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Wider community should be on guard

Environmental incidents can hit a wider range of businesses than many assume

ENVIRONMENTAL INCIDENTS CAN have long-lasting impacts. You don't have to look to examples such as the Deepwater oil spill that remain in the headlines; current protests over Dow's sponsorship of this year's Olympics – over the Bhopal gas tragedy almost three decades ago – make the point.

Whether such disasters do much to raise awareness of the risks of environmental liability among the wider business community is questionable, though. For many, it seems, they are too remote and the companies involved too obviously engaged in potentially hazardous industries for them to relate to.

The EU is increasingly aligned with the hard line pioneered across the pond

But, in fact, the range of businesses that can experience an environmental incident of a significant scale is wide. For those that wish to insure, it is important to stress-test the proffered policy wordings against potential losses to ensure there are no potentially costly gaps in the coverage. Whatever the merits of specialist cover for any individual business, a thorough risk analysis and review of policy wordings is undoubtedly overdue for many.

It's an issue that's daily becoming more pressing. Al Armendariz, a senior official in the US Environmental Protection Agency who threatened to "crucify" businesses, may have been forced to resign, but there's little doubt that regulations are ever more stringent. And with its Environmental Liability Directive (ELD), the EU is increasingly aligned with the hard line across the pond. Public interest in sustainability and the demands put on business are also moving in the same direction.

Risk managers may say that environmental management is outside their remit. The only response necessary is increasingly obvious: it shouldn't be. **SR**

Risk is wider than most firms believe

Environmental disasters aren't just a problem for companies handling hazardous waste

MOST WOULD BE HARD-PRESSED to deny the risks posed by environmental catastrophes. April, for instance, saw the first arrest relating to the Deepwater oil spill, and BP finalising details of a $7.8bn settlement for damages. In Europe, MAL, the Hungarian aluminium producer responsible for the country's 'red sludge' spill, is reported to be on the verge of bankruptcy.

But there has been less success convincing companies that environmental risks are relevant to them. Airmic's *Global Casualty Insurance Programmes Benchmarking Report*, published this year, found that, despite new legislation and high-profile disasters, few risk managers thought their businesses were more exposed to environmental issues than in the past. The percentage buying insurance to cover such risks, both overseas and in the UK, was static at best.

'We're finding that environmental incidents can be from any trade'

Graham Hawkins Cunningham Lindsey

"A lot of companies assume this won't touch them because they relate it only to hazardous waste," says Barbara Goldsmith, head of the Ad-Hoc Industry Natural Resource Damage Group, an industrial group focused on environmental liabilities.

In fact, that's not necessarily the case. At loss adjuster Cunningham Lindsey, principal specialist in environmental solutions Graham Hawkins says few

DISASTROUS YEARS: RECENT CASES AND THE ELD

Hungarian red sludge

More than 700,000m cubic metres of toxic sludge flooded surrounding towns, killing seven people, injuring 150 others and contaminating the Danube after a dam burst at the Ajkai Timföldgyár aluminium processing plant in Hungary in October 2010. Last September, the owner MAL Zrt was fined €470m. Widely expected to be a major test case for the ELD, it was in fact prosecuted under Hungarian criminal law.

Deepwater Horizon

The largest oil spill in US history was caused by an explosion on the offshore oil rig in the Gulf of Mexico in April 2010. BP set aside a $20bn fund for compensation. The $7.8bn settlement recently announced does not include fines from the federal government, which could be as high as $17.6bn. In response, the European Commission has proposed extending the ELD to cover offshore operations.

Augusta Roadstead

In March 2010 the European Court confirmed Italian authorities' decision to hold refinery operators around the Augusta Roadstead harbour in Sicily responsible for cleaning up pollution there. The decision confirmed that refinery operators were strictly liable, so authorities did not need to prove they were at fault in causing the pollution.

Bouches-du-Rhône Nature Reserve

A pipeline west of Marseille spilled 4,000 cubic metres of oil over five acres of France's Coussouls de Crau reserve in August 2009. Clean-up costs topped €25m, although in this case the activities of the operator responsible did not qualify for strict liability under the ELD, prompting a change in French law to address the loophole.

cases it deals with come from typical high-risk industries, such as those processing chemicals. Many are simply the result of water run-off in the aftermath of fires, where the water used to extinguish the flames flows onto a third party site or into a river, giving rise to clean-up costs "We're finding that environmental incidents can be from any trade," he says.

And it takes relatively little for businesses to find themselves with significant exposure. A case in April reported by another loss adjuster, QuestGates, involved a horticultural nursery. Thieves broke in and stole the copper piping running from the fuel tank to the hot air blowers in the greenhouses. The oil subsequently leaked into an area designated a groundwater protection zone by the UK Environment Agency, leaving the company with the costs of monitoring the groundwater, digging out close to 200 tonnes of soil, and treating the contamination on its own property.

"For £10 worth of scrap copper, they're looking at costs in the region of £250,000," says QuestGates' environmental team director Alan Dobson. "There are hundreds of cases like that."

Room to improve

There are probably a number of reasons for the difficulty in getting that message through to risk managers.

One is that environmental management is often outside their remit, being handled elsewhere in the organisation. "There's still work to be done linking up the insurance function with the environmental function," as Simon Collings, partner at broker Jardine Lloyd Thompson, puts it.

'If someone has an environmental problem and a large clean-up, they tend not to broadcast it'

Stephen Andrews AIG

Another is that, aside from the biggest cases, cautionary examples are not that well publicised. Last December, the International Underwriting Association's non-marine environmental committee urged the industry to do more to collect environmental liability claims data so as to educate companies about potential exposures

As Stephen Andrews, senior vice president and head of environmental at insurer AIG, points out: "If someone has an environmental problem and large clean-up, they tend not to broadcast it." Moreover, partly because of that, there remain misconceptions over the extent of cover provided by other policies – particularly public liability.

Perhaps more importantly, many of the recent warnings from insurers and brokers relate to the European ELD, yet its impact remains uncertain. Tardy implementation on the part of the EU member states, and a preference on the part of enforcing authorities for existing law, mean there remain relatively few cases. The authorities in the Hungarian spill, for example, chose to use the country's criminal law to prosecute MAL.


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'There's still work to be done linking up the insurance function and the environmental function'

Simon Collings Jardine Lloyd Thompson

"It's difficult to estimate the full impact of the ELD and that makes it a problem when you're trying to raise awareness of the risks," says the International Underwriting Association's head of market services Christopher Jones.

For all that, most agree that the tide is turning. Increased public awareness, a supply-side push from insurers offering new environmental impairment liability policies, and national regulatory developments, such as the introduction of civil sanctions for environmental damage in the UK, are helping to push the issue up the agenda. The number of ELD cases will also grow with time.

"It is only going to increase as regulators get more and more comfortable with the legislation," says Clive Walker, a project manager in the environmental insurance practice of Willis. Andrews agrees. Both awareness and enforcement will only go one way, he says. "The cat won't go back in the bag." **SR**

Directive broadens liability in hazardous industries

Its implementation has been slow, but the Environmental Liability Directive adds significant responsibilities to businesses

THE EU ENVIRONMENTAL Liability Directive (ELD) represents a significant change to the laws of most member states. The directive:

- Introduces a system of strict liability for those in hazardous industries, holding them responsible for pollution regardless of fault.
- Introduces duties on businesses to take preventative measures in the event of threats to the environment and notify authorities of any damage that occurs.
- Obliges authorities to act if they become aware of damage.
- Is not restricted to pollution, but any event harming the environment.
- Most importantly, introduces liability for damage to land, water or biodiversity, even where no person or business is harmed.

"The concept of biodiversity damage particularly is a new one for businesses. There's not much experience to draw on," says Dr Gerhard Roller, professor in law at the University of Applied Science in Bingen, Germany, which published guidelines on the practical implementation of the ELD for various industries last year.

The new duty to notify regulators means companies need to look at their training and management systems, while the particular protection for land covered by the European Habitats Directive and Birds Directive means they must audit their sites to see which are near "Natura 2000" sites – such as sites of special scientific interest in the UK. "Most companies will have done neither of those," says Keith Davidson, head of the environment and energy team at law firm Pannone.

The new regime also carries significant penalties with three types of "remediation" businesses may have to pay:

- Primary remediation, to return the environment to its state before the damage.
- Complementary remediation, either at the site in question or an alternative when primary remediation is impossible.

Key points

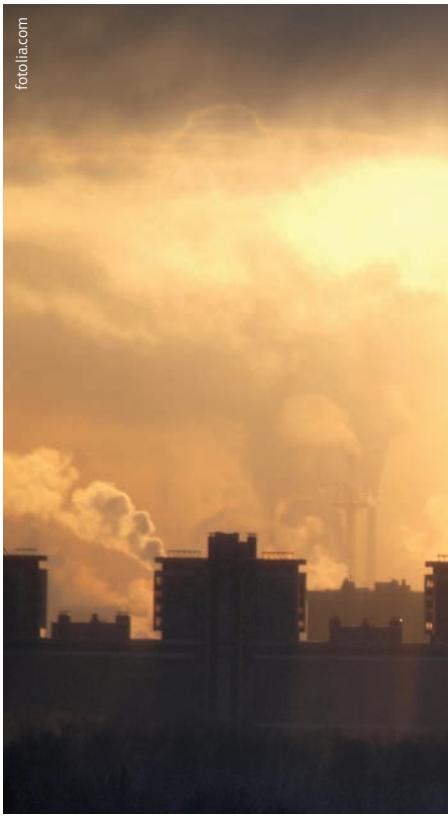
01: Strict liability for hazardous industries: no need for authorities to prove negligence.

02: Public law: doesn't need a third party claim for liability to arise.

03: New types of remediation: costs for complementary and compensatory remediation are still unclear.

04: Interpretation of "significant damage" varies: hundreds of cases in some countries; none in others.

05: New duties: businesses must take preventative action and notify authorities of incidents



'It is designed to deal with significant, serious accidents and, fortunately, we only have so many of those'

Lucas Bergkamp Hunton & Williams

- Compensatory remediation for interim losses of natural resources. That could include, for example, improving facilities for those fishing on a river while pollution is cleared and fish stocks restored.

Together these remedies mean that where the directive does apply, there is little doubt its potential impact is huge. The French government's study in April 2010 looked at previous cases of environmental damage and evaluated the likely outcome of applying the new law. It concluded that costs could be 40 times higher than in the past. However, how significant the directive is in practice is less certain.

"It certainly represents an unprecedented expansion of environmental liability in European law but it's perhaps more in principle than in practice," says Sam Boileau, an environmental law specialist with lawyers SNR Denton. "Only time will tell how it actually impacts businesses across Europe."

For some the lack of cases to date simply reflects member states' slow implementation – with countries missing the April 2007 deadline by up to three years. For others, though, the meagre case law reflects the original intention.

"It is a directive designed to deal with significant, serious accidents and, fortunately, we only have so many of those," says professor Lucas Bergkamp, partner at law firm Hunton & Williams in Brussels, Belgium.

Similarly, at UK broker Tysers, director of environmental risks Mathew Hussey argues that there has been a tendency to overplay its import in the insurance industry.

"It's been somewhat overcooked," he says. "If you are next to a very sensitive environment you may face difficulties, but if you run a petrol station in the middle of Birmingham, the ELD is not likely to affect you."

In fact, this uncertainty is reflected in widely different approaches to enforcement. A European Commission workshop on implementation reported last November that some countries had yet to see a case under the ELD, while Poland had seen 400.

That's partly symptomatic of the present regulatory environment, according to Barbara Goldsmith of the Ad-Hoc Industry Natural Resource Damage Group, who says it is most widely enforced in countries that previously had less "robust" environmental programmes. "In those states, there's potential for hundreds of cases to be brought," she says.

Importantly, however, where a country is seeing little application, it is usually because regulators are simply using existing law, not because companies are escaping liability.

Moreover, the number of cases may well understate the impact of the directive.

Aidan Thomson, partner at lawyers Berwin Leighton Paisner in the UK, points out that companies won't always wait for enforcement action before cleaning up damage. As he says: "Just because the Environment Agency doesn't have many instances on its website doesn't mean to say these liabilities are not being incurred." **SR**

Market continues to expand rapidly

The number of environmental impairment liability insurers has doubled in recent years


Reuters

Key points

01: Number and range of policies has increased greatly

02: Relatively small number of companies have dedicated ELD cover

03: Compulsory cover still favoured by many in EU, but not backed by the insurance industry

THE INSURANCE MARKET FOR environmental impairment liability (EIL) is developing. The number of insurers in the London market, for example, has doubled in the last few years. There is also a greater range of policies than in the past, from those focused simply on historic land contamination to those explicitly geared towards operational risks and liabilities under the Environmental Liability Directive (ELD).

"It's a quickly maturing market," according to Cliff Warman, Marsh's environmental practice leader for Europe, the Middle East and Asia. But it is still small. In France, for example, a country with a significant industrial base of around 2 million companies, estimates put the number of policies at little more than 10,000.

This is probably due, in part, to demands from insurers. It's a technical underwriting process, says Alessandro De Felice, group risk manager at Italian cabling company Prysmian SpA, with demand for full underwriting information. "You have to be able to demonstrate you have the right procedures and risk evaluation in place to find capacity," he says.

On the other hand, brokers say this is getting easier, and while some baulk at the cost, many maintain that the market is competitive, helping to drive uptake. Swiss semiconductor company ST Microelectronics NV, for example, switched to dedicated EIL cover from a general liability extension partly because rearranging its cover to source environmental and product liability policies through specialist markets worked out cheaper. "We ended up with significant savings," says its director of risk management and insurance Maurizio Micale.

As it is, when the European Commission published its first appraisal of implementation of the ELD in 2010, it found demand, not supply, was the main

limiting factor. Many just don't see they are exposed or think they have cover elsewhere; Airmic's recent *Global Casualty Insurance Programmes Benchmarking Report* found 45% of respondents thought they were adequately covered under their general liability policies.

"The biggest challenge we have in the development of the market is that people still look for their traditional insurance to solve the problem," says Stephen Andrews at AIG.

One way or another, though, take-up of specialist cover is likely to grow.

When the ELD was originally drafted there was pressure from NGOs and others for the introduction of compulsory insurance, or some form of equivalent financial security. That was rejected in the face of opposition from mainstream insurers and several member states, but remains a long-term policy objective for many in the EU, says Chris Clarke, a public policy analyst specialising in

'The biggest challenge is that people still look for their traditional insurance to solve the problem'

Stephen Andrews AIG

environmental liability, who worked on the directive for the European Commission in its early stages.

Clarke, now a visiting fellow of University College London's legal programme on carbon capture and storage (CCS), notes that provisions for mandatory financial security in the CCS directive show the EU's preference for this approach is undimmed. "The commission would still like to see it," he says.

It could soon have an opportunity to do so. Reviews of the extent to which the market was providing cover of environmental liability were included in the ELD. At the time of the first appraisal, in 2010, it was obviously too soon to evaluate since some countries had only just implemented the law. However, another appraisal is due in April 2014.

In the insurance industry there is little support for compulsion, with both the International Underwriting Association and Insurance Europe opposed. As Nils Hellberg, head of liability at the German Insurance Association GDV explains, there are a number of objections – not least that whatever level of cover the commission required, it would prove too high for some (and therefore unnecessarily expensive) and too low for others (encouraging them to under-insure).

'Germany is proof that it works without a mandatory insurance system'

Nils Hellberg GDV

"There isn't a one-size-fits-all solution to this," he says. Of the eight member states that have introduced mandatory cover anyway, he adds, only Portugal and Bulgaria have so far managed to implement it – evidence of the difficulties in doing so.

In any case, the German market shows that compulsory insurance is unnecessary, according to Hellberg. EIL cover there, written on a voluntary, individual basis, is increasingly widespread among both industrial companies and the wider economy. In fact, he worries that introducing a compulsory regime would damage what is an increasingly well-developed market. "We are proof that it works without a mandatory insurance system," he says.

Whether that will be enough for the commission to finally dismiss compulsory solutions, though, is another question. It may require that a few more countries can say the same by the time the review comes around in 2014. **SR**

CONSIDERING THE ALTERNATIVES FOR HISTORIC CONTAMINATION

The fundamental problem with the 'polluter pays' principle is that it presumes the polluter is still around, says Peter Vanderweele, a director at Oval Insurance Broking. An insolvent printing works bought by a firm of architects – to give one real-life example – may find neighbours a decade later complaining that contaminants have spread to their site. With the printing company no longer around, the architects are left with the bill. "That's the biggest problem – bounce back," says Vanderweele.

Insurance is one option. Another is a captive or captive pod, a single item on another captive. Since it is a separate company, it prevents liability falling back on the owner.

A third option, however, is 'active transfer', with clean-up specialists indemnifying clients against future claims. In Europe, consultant WSP Environment & Energy completed the first, and so far only, transaction with the sale of a former Kodak chemicals facility in Kirby, England. For an up front cost, WSP took on the environmental risk and liabilities, as well as undertaking the remediation.

Critics argue that this solution still leaves companies open to bounce back should the firm taking the liability fail. But WSP Remediation director Richard Clayton says it is secure. Remediation of known conditions is pre-funded into an escrow account, and the remaining risk – both for any overrun and for unknown contamination discovered later – is backed by insurance. "This is about outsourcing the risk," says Clayton.

For now, a sluggish development market means there has been little call for such innovations, but as the economy recovers, they could play a bigger role.

Blemished record despite best efforts

Even with regular risk appraisals, a printing firm twice suffered environmental mishaps

Key points

01: The firm had a significant environmental policy

02: Contamination of its own site meant it was not covered by its public liability policy

03: Extensive modelling can help identify potential risks

04: If an incident does occur, quick containment is vital

Polestar

Part of the problem with trying to establish the risks and costs of environmental incidents is a reluctance to talk about them. "For every one prepared to put his head above the parapet, there are lots lying low," says Gary Marshall, group risk manager at Polestar, one of the largest printing firms in the world. It produces publications such as *Woman's Own*, *Radio Times* and supplements for most British newspapers.

As a printer, the firm is regulated by the EU under waste and air emissions regimes, and has a significant environmental policy, including a commitment to regular risk appraisals of its operations. Nevertheless, Polestar has had two significant incidents in the last few years.

The first was at the company's printing works in Paulton, Somerset, now a growing housing development. When the site was sold in 2005, it was with the understanding that purchasers would face costs. "It was more than 100 years old, so it was going to come with a history," says Marshall.

It was discovered that waste sludge, produced in the printing process and stored underground while awaiting treatment, had been leaking out and contaminating the land. That was reflected in the sale price.

As a typical gradual pollution event with the contamination on the company's own site, there was no cover under its public liability policy. "We took the hit on that," says Marshall.

More recently, the firm suffered a spill of a solvent, toluene, at its plant in

Pinvin, Worcestershire. Again, it was a plant nearing the end of its life, due to be closed in a few months. This time, though, the cause was the simultaneous failure of three different safety devices designed to prevent overflow of the storage area.

Apart from the leak flowing into the plant's own service drainage, which was easily dealt with, there was also the possibility of it running onto adjoining land, a nearby stream, and, eventually, the groundwater. That necessarily meant involving the environmental health officer and the Environment Agency, as well as liaising with the neighbouring land owners.

'You can't go far enough in trying to understand how you might end up with an incident'

Gary Marshall Polestar

"It quickly became quite a complicated network with different demands," says Marshall. Fortunately, the company contained the spill before it caused any significant damage.

There are a few lessons Marshall draws from the experiences. The first is that both sudden, accidental incidents and cases of gradual pollution are realistic risks. The second is that it's almost impossible to anticipate all the ways in which environmental incidents can occur. "We felt we were on top of it; we felt our alarms were working properly," he says.

That means companies need to do extensive modelling to try to identify potential risks. "You can never go far enough in trying to understand how you might end up with an incident," says Marshall. It also means that businesses need to have plans in place to deal with an incident if one does occur, because at that stage what matters is how well and quickly it is contained.

Marshall concludes: "A sudden and unforeseen event can become a lot more costly if it goes on for a while." **SR**

Keeping your liability under control

Seven essential approaches to managing a business's environmental risk

Key points

01: Carry out a sites audit
02: Be aware of the environmental liabilities that come with a potential deal
03: Consider non-pollution biodiversity damage

ENVIRONMENTAL LIABILITY insurance is not a substitute for risk management. The latter is a prerequisite to obtaining cover to begin with. "If you are not controlling the risk, it is very difficult to find cover at a reasonable cost," says Alessandro De Felice at Prysmian.

There are a number of pointers for good control.

1) Be aware of the situations giving rise to liability

As printing firm Polestar found (see case study), there is the potential for problems from both historic contamination and operational incidents.

2) Carry out a sites audit

If you have a facility close to a Natura 2000 location, protected under EU law, it is a particular risk, warns Carl Leeman, chief risk officer at logistics group Katoen Natie and president of the International Federation of Risk and Insurance Management Associations. "If you contaminate them, the problem is even bigger."

Focus on these sites first. In any case, each site needs its own specific contingency plans and emergency response procedures.

3) Establish the baseline

"If you damage a species or habitat, the Environmental Liability Directive requires it to be restored," says Dr Simon Johnson of Aon's environmental services group. "The question is: restored to what? You should have a baseline."

Unfortunately, there's not always one available or it may be out of date.

Lucas Bergkamp at solicitor Hunton & Williams warns: "If there is no better data available, the authorities may use information reflecting the state of that environment two decades ago rather than the day before the accident."

4) Don't take on more than you have to

Much of De Felice's work is in the due diligence process during mergers and acquisitions. "We've abandoned certain deals because of the potential for taking on environmental liabilities," he says.

Similarly, Bergkamp suggests one counterproductive effect of the ELD is to encourage some companies to scale back their role in the environmental management of subsidiaries for fear of being held liable as an "operator".

At the very least, companies need to address ELD liabilities in contracts such as tolling agreements and certain services agreements.

5) Be realistic with land sales

"The land owner's starting point will be 100% transfer of liability, but they need to see if legislation actually supports that, and if the land purchaser – the potential recipient of liability – will accommodate it," says developer Taylor Wimpey's Ian Heasman, who chaired the working group on a report on liability transfer by NICOLE (the Network for Industrially Contaminated Land in Europe) last year.

That means matching the liability transfer objectives of the transferring organisation with what's possible on the site. It should allow the land to be brought back into use, and, in most cases, that will be better – and cheaper – than just closing the gates and paying to secure the site in perpetuity.

6) It's not just about pollution

"You need to consider non-pollution biodiversity damage as well," says Johnson. "If you have a fire and it burns down an adjacent habitat, that might not be pollution, but you may still be liable."

7) Check existing cover

"Our advice to members is to manage the risk, but also check what cover they have because it may not be sufficient," says Conor Gouldsbury, head of the environmental policy executive of the Irish Business and Employers Confederation.

Alan Dobson at loss adjuster Questgates warns: "There will be gaps. The devil is in the detail." **SR**

Talk to one another

Ferma's Pierre Sonigo urges risk managers to become more involved with environmental management

FERMA (FEDERATION OF EUROPEAN Risk Management Associations) general secretary Pierre Sonigo has long had an interest in environmental liability, and spearheaded the federation's work on the Environmental Liability Directive (ELD).

However, much of this predates his time at the federation, and can be traced to his time as president of risk management at Pechiney, the French aluminium manufacturer.

As Sonigo acknowledges, aluminium can be a hazardous business, particularly historically – and Pechiney was more than 100 years old. "In one area near the Alps we had polluted the whole valley with fluoride fumes," he says. "Pechiney had lengthy experience of dealing with environmental issues."

Even today, the challenges for the industry remain: it is energy intensive; it is responsible for 1% of the global human-induced greenhouse gas emissions; it uses large quantities of water; it causes other polluting emissions, such as fluoride gases; and it produces significant quantities of waste, including bauxite residue – the red mud that caused so much damage when it burst from a dam at Ajkai Timföldgyár aluminium plant in 2010.

And Sonigo was directly responsible for these types of issues. "We decided the environment was a major issue and should be handled by the risk management department," he says.

"It meant I was the one responsible for negotiating remediation cases with

the authorities, putting in place adequate prevention measures and getting our facilities up to the ISO1400 standard."

All environment, health and safety, and risk management and insurance staff reported to him. Even today, that's unusual. Environmental management is still often handled elsewhere in an organisation – and with limited input from the risk manager.

"It's a serious issue that continues to affect many, many corporations," Sonigo says. "Environmental and risk management are in two very definite separate silos. One reports to the technical management, the other to the financial side, and they rarely exchange information or try to find solutions."

For example, he suggests it would be difficult for most risk managers to convince a director of environment to let them take charge of remediation. Similarly, the attendance lists of most risk management conferences or memberships of risk management associations would reveal precious few professionals from the environmental function.

Despite this, Sonigo is reluctant to blame such divisions for the somewhat patchy progress made by risk managers in addressing the challenges of the ELD. He holds that its impact can easily be overplayed. Nevertheless, it is significant for other reasons.

First, for what it reflects: "One of the big changes I've seen in my time is the willingness of Brussels to play a much more prominent role in establishing new rules and shaping the environmental framework," he says.

'At one time you could feel secure that if you complied with national law you were safe. That's no longer the case'

It's not just the ELD, he adds. Consider the REACH (Registration, Evaluation, Authorisation and restriction of Chemicals) regulations or the Seveso Directive, which deals with the control of on-shore major accident hazards involving dangerous substances ("much more important than the ELD").

He says: "At one time you could feel secure that if you complied with the national law you were safe. That's no longer the case."

Compulsory insurance

Adapting to the ELD also poses potential challenges. The market faces two major issues, says Sonigo. The first is whether the EU imposes provisions for financial security – shorthand in most cases for compulsory insurance. That will need a pooled solution, which would radically transform the market.

"That will completely change the rules," he says. He notes the opposition from both insurers and brokers, and has sympathy for the arguments against it.

There's still considerable uncertainty over cover for ELD liabilities, he notes – particularly over the extent of cover for the new types of remediation.

"It is not like fire damage where you have damage, you evaluate the cost and you pay for it," he says. "There are so many options when it comes to remediation." If insurance is to be compulsory, it has to be sure to adequately cover those forced to buy it. For these and other reasons, Ferma prefers a voluntary solution.

However, the other big issue, according to Sonigo, is the challenge of developing a mature environmental impairment liability insurance market. There is, for example, the issue of adverse selection, with only badly exposed companies choosing to buy. And then there's the fact that smaller companies are still largely excluded from the market.

"They can't afford it," he says. "Not so much in terms of the cost, but because they don't have sufficient information for underwriters to assess the risk. Only large companies have done the studies to be able to provide the level of information that underwriters are demanding."

Again, it comes down to the problem of silos. The press coverage, and publicity from insurers and conferences mean risk managers are increasingly aware of the risks, says Sonigo. "That's not the problem; the problem is they don't have the responsibility to do a proper risk assessment of those environmental liabilities because it belongs to someone else," he says.

Without that risk assessment, there's unlikely to be the demand even if the market were willing to write it. Risk managers will either believe they're covered under existing general liability policies or simply conclude – correctly – that they're not comfortable adding another heading of cover without adequate understanding. "Buying insurance without properly evaluating the risks first is not modern risk management; you don't do that any more," says Sonigo.

PIERRE SONIGO ON...

Risk management and environmental silos
"They don't talk to each other and they're often in competition."

Brussels
"Much more willing to establish new rules to level the playing field in Europe."

ELD
"For many companies it doesn't have a major impact. If you talk to the environmental specialist they don't consider it to be a big problem."

Compulsory insurance
"There is always a gap and there will always be a gap whatever insurance scheme you put in place."

'Buying insurance without properly evaluating the risk first is not modern risk management'

So what should risk managers be doing now? Building bridges, according to Sonigo.

"Get more knowledgeable and interested in environmental issues by talking to the people in their own companies who are dealing with the issues on a regular basis," he says.

It means having regular meetings with their environmental specialists, trying to become part of the evaluation of provisions being reserved for environmental liability (or at least so that they're aware how much is being set aside), for example. The outside auditors and finance functions in an organisation can also be helpful.

"They really have to deal with all these people," says Sonigo. "It's a big issue for companies, and also for environmental protection." **SR**

EU legislation extends beyond the ELD

Amid the constant stream of environmental regulation, here are five areas of European law of which you should be aware

Key points

01: EU environment law extends beyond ELD

02: CO_2 directive requires financial security

03: Emissions rules are becoming stricter

AS PIERRE SONIGO SAYS IN HIS interview on the previous pages 18-21, there is more to European Law than the Environmental Liability Directive (ELD).

In fact, the ELD itself refers to existing EU regulation; damage to biodiversity, and to water, for example, are defined with reference to the Wild Birds Directive and Habitat Directive, for the first, and the Water Framework Directive for the latter.

As Aidan Thomson at solicitor Berwin Leighton Paisner says: "There's a constant stream of regulations coming out of the EU."

Carbon Capture and Storage Directive

The Carbon Capture and Storage (CCS) Directive came into force in April 2009, to be implemented by member states in June 2011. It regulates CO_2 storage, addressing site selection, exploration permits, storage permits, operation, closure and post-closure obligations and third-party access to CCS infrastructure.

For Thomson, though, one particular area of interest is Article 19 of the directive, which requires CCS operators to provide evidence of "financial security or any other equivalent", for which one option would be insurance. Article 34 of the CCS Directive, meanwhile, adds the operation of storage sites for carbon dioxide to the list of activities subject to strict liability under the ELD.

The REACH Regulation

The EU's regulation on chemical handling deals with registration, evaluation, authorisation and restriction of chemical substances. The law came into force in June 2007, but provisions are phased in over 11 years. The strictest law to date on chemicals, it puts greater onus on companies to manage the risks and provide safety information.

Compliance with its 849 pages remains a struggle, however. Earlier this year the EU's Forum for Exchange of Information on Enforcement published its report of 791 inspections. One in five companies inspected was not compliant.

The Industrial Emissions Directive

Proof that nothing is ever settled at the EU, the IED was the result of the European Commission's review of its industrial emissions legislation in 2005, ultimately recasting seven existing directives – including the IPPC (Integrated Pollution Prevention and Control) Directive – into one, ratified in January 2011.

As former environment commissioner Stavros Dimas puts it: "Clearer and stricter rules are needed to ensure that industrial installations comply with the necessary high environmental standards across the EU.

Keith Davidson at Pannone Solicitors says: "It will make compliance a lot more expensive."

The directive requires transposition into national law by next January.

The Water Framework Directive

In another example of the EU strengthening existing requirements, the European Commission proposed amending the priority substances list under the Water Framework Directive, and received agreement from the European Parliament last year.

The change will add 15 chemicals to the list of 33 pollutants monitored and controlled in EU surface waters.

The Revised Waste Framework Directive

More immediately concerning for businesses, revisions to the Waste Framework Directive, implemented in the UK last year, bring significant changes to the regime.

These include new definitions of what constitutes waste, new rules for waste carriers, and a new "waste hierarchy", which classifies waste management strategies according to their desirability (reduce, reuse, recycle and so on).

Davidson says: "It affects everyone, but many businesses even in the waste industry probably haven't heard of it." **SR**

Interpretation varies from state to state

Enforcement and allowable defences for the environmental directive are not consistent

Key points

01: Many northern European states already had tough pollution laws in place

02: Eight EU states have imposed compulsory ELD insurance

03: Permissible defences to the directive vary between countries

04: Levels of enforcement are inconsistent

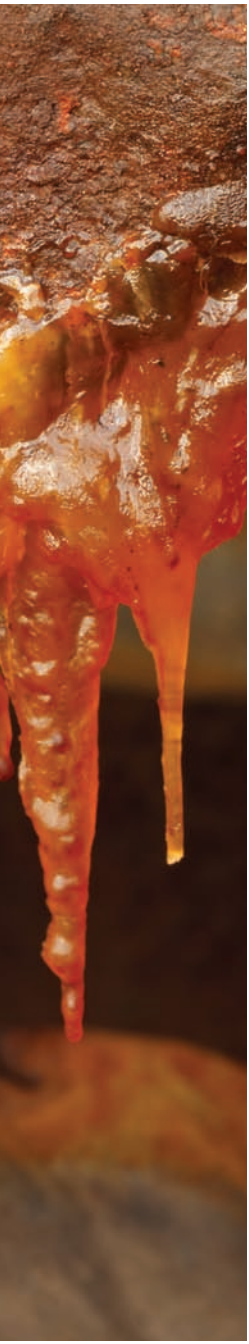
WHATEVER ELSE THE Environmental Liability Directive (ELD) has done, it has not made life any easier for businesses.

According to Gavin Reese, a partner with lawyer Reynolds Porter Chamberlain, the law governing environmental liability remains fiendishly complicated. "Trying to work out which regulations apply in which circumstances is not easy," he says. "The ELD hasn't really streamlined things."

Partly that's because it was drafted to avoid undermining other efforts to protect the environment. It therefore imposes minimum requirements but doesn't stop states from having tougher regulation.

That is particularly significant in northern Europe, where member states already had quite tough contaminated land and water pollution laws, according to Chris Clarke of University College London. "In many respects the ELD is weaker," he says.

It's also because, like all directives, it has to be passed into national law. In the UK it is implemented through the



Environmental Damage (Prevention & Remediation) Regulations 2009; in Germany, through the Environmental Damage Act (Umweltschadensgesetz) 2007. That leads to widely differing outcomes – as can be seen in other areas of law, according to Ian Heasman, who led the team putting together NICOLE's (Network for Industrially Contaminated Land in Europe) guide to environmental liability regimes across Europe.

"National interpretations of the same directive often result in substantial differences in national practice," he says. Indeed, that's partly the intention. Approaches to treating soil as waste under the Waste Framework Directive, for example, vary enormously. Where regulations are purely derived from national regulations, meanwhile, there is even greater variation, as can be seen in differing definitions of what constitutes brownfield or contaminated land.

Regulations even vary within countries. In Spain, Catalonia and the Basque Country have led the way in contaminated land regulation; much of Germany's regulation is regional, rather than federal; and even in the UK, part 2a of the Environmental Protection Act 1990, which deals with contaminated land, applies to England, Scotland and Wales, but not Northern Ireland.

'National interpretations of the same directive often result in substantial differences in practice'

Ian Heasman NICOLE

Environmental regulation is influenced by the legal context, socio-political priorities and historical conditions, says Heasman: "It's a right old mishmash."

Moreover, the ELD allows more discretion than most. One key difference

ELD DEFENCES

• The state-of-the-art defence lets companies off remediation costs where they can show they were not at fault and damage was the result of activity not considered likely to cause environmental damage, according to the best scientific and technical knowledge at the time. The defence is allowed by Belgium, Cyprus, Czech Republic, Estonia, Greece, Italy, Latvia, Malta, Portugal, Slovakia, Spain, UK and France.

• The permit defence provides an escape if a company can show the damage was the result of activity expressly allowed by the authorities, such as under the conditions of a permit. It's implemented by Denmark, Finland and Lithuania, as well as all those countries allowing the state-of-art defence, apart from France.

TAKING ACTION

The other big variability that businesses face is enforcement. Powers are usually stronger where environmental regulation is well established. The UK's Environment Agency (EA), for example, is one of the few regulators with the power to ask for an international arrest warrant.

"They're a very savvy regulator with extremely wide-ranging powers," says Rod Hunt, who used to prosecute for the EA and is now a partner at solicitors Clyde & Co.

The EA is also the first regulator in the UK to be able to issue civil sanctions, giving it an alternative to criminal prosecution for less serious environmental offences.

Businesses may be served with a penalty (up to £250,000), a compliance notice, a restoration notice to put environmental damage right, a stop notice, or, most commonly, an enforcement undertaking, where an offender makes an offer to make amends. The first such sanction, accepted last July, was £21,000 from a London engineering and IT company for packaging waste offences, with the funding given to environmental groups.

On the one hand, the new regime represents an opportunity for businesses. "They really ought to be identifying the offences for which civil sanctions are available so that if there is an incident they can liaise with the regulator and try to deter them from prosecution," says Hunt.

On the other hand, one factor arguably limiting prosecutions in Europe is tighter government budgets resulting from the economic malaise. Cheaper options, such as civil sanctions, may mean regulators are more willing to take action in the first place.

As Hunt says, "We will have to see how it plays out."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is compulsory insurance, with eight member states taking up the option of introducing financial security provisions (Portugal, Bulgaria, Spain, Greece, Hungary, Slovakia, the Czech Republic and Romania), providing a guarantee where the polluter becomes insolvent.

Another is the defences that the directive left as discretionary (see box, page 25). Half the countries decided to allow both defences; nine allow neither; six allowed the permit defence without the state-of-the-art defence; while France allows the state-of-the-art defence but not the permit defence. Sweden, meanwhile, has both, but only as mitigating factors, rather than full defences to liability. And these aren't small issues. A recent analysis of decisions by the Conseil d'Etat, the highest court in France, found that 50% of those held liable in environmental cases had complied with the relevant permits.

"In Germany [which allows the permit defence] all those cases would in theory be thrown out," says Michael Faure, professor of comparative and international environmental law at Maastricht University.

Areas such as causation are also left to member states. Since it's not always possible to be sure of the source of pollutants, most countries hold companies liable if it's more likely than not that they caused the damage. If

'People have focused a lot on whether they face strict liability, but that's not really the issue'

Michael Faure Maastricht University

experts determine there is only a 20% likelihood, then liability is excluded. In the same situation in the UK or the Netherlands, however, the company would have to pay for a fifth of the damages. "That makes a hell of a difference," says Faure.

Spain, meanwhile, reverses the burden of proof, so companies must prove they didn't cause the damage.

Similarly, while for many countries liability for biodiversity damage without loss to a third party is new, some, such as the Netherlands, already grant standing rights to NGOs, enabling them to claim for clean-up costs in such cases.

"People have focused a lot on whether they face strict liability," says Faure, "but that's not really the issue. The things you really need to worry about are whether you can still be liable when you comply with the licence; whether there is an insolvency guarantee; and how the causation is taken care of.

"These are the things that really determine the scope of liability." **SR**

The right insurance policy for environmental liability

There are plenty of pollution scenarios that a traditional public liability policy will fail to cover

A BIG PART OF THE CHALLENGE FOR insurers trying to develop the market for environmental impairment liability (EIL) is the difficulty persuading companies that they need it.

"There has been an assumption that they have environmental cover through their other policies," says Chris Jones of the International Underwriting Association (IUA). The misconception is so persistent because, in part, it's true. Public liability, property, directors' and officers' (D&0) cover, and even automotive policies often cover pollution to an extent.

Says Cliff Warman at broker Marsh: "There's a modicum of environmental cover in many lines." But it's a question of how wide that cover is, and the answer, suggests Warman, is: "Not enough."

The best-known limitation in the UK market is probably that highlighted by the Bartoline case – which made it clear that general liability policies would not cover the clean-up costs imposed by the regulators, as opposed to damages claimed by third parties. "That put the nail in the coffin of some of the misunderstandings," according to Mathew Hussey at Tysers.

Other misunderstandings remain, though. The result is that businesses are perhaps taking false comfort from the increasing number of policies now written with 'Bartoline extensions', providing for regulatory clean-up. In reality these still have limitations. Even with an extension, for example, the policy still requires a third-party liability claim to trigger it. That's a problem, particularly under Environmental Liability Directive provisions for damage to habitats.

Without the third-party trigger, companies may be left to pay for clearing their own sites.

"On-site clean up costs are actually where environmental policies see the most claims," says Simon Johnson at Aon.

It's one of many gaps: cover is likely to be for sudden and accidental events, rather than gradual pollution; it will often be restricted to pollution, rather than environmental damage from other causes; property policies are likely to cover real property – the buildings, rather than the land; D&O policies will cover legal defence costs, but often not directors held singularly and individually liable for third-party damages; and preventative work to stop the pollution spreading – key to keeping down the costs of any incident – is also likely to fall into outside the policy terms. The list goes on.

"Most extensions we see are lacking, and in some instances fundamentally flawed," says Hussey. That was also, broadly, the finding of the IUA's report in

'On-site clean-up costs are where environmental policies see the most claims'

Simon Johnson Aon

Key points

01: General insurance policies are unlikely to offer sufficient cover

02: 'Bartoline extensions' may still leave companies having to pay for clean-up on their own sites

03: Policies will give immediate access to emergency response teams in the event of an incident


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MIND THE GAPS – EXPOSURE UNDER TRADITIONAL POLICIES

Statutory charges
Clean-up costs imposed by the regulator may not be covered unless you have a 'Bartoline extension'.

Own-site
On-site clean-up accounts for the majority of costs in most cases; no third party is involved.
Non-polluting damage: The policy may cover pollution, but environmental damage can occur in a variety of ways.

Gradual events
Requirements for "sudden and accidental" damage can leave businesses badly exposed.

Liability triggers
Don't be forced to wait until regulators get involved before stopping damage.

Land
Property policies are focused on real property, not land.

2010, Environment Risks: Insured or Not? It concluded that those relying on traditional cover were leaving themselves with significant exposures.

The reason is simple, according to Graeme Merry, head of Gallagher Heath's environmental solutions team: "These policies were never set up specifically to provide cover for pollution." (Heath Lambert, as it was then, was the broker involved in the Bartoline case.)

A dedicated solution

It is true that EIL policies are not without criticism, not least in the difficulty policyholders face in satisfying underwriters' requirements. But Merry suggests much of this is outmoded, with providers working hard to increase availability for businesses in lower-risk industries.

"It's frustrating because there are still many misconceptions," he says. Many still believe, for example, that insurers will insist on a site survey before covering operational risk. Not true, says Merry.

There remains, however, a distinction in the market between multi-year policies covering individual sites for historic contamination, usually linked to land transactions to indemnify buyer or seller, and those written to provide operational cover – usually on an annual basis. However, this too can be overplayed, being mainly an issue for the UK.

"If you look at Germany, they have been buying operational cover for

'Most extensions we see are lacking and in some instances fundamentally flawed'

Mathew Hussey Tysers

decades," says Stephen Andrews at insurer AIG. Increasingly, he says, specialist cover will be bought in a similar way to casualty products or property policies, although cover for historic contamination predating the cover still needs to be written on a site-by-site basis. "It's a technical process," he admits.

The most obvious benefit of a separate EIL policy, of course, is that it plugs the major gaps in general liability policies, with heads of cover for own-site clean-up and both gradual and sudden pollution incidents, for example, as well as the less obvious, such as cover for transport.

"Hauliers are covered by their motor policies for damage to other vehicles if they have a road traffic accident, but not if the vehicle ends up on its side with the diesel tank flowing into a brook," says Simon Collings at JLT. "Most EIL policies will cover that."

As well as looking for these, buyers should favour policies that cover against non-polluting environmental damage and – importantly – should not rely on a liability trigger, enabling companies to claim for work that will prevent an environmental incident from escalating.

There is also an increasing range of extended cover available. "We're starting

COSTING THE EARTH

There are two problems for insurers (and potentially their insureds) from the remediation that can be demanded under the European Liability Directive.

The first is determining when it is likely to apply, with uncertainty over what constitutes "significant damage". The second is how to value the exposure – particularly important when determining what levels of complementary or compensatory remediation a company may be asked to undertake.

In fact, there are several ways of putting a sum on natural resources, explains Ece Ozdemiroglu, founder of Eftec (Economics for the Environment Consultancy), whose clients include several national governments, the European Commission and the World Bank.

The starting point is to look for markets: figures for tourism and visitors' spending are often available, and can be supplemented with analysis of the mileage (and therefore travel costs) visitors are prepared to put in to visit. "Surrogate" markets can also be used: in the UK, particularly, house-price data is extensive enough to be able to calculate the premium for good views and a scenic setting.

Finally, where the information isn't available, surveys can determine the value people place on a natural resource: asking them, for example, how much they would be willing to contribute to a project improving it. Such primary research would prove too costly in most cases, but values can be inferred from surveys already conducted elsewhere.

And that's arguably where businesses should start in evaluating their surroundings, and therefore the scope of their exposure: desk research to estimate a value.

As Ozdemiroglu puts it: "If that gives you a figure of a few pounds a hectare, then that's one thing; if you're looking at a few hundred or a thousand, then that's quite another signal."

to see a lot more product innovation now," says Clive Walker at Willis. That might include anything from cover for business interruption during the clean-up, to policies covering the impact of bio-terrorism. Another option popular with buyers is media response coverage, providing advice on protecting the company's reputation in the event of an accident – a key concern.

In fact, more generally it's this potential to tap into expert support that has helped drive demand, says Walker, particularly outside the hazardous industries, which have environmental expertise in-house.

He says: "Having these policies in place means that in the event of a claim, you have immediate access to environmental consultants and emergency response teams to help you manage the incident and reduce the exposure by preventing further damage. If they don't have that in place they can find themselves floundering when an incident occurs." **SR**

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