, our guests bring sharp insight into how companies can lead confidently through the energy transition. I'm Sarah Baldys, US power and renewables leader at Marsh's financial and professional liability practice, and I am thrilled to hand things over to your host, Grace Brighter.

Grace Brighter:

Kim is currently a senior advisory specialist and national leader in Marsh's global environmental practice. In her role, she is responsible for leading the development of cutting-edge strategies tailored to meet the evolving needs of clients in an increasingly complex environmental landscape. Her deep expertise spans environmental risk management where she helps clients navigate regulatory changes, mitigate risks, facilitate transactions and redevelopment projects, and prioritize business performance. She excels in designing bespoke insurance solutions that offer comprehensive protection against environmental liabilities, ensuring clients are equipped to manage both current and emerging risks effectively.

Grace Brighter:

Hey Kim, thanks for being here today. Let's just start with maybe having you speak a little bit about your role at Marsh and what your team does.

Kimberley Mann:

Good. Thanks for having me. So, I work in the environmental practice as a managing director. And what our team does and how we fit into Marsh as a

whole is our team focuses very specifically on pollution related risks. So, think about releases of pollutants and contaminants into environmental receptacles such as soil, groundwater, surface water, and the air. And so, when we're thinking about environmental in the context of today's conversation, a lot of it has to do with that kind of pollution aspect of the environmental risks. And so, our team works with clients to identify what types of risks they could have through the course of their business, whether it's properties that they own, services that they provide, and how that could result in liability coming from a pollution event. And so that's how our team looks at things. And then we from there, get involved in building out designing insurance policies that are going to respond specifically to pollution. So when you think about general liability policies, a lot of them have a pollution exclusion, so they're responding to bodily injury and property damage claims, but maybe have some level of minimal give back for pollution on the property side that's going to respond to a property damage loss and might have some small element of extension for pollution related coverages. Our team and our marketplace are really designed to compliment those coverages and fill those gaps in order to address environmental damage arising from a pollution event.

Grace Brighter:

So that's great. Thanks so much, Kim. So, if we could just get into a little bit about the land acquisition process starting at the very beginning. So, when a company is looking to acquire land for maybe a new power facility or a data center, one could assume that they often face a lot of pressures from regulators or community groups to ensure maybe the site is clean and safe. Could you just walk us through why due diligence on land use is so critical at this stage? And maybe if you could share an example of what could potentially go wrong if an important step is missed in this process.

Kimberley Mann:

Yeah, absolutely. And that's a great place to start. So, when I think about project risk and developments and acquisitions, really no different from the rest of the work that you're going to be doing with your other advisors. Looking at this strictly from the lens of environmental risk, you're going to want to understand what liability am I assuming by purchasing this property, by leasing this property, by developing this property. And so, a lot of that starts with that baseline environmental evaluation.

And so typically starting with what's called a phase one environmental site assessment, which is going to be a noninvasive survey. You're going to work with your technical environmental consultant to understand what was this property, how has it been used historically? Were there industrial uses? Were there chemicals used on site? What were prior operations? What maybe has been done from a remedial perspective, really to give you a snapshot of what that look back in time might have been and how the use of that site has changed over time.

So if you're looking at a wooded property that's never been developed, that's probably not going to be a very involved process and you're going to cut through maybe any minimal things that might've gone on. If you're talking about an industrial site with over a hundred years of industrial operations, whether it power generation, chemical manufacturing, or other types of uses, you're going to start to get into a long history of what could be there. And so that phase one's really your first step into what do we know as of today? What can we identify has happened? And then from there, what are maybe some of the speculative issues of things that we don't necessarily know is there, but we think could be there? And so that's really going to be your first step and that's going to be important for you as an owner, but also for any of your stakeholders. So, when you're thinking about raising capital for these types of projects, you're going to have a lot of times institutional lenders, institutional investors, who are going to be very focused on environmental matters. And you're going to want to make sure that you're starting with that very basic process of what do we know that could be there so we can start parsing out allocation of liability, other contractual ramifications and strategies for potential historical environmental issues that you could be stepping into through the purchase of a property or the lease of a property.

Grace Brighter:

Thanks so much. So I think you kind of touched on this a little bit, but taking it just a step further, when any type of maybe potential contamination is found, what are some ways that lease agreements can kind of be structured or really handled to address some of these environmental liabilities? In other words, like how maybe various legal tools that can be implemented to protect the projects and investors.

Kimberley Mann:

So that alignment with your environmental consultant and your legal team is so important when you're talking about due diligence. So first, getting that baseline for what we know or what we think we know, and then putting together a strategy around whether you are assuming that risk or you are receiving an indemnification for that risk. So, the first is going to be your set of very traditional risk strategies. So you think about indemnities that could be in place, an escrow or a holdback to account for either all historical environmental issues or maybe only very specific quantified issues where you're going to take on unknown issues, but you want to make sure that, for example, your seller is going to finish that cleanup that's going on at the property. So, getting the sense of what you are taking, what you're not taking, and how you can structure that through a purchase agreement or a lease is going to be part one.

And then that's where you start to think about, okay, well, of the liability, I am assuming whether it's a known identified issue that yes, I've decided to take that on and take on that cleanup project. You want to start quantifying that, well, we think it's going to cost \$10 million, but what if it costs \$20 million? Are there ways to kind of cap that risk either contractually or through insurance? And then there's those pure unknowns, I think that you alluded to earlier of, well, what if we buy this site and we start digging around and we find something that we just no one knew was there someone buried drums there 75 years ago and they've got contaminants and now we're on the hook because we do own this property and we assumed, assumed liability through that purchase agreement. And so those are different things that you can look to address through a pollution insurance policy to help backstop that unknown or unexpected cost and liability.

And this is going to be a really important aspect of raising that capital because while depending on who the stakeholders are in different development type of projects, a lot of times institutional investors and lenders are going to really want to make sure that in order to provide that capital, that they're not walking into a liability that's going to impact their return on investment from the financial side of things. And so, when we kind of think about the first phase of a project, it's what do we know? What don't we know? How do we address those uncertainties? Because as we all know, no one +likes uncertainty. And how do we wrap that up through contractual and other financial and insurance vehicles

in order to advance the project? And so, I think today we're talking a lot about digital infrastructure, which is a big topic, and there's a lot of different parties and stakeholders that are going to go into a project like this.

So it's really a lot of these principles are going to apply on any single land acquisition, any single development project. But when you start thinking about a mega project where you've got potentially power generation, other infrastructure, investment data centers, and other types of digital infrastructure that are going to go into this, you're going to have a very wide range of risk appetite amongst those stakeholders. But really the overarching theme is going to be that you're going to be raising capital for this project. So having to think along the lines of a risk averse party in order to satisfy their needs is going to be really a driving factor in some of these projects because pollution tends to drive a lot of uncertainty and can make that financial aspect of investability a little bit difficult, which before you can start thinking about the project risk, you have to think about how you're going to finance.

Grace Brighter:

So, Kim, thinking about all of this, what are some of the biggest challenges in integrating environmental due diligence into construction?

Kimberley Mann:

That's a great question. So, I think we want to really break this down into a couple of phases. And depending on the project facts, each of them may or may not apply. So, when I first start thinking about project risks, we've gone through the land acquisition, the diligence, the financial aspects, but now it's actually time to start putting shovels in the ground. And so, when you think about the due diligence that goes into that, I like to think about it as first, that aspect that we already talked a little bit about, but what is already there? Number one, what do we know is there, and what's the potential around what we know and what we expect from a project cost and a remedial cost perspective to escalate, and how can we potentially address those risks? The next piece is going to be what about the pure unknowns?

What about something that we really don't know about that we can discover that's going to not just impact our budget from a remedial dollar perspective, but also from a project delay perspective? So, once you start getting into unexpected remediation projects, that takes time because those things don't happen very quickly. So, we

kind of think about the overrun of the existing, the things that we know. You think about the pure discovery of an unknown, and that all kind of comes about from your diligence, but then you want to get into the project risk of what could happen during the course of this actual project. So, the next aspect in my mind as I go through this is going to be that exacerbation risk. So, think about you've got contractors there, they're doing their grading, and whether we knew about something, we didn't know about something, but the contractor makes it worse.

So a great example of this is let's say there was a little pocket of fuel oil that had been spilled, and maybe it would've cost a couple hundred thousand dollars to excavate it out and haul it off as that kind of unknown discovered condition, but instead, it's not detected through the different kind of health and safety plans and contractor oversight, and your contractor now spreads that across a hundred acres and suddenly instead of it being a very easy, very manageable cleanup, you've got a lot more impacts across the site and you've got a much larger remediation. So that exacerbation issue is very real, especially on sites where there is historical contamination. So, making sure you've got that oversight from a project risk perspective, but also addressing that risk from an insurance perspective is incredibly important. And then when I go into just the pure new construction risks that can happen.

So you've got a lot of people on site, especially for some of these really large projects where you've got generators, you've got things going on, your stockpiling soils, depending on what environment you're in, that's going to raise a lot of new risk issues. And so, then you get into just the pure new creation of pollution. And so, when I think about the spectrum of pollution in a development project, each and every one of those, depending on your project's fact profile, has the capability of being presented as a risk issue. And all of those can lead to, as I talked about already, additional remedial dollar costs, disposal costs, project delays, and then you've got third party liability. So, depending on where your project is situated, do you have the potential for that contamination to impact neighbors, whether it's residential or other businesses causing injury, causing property damage, causing their loss of use.

And so again, when we kind of think about environmental risk, it's really a spectrum and it kind of looks backwards as well as forwards. And you want to make sure that you're addressing each of those pieces

throughout the process when you have multiple projects all going on at one time for different types of end use. So, let's say you have a power generation site being developed next to that data center, one might be done faster than the other one. And so that co-location is another really critical risk issue where let's say the power generation is operating and if they have a major operational event that could then impact your development on the data center side or vice versa. So you really want to kind of take that factor into consideration as you're really doing a risk matrix evaluation on what those factors could be, but then also how the different stakeholders and contractual arrangements are of do you have one project owner, do you have a series of project owners?

Do you have a single EPC? Are you doing a lot of direct hiring with your contractors and with your subs? And so when you're building out an insurance program, you want to make sure that depending on how your project is structured, that you are addressing each of those risks either through a comprehensive owner type of an insurance policy or on the individual contractor or stakeholder level where you're pushing all of those obligations out, but really making sure that it's very clear from a liability allocation perspective of who's handling what and that it's getting addressed. And so that devil in the details is really important.

Grace Brighter:

Great. So, thanks, Kim. Just curious, how are you advising your clients on addressing a lot of these issues and challenges you just mentioned?

Kimberley Mann:

Yep. So, there are a suite of pollution liability insurance policies that address the different risks throughout that kind of project lifecycle spectrum that we just spent some time on. So, the first is really going to be the bread-and-butter product of the pollution insurance marketplace, which is called a pollution legal liability, A PLL, which is a site policy. So that's going to pick up that unknown preexisting issue that we talked about of we found this after closing, it's generating liability. It can also cover things that we might know about but maybe weren't actionable at the time of closing but become actionable either through additional investigation or a regulatory change in law, which is especially important right now. We're in a point where we're seeing a lot of regulatory changes federally, which is then introducing regulatory changes in certain states. I always think about regulation as a pendulum.

Depending on what different administrations are in office, priorities can change, but a lot of times they do swing back. And then also that social activism is really important right now. So maybe from a regulatory perspective, it's not driving cleanup, but you are still receiving third party claims. So that pollution, legal liability is really going to address those existing site issues that result in cleanup costs that result in third party injury, third party property damage type claims. It's also going to compliment really nicely with your property policy around business interruption. So, a lot of times we think about business interruption that's going to arise from an actual property damage event, but that's not going to pick up if it's simply a pollution event or the indemnification period around that business income loss. It's going to end once the property is restored. So let's think about if your boiler explodes and that gets restored within a couple of weeks or a couple of months, but the pollution that resulted from that event is going to take six months to remediate the pollution liability policy also steps in and provides you with additional business income loss resulting from that pollution.

So again, when you're thinking about that, these co-located sites, that can be incredibly important because if you're not able to operate, you're not able to generate income. So that site pollution really tends to be that first phase of coverage, which most of our clients are looking to enact on any type of development project, especially in this digital infrastructure space where you've got these mega projects. Then we look at the contractor's pollution, and that's going to be those events created or exacerbated through the course of the actual contracting operations and those project activities. And so those can be put together at either the project owner level through an owner-controlled insurance program covering your contractors and subs at all tiers. If you are the project owner, if you're an EPC for example, or a GC [General Counsel], you can put that into place through a CCIP or a contractor controlled insurance program where you're going to offer that up to your project owner and cover your contractors and subs below.

Again, kind of wrapping all of that up or depending on how that the actual project structure is organized, if you've just got a lot of direct hiring, but you don't maybe have that centralized point through an EPC, you can also look at just pushing that requirement out. But really, really critical, and we always advise our clients of this, you want to make sure that anyone who steps foot

on your job site has contractors' pollution, because even some of the most seemingly benign services can also create some of the most significant environmental liability. You could have somebody delivering materials but backup into a generator and cause that release. They don't have to be doing environmental work. So, you really want to think about that through how you are structuring your agreements and then weighing the different cost benefit depending on who you are in the project and how you want to make sure you're managing the other parties to have those insurances.

And then of course, both that site pollution and that contractor's pollution are very often required by institutional lenders and potentially investors. And so, getting those programs proactively put together and analyzing what we see as kind of a best in class helps our clients move faster, which in this space is all anybody wants to do. And so if you're addressing these things in the very beginning, a lot of times it makes for a much easier process when it does come time to review lender requirements because a lot of the programs that we're putting together are going to really proactively address their asks.

Grace Brighter:

Well, thanks for explaining a lot of those products, which obviously enable all of our clients to deploy capital and take on various projects. So, insurance is for sure playing a huge role there. I did want to circle back to something you mentioned earlier. Data centers obviously something we're all talking about more now than ever. What are you really seeing with this intersection between environmental and data centers?

Kimberley Mann:

Yep. No, that's a great question. So, we've mostly talked about the acquisition and project phase, but what happens once the project work is done, and these sites are actually operating? And so, I think a lot of our energy and power clients are very familiar with what their operational exposures might be. The data centers, not that data centers, are brand new. They've been around for a long time, but they are something that more and more of us are evaluating and integrating into our daily lives here. And so, when we think about the operational exposures, this is going to be an area that's really important as all of these go live. And so, thinking about the water that gets used from the cooling system perspective in these data centers is going to be really important. So, kind of overall big picture environmentally, where are we sourcing that from?

What does that look like? Making sure that that's being done responsibly and in line with what's being represented by the project owners is important. But then the actual wastewater and the treatment and potential black dusts that can be released to the environment as a result of these operations is important. What that waste stream looks like and how you're managing that waste stream proactively, of course, and then how you're insuring it on the backend can be really important. Another thing, and this is maybe less of a traditional pollutant, but a lot of people are talking about it, is the noise pollution element of to run these data centers, there's an extreme amount of potential around depending on where they're situated, the noise that comes from them and what that looks like, how you can proactively mitigate it or look to ensure those risks. And so, it's really kind of getting into the nitty gritty.

Every technology is a little bit different from the actual operations, looking at what that waste stream looks like, and then really just any type of ownership of real estate. So, when you've got that volume of equipment, you've got chemicals and housekeeping that goes into that, but you also have that water that we talked about. So, you think about indoor air, environmental issues like mold that could ultimately cause the shutdown of that operation. And that's really the worst-case scenario is these data centers shutting down. And so just thinking about what's going into your business, what you're doing, and then what are different ways through, whether it's environmental insurance or other insurance products or self-insurance, to make sure that you're just aware of where your exposure lies and how your business will be resilient through a potential event.

Grace Brighter:

Thanks, Kim. So, we've talked a lot about the importance here on investment and due diligence in this entire process, but it really sounds like this is something leadership has a responsibility to sort of oversee. So just curious if you could kind of share your perspective on that and maybe discuss why it's so important to manage a lot of these environmental risks comprehensively across an organization.

Kimberley Mann:

Yeah, that's a great question. So, a lot of what we've talked about today has been the environmental damage and the potential liability resulting from an actual pollution event. But clearly throughout the course of this project and this type of a project lifecycle, you're going

to have a lot of representations that are made from maintaining oversight and what the leadership is, what commitments you may have made to either your board or your shareholders or from a financial perspective to your investors. And so ensuring that you are working together with your leadership team kind of from the top all the way down to the contractual aspect, the technical aspect, the operational aspect, and really just having that alignment from an organizational perspective around not just environmental objectives, but also kind of oversight and implementation is just incredibly important for this type of a project and a business.

Grace Brighter:

Great. Well, thanks so much for the time today, Kim. Really appreciate your insights and you walking us through all the great things you and your team are doing. Thank you.

Kimberley Mann:

Thanks so much for having me.

That's all for this edition of Powered by Marsh FINPRO. We hope you enjoyed our discussion and thank you for listening. You can rate, review and subscribe to Powered by Marsh FINPRO on Spotify, apple Podcasts, or any other app you're using. You can also follow Marsh on LinkedIn or X. In addition to your podcast feed, you can find more episodes of Powered by Marsh FINPRO at www.marsh.com/poweredbypod and more insights from Marsh on our website, Marsh.com. Until next time, thanks for listening.

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