BUSINESS INSURANCE

Ohio Derailment Puts Focus on Railroad Insurance, Risk Management
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As investigations continue into the cause of the Feb. 3 derailment and chemical spill involving a freight train carrying hazardous materials operated by Norfolk Southern Corp. in East Palestine, Ohio, the event is likely to trigger claims on a widening web of property and liability insurance policies, experts say.

The incident will have significant risk management and safety implications, and railroads and related businesses can expect greater scrutiny by insurers in the months ahead, they say.

Numerous lawsuits seeking class-action status have already been filed against the Atlanta-based railroad holding company and unit Norfolk Southern Railway Co. on behalf of businesses and residents, alleging negligence and seeking millions of dollars in damages.

A class-action lawsuit filed Friday seeks to compel Norfolk Southern to establish new testing and cleaning protocols and to create a fund for medical monitoring, in addition to punitive damages to be paid to affected businesses and residents within a 30-mile radius of the derailment. Directors and officers liability claims could also follow, several sources said.

Thirty-eight rail cars derailed and 12 more were damaged by fire in the derailment. Eleven of the cars that derailed carried hazardous substances, including 115,580 gallons of vinyl chloride. Authorities later carried out a controlled burn of hazardous materials amid concerns that rising temperatures inside one of the cars would cause an explosion.

The U.S. Environmental Protection Agency last week ordered Norfolk Southern to conduct and pay for all cleanup actions associated with the derailment or be fined triple the cost.

Municipal drinking water tests continue to show no water quality concerns, and there is no indication the air is unsafe, according to the EPA.

Insurance Impact

The insured loss will most likely exceed $50 million and could exceed $100 million, said Robert Hartwig, clinical associate professor of finance and director, Risk and Uncertainty Management Center, at the University of South Carolina’s Darla Moore School of Business.

Property damage claims will be significant, but the potential environmental loss is “harder to get a handle on,” Mr. Hartwig said.

Norfolk Southern will likely penetrate its insurance and exceed its self-insured retention, but it will take time for litigation against the company to be consolidated by the courts and for cases to proceed, he said.

The accident and its aftermath have become heavily politicized which will drive up settlement costs, Mr. Hartwig said. Congressional hearings are likely, according to several news reports.

Norfolk Southern has two separate insurance policies providing coverage for third-party liabilities and first-party property losses. Coverage under each tower attaches excess of two separate $75 million self-insured retentions.

“Our liability policy attaches for losses above $75 million and up to $800 million, or up to $1.1 billion for specified types of pollution releases. It is intended to protect against legal liabilities for bodily injury and property damage to third parties,” Norfolk Southern Chief Financial Officer Mark George said during a presentation at the Barclays Industry Select Conference in Miami on Feb. 22, which was posted on the rail company's website.

Its property policy is intended to cover loss or damage to property that the company owns or that is in its custody or control and certain types of lost revenue and extra expenses. It covers approximately 82% of covered losses above the $75 million attachment point up to $275 million, he said.

"As you would expect with any discussion of insurance there are many qualifiers including our insurers' reservation of their rights to further investigate and contest coverage, express restrictions and sublimits of coverage, and various policy exclusions, including those for governmental fines and penalties," Mr. George said.

Large transportation companies tend to be self-funded and are used to handling environmental remediation in the course of their day-to-day operations, said Tim Donnellon, Charleston, South Carolina-based senior broker, environmental, with Burns & Wilcox Ltd.

Over time Norfolk Southern has paid out hundreds of millions of dollars in claims costs including for environmental expenses or remediation, Mr. Donnellon said.

"This isn't a new thing for them," based on the company's 10K financial statements, he said.

Because of the bodily injury, property damage, contamination and pollution conditions surrounding the loss, many of the claims will likely fall on pollution coverages, said Jim Hamilton, Philadelphia-based environmental practice group leader and senior broker at CRC Insurance Services LLC.

"All general liability policies contain a pollution exclusion of one form or another, so, given the spill, the release, escape and migration of pollutants from the rail cars, that's going to fall squarely on pollution liability coverage," Mr. Hamilton said.

General liability, whether it be rail general liability or commercial general liability, may or may not respond, he said.

Other businesses, such as the owners, lessors and lessees of the rail cars and manufacturers of the goods and hazardous materials being transported, could also find themselves on the hook for damages associated with the event, sources said.

If the railroad were to blow through its insurance limits, there's the potential for the manufacturers of the chemicals to be sued, said Daniel Drennen, national environmental practice leader at Amwins Group Inc. in Atlanta.

"Whoever manufactured the rail car could have a products pollution claim if for some reason a lawyer made a case that the valve wasn't working properly," Mr. Drennan said.

The insurance market for railroad risks tends to be limited, because of their risky nature and the severity of derailments, he said.

Coverage questions

The cause of the derailment is still under investigation, but in a preliminary report issued last week the National Transportation Safety Board pointed to an overheated wheel bearing, among other factors.

There are many different variables that come into play with rail accidents and that plays through into the insurance coverage, said Rhonda Orin, Washington-based managing partner at Anderson Kill P.C.

"There are trains and there are tracks. An incident can come from the train, the track and from a third-party problem like someone being on the track or something being on the track that isn't supposed to be there," Ms. Orin said.

Who owns the track, who owns the train and who was responsible for the object that caused something to happen are other variables, she said.

There will be "significant issues" around whether insurance coverage will respond based on initial reports about causation and whether a pollution exclusion will preclude coverage, said Michael Miguel, Los Angeles-based principal at McKool Smith.

As with other catastrophic events, insurers that pay out for first-party claims made by local businesses and homeowners will likely subrogate against Norfolk Southern's insurers, Mr. Miguel said.

"The potential liabilities are likely going to come in waves," and they aren't going to manifest in the next couple of weeks or next month, Mr. Miguel said.

In a Feb. 23 briefing, NTSB Chair Jennifer Homendy said the derailment was "100% preventable."

"We call things an accident. There is no accident. Every single event that we investigate is preventable," Ms. Homendy said.

The NTSB had not identified any operational issues with the wayside detectors – trackside devices that can detect rising temperatures or other problems with rail-car parts – or track defects, but it is still investigating.

The NTSB will hold an investigative hearing in East Palestine in the spring, she said.

Risk management and safety

In the wake of the derailment, safety concerns such as regulations around the shipment of hazardous materials and staffing levels on trains, will come under greater scrutiny, experts said.

Fred Millar, an Alexandria, Virginia-based independent transportation consultant, said the incident raises questions about trains carrying dangerous cargoes through major cities.

"What if this had happened in Chicago or Toronto, or Pittsburgh or St. Louis?" Mr. Millar said.

Railroads have successfully resisted efforts to limit train lengths, he said. The Federal Railroad Administration, the agency responsible for regulating railroad industry safety, does not set limits on train lengths, according to news reports.

The train that derailed, which was en route from Madison, Illinois, to Conway, Pennsylvania, had 149 rail cars and three crew.

The incident also raises questions about Precision Scheduled Railroading, a cost-cutting initiative adopted by nearly every Class 1 railroad that has led to longer trains, he said.

"Railroads are playing a high-risk game and sometimes they lose, and they have to pay out big settlements, but their insurance companies must think about whether they're charging enough premiums to make it a reasonable proposition," Mr. Millar said.

Some 99.9% of all hazardous material shipments reach their destination safely without a release caused by a train accident, according to the Washington-based Association of American Railroads.

In 2013, a train of more than 70 tanker cars of Bakken crude oil derailed and exploded, destroying the town of Lac Megantic, Quebec, and leaving 47 dead. That disaster led to new guidelines for rail tanker cars, among other changes.