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Global Environmental:
Debunking the Myth, Not Just Third-Party Insurance

By Karl J. Russek and William P. Hazelton

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Over the past several decades, businesses have faced ever-larger environmental liabilities and ever-stricter regulations. Among nations, the United States has been at the forefront of environmental litigation and, often, in regulation as well. Now, stricter environmental regulations are becoming a global phenomenon, with both developed and emerging nations attempting to limit and repair the damage of pollution, and establish legal means to fund remediation. The European Union (EU), for example, has enacted far-reaching changes in environmental laws under its Environmental Liability Directive, affecting all twenty-seven of its member countries, from the Balkans to the British Isles.

In the United States, environmental insurance has evolved primarily as a means to protect against the risks of lawsuits and legal judgments tied to pollution. In some cases, companies did not cause, but acquired these pollution exposures through mergers or other corporate transactions. Those acquired liabilities may extend far beyond United States borders. When Chevron, for instance, acquired Texaco for $35 billion in 2001, it also acquired an environmental claim brought by Ecuador and stemming from Texaco's operations in that country. The claim carried potential liability of up to $27 billion.[1]

While those kinds of figures make headlines, another, perhaps more likely danger for most businesses is an accidental spill or leak of pollutants that damages their own property. The accidental pollution must be cleaned up, and often at great expense.

Even so, environmental insurance is viewed primarily as third-party liability coverage, designed to mitigate the risk of pollution-related lawsuits that have been specifically excluded under general liability, excess and umbrella policies since the mid-1980s.

While this view has its foundation in the flood of environmental litigation that assailed businesses across the United States since the 1970s, it overlooks a crucial point. Businesses around the world also need to insure against the risks of pollution-related damage to their own property, as well as offset the cost of clean-up and associated liabilities for damage to the property of others.

Companies routinely protect their physical property against risks such as fire and storm damage, but may not take the same precaution for the inadvertent release of pollutant materials that could cause even more expensive damage. Although it may not carry the risk of third-party action, a spill of pollutants contained within a property's boundaries may still need to be cleaned up to protect workers and prevent damage to soil and groundwater. These costs easily can run into the hundreds of thousands or even millions of dollars. In addition to the environmental damage, a spill or leak of hazardous substances also will degrade the value of the property if it is not cleaned up properly. Should the company later decide to sell the property, it will be more valuable if the proper remediation measures have been taken.

Property is an asset for any business, and often one of the most valuable. To protect that value, companies should consider premises pollution policies that provide coverage for the first-party costs of environmental clean-up and remediation, as well as the potential liabilities arising from on-site incidents. Because environmental laws and regulations are constantly changing, that coverage should be adaptable, providing protection for changes in laws and regulations, as well. Besides short-term financial concerns, more and more businesses are realizing that environmental stewardship of their land makes long-term sense, both in terms of protecting asset values and their corporate reputation.

Liability and Regulation

Concerns about the environment exploded into public consciousness in the United States in the late 1960s and 1970s with incidents such as the Santa Barbara oil spill off California, and the Cuyahoga River fire in Ohio, in 1969. The discovery of the toxic waste at Love Canal in Niagara Falls, New York, in the late 1970s sparked widespread concern about hidden pollution across the United States, and led to the Superfund law. In Europe, incidents such as the Torrey Canyon oil spill off Cornwall, England, in 1967, and the 1978 Amoco Cadiz oil spill on the Brittany Coast in France had the same impact. More recently, in 1998, a dam containing mine waste burst in the south of Spain, releasing a wave of toxic sludge into a river. This sludge threatened a major nature reserve, endangered wildlife, and polluted thousands of acres of farmland.[2] The cost of clean-up was more than €250 million.[3]

As environmental concerns have intensified over the years, it has taken some time for both the law and the insurance industry to adjust. The United States responded with a number of laws: the Clean Air Act, first enacted in 1970 and dramatically revised in 1990; the 1972 Clean Water Act; the 1976 Resource Conservation and Recovery Act, which gave the Environmental Protection Agency (EPA) the power to regulate toxic waste; and the 1980 Superfund law (Comprehensive Environmental Response, Compensation and Liability Act). The Superfund law, enacted after the Love Canal disaster, applied a strict "polluter pays" principle to the cost of cleaning up toxic waste. But it also imposed joint and several liabilities that made each polluter at a site potentially responsible for the entire cost of clean up. The law additionally made that liability retroactive, so that companies could be held liable for their actions before the law was enacted, no matter how careful they had been under the old legal standards.

The Superfund law, in particular, sparked a massive wave of litigation by companies facing potential liabilities against their insurers, each other, and even the EPA. Companies sought coverage for their new liabilities under commercial general liability, umbrella, and excess policies that insurers had never intended to apply to such claims.

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The insurance industry responded by seeking to eliminate most pollution coverage from general liability policies through new exclusions, and by developing stand-alone environmental insurance policies. Such policies didn't gain widespread acceptance until the 1990s. Demand for the policies was sparked, in part, by the introduction of absolute pollution exclusions in commercial general liability policies. In addition, as insurers gained increased expertise in underwriting as well as loss control measures, they became more willing to offer policies designed to cover environmental damage. By offering environmental insurance on a claims-made or loss-discovery basis, insurers also were able to limit their liability to claims made in a single policy period.

Buried liabilities

Because of the sheer volume and expense of litigation, the demand for environmental insurance has largely been driven by the desire to protect against the risks of lawsuits and legal judgments. Those legal actions either could be tied to pollution caused by an accident, or to previously unregulated practices subsequently deemed to be illegal. In many cases, companies acquired buried liabilities in a corporate transaction. With its acquisition of Hooker Chemical in 1968, for example, Occidental Petroleum also acquired liabilities related to Love Canal, a toxic waste pollution site which would become national news a decade later. From 1942 to 1952 Hooker Chemical disposed of toxic waste that eventually leached into neighboring residential properties. After this toxic waste was discovered in 1977, hundreds of residents were relocated, and massive remediation efforts undertaken. In 1995, Occidental Petroleum agreed to pay the Federal Government $129 million to settle the case.[4]

In Europe, A "Polluter Pays" Approach

In Europe, the insurance market has faced a more fractured legal landscape, since each of the EU's member states has its own laws. The enactment of the European Union's Environmental Liability Directive (ELD), however, has established a common baseline for all 27 member nations, while steering the concept of environmental liability in new directions. Enforcement of the directive began on April 30, 2007, and it has now been put into effect or "transposed" by the members' states under their own laws. While the directive enshrines a "polluter pays" principle similar to the United States Superfund law, there are some distinct differences. The EU law does not apply retroactively nor does it apply joint and several liability. It does not preclude member states from having stricter requirements.[5]

At heart, the EU directive seeks to prevent and remedy environmental damage,[6] which is defined as damage to water, soil, and protected species and habitats. One of the key aspects of environmental damage under the directive is that it not only covers primary remediation, but also "biodiversity" damage. This is a broader concept that isn't necessarily limited to a specific incidence of pollution, since environmental damage can be caused without an actual spill.

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The directive mandates that operators of a given facility must take the necessary preventive action, in case of immediate threat of environmental harm, and remedy the damage once it has occurred. That requires the operator either to restore the damaged natural resources, or to recreate a similar resource. In the case of contaminated soil, for instance, the land would have to be returned to a state where it no longer poses any significant threat to human health. If a damaged site cannot be restored, then a nearby equivalent site has to be enhanced, or a site farther away that plays a similar role in the environment must be improved.

Besides damage by traditionally recognized pollutants, such as toxic waste or poisonous chemicals, the directive also applies to environmental damage caused by the release of genetically modified organisms (GMOs) into the wider environment.[7]

The directive gives member states significant leeway in implementing the rules, including the requirement for financial assurance. That means companies with operations in a number of EU states must take into account the varying rules as they apply country to country. In the case of Great Britain, this will mean the varying laws of England, Wales, Scotland, and Northern Ireland.

The directive does not require companies to purchase insurance, nor does it set a limit on the amount of damages that a polluter would be required to pay to remedy the damage of an incident. It does allow member states to decide on a case-by-case basis to limit the liability – when, for instance, remedial measures have already been taken, and the cost of further clean-up would outweigh the environmental benefits.[8]

The directive includes exemptions for damage caused as a result of war or natural disasters, and excludes maritime oil disasters, which are covered under international treaty. Traditional liability issues such as personal injury and property damage are not covered under the directive, and remain the purview of national laws.

Companies involved in recognized environmentally hazardous activities are subject to a strict liability standard, while others are held to a negligence or reasonable care standard. Unlike the equivalent American law, the EU directive does not grant the right to sue the polluter directly.

Nearest Polluter Pays

Because the directive is new, there is little case law. One early case, however, shows that the individual countries may take an expansive view of the polluter pays principle, and make the ELD more like the American Superfund law.

In this case, Italian authorities required companies operating a Sicilian petrochemical complex to take measures to clean up pollution near Augusta harbor, in an area that has been subject to recurring pollution since the 1960s, from a variety of sources. Those measures included removing the sediment from the seabed to a depth of two meters. The companies challenged the mandate on the basis of the "polluter pays" principle, arguing that no link had been established between their facilities and the pollution.

The Italian courts then sought an opinion from the European Court of Justice about whether the polluter pays principle would preclude efforts by Italy to impose clean-up measures, based on the fact that the installations were located near the pollution. The Italian court pointed out that there had been a succession of petrochemical operators

in the area, making it impossible to determine each one's share or responsibility, and argued that the fact that the companies were using hazardous materials on a contaminated site would suffice to hold them liable.[9]

The European Court found that the directive allowed national authorities to act on the presumption of a link provided they had "plausible evidence," such as the proximity of the facility, and a correlation between the pollutants found and the substances used by the operator.

Here is a section of their findings:

"In its judgment today, the Court finds that the Environmental Liability Directive does not preclude national legislation which allows the competent authority to operate on the presumption that there is a causal link between operators and the pollution found, on account of the fact that the operators' installations are located close to the polluted area. However, in accordance with the 'polluter pays' principle, in order for such a causal link to be presumed, that authority must have plausible evidence capable of justifying its presumption, such as the fact that the operator's installation is located close to the pollution found, and that there is a correlation between the pollutants identified and the substances used by the operator in connection with his activities."[10]

Regulatory Changes

The early development of EU case law on the environment highlights the need for businesses to be aware of how their environmental obligations and liabilities may change over time – not only in Europe, but also in the United States and around the world. As emerging nations progress, they may begin to place greater importance on pollution and other environmental issues. China, for instance, has called for the development of an effective system of environmental pollution liability insurance.[11]

Even in nations with well-developed environmental laws, regulations are constantly being updated and amended. For that reason, businesses have to be concerned not just about their obligations under current standards, but about the effect of more stringent standards in the future. Levels of pollutants that are currently designated as acceptable, may later be ruled unacceptable.

In the United States, for example, the EPA recently announced the first expansion of its Toxic Release Inventory list of reportable chemicals in more than a decade. Under the proposal, the agency would add sixteen chemicals to the list as potential carcinogens.[12]

That move is just part of a more aggressive stance being taken by the EPA, which has received significantly more funding under the Obama Administration than under the Bush Administration. For instance, the EPA's budget for fiscal year 2010, the first new fiscal year under the Obama Administration, was increased more than it had been in two decades.[13] The $2.65 billion budget increase (34.7 percent) to $10.3 billion was the largest, in percentage terms, since fiscal year 1987. The allocation for enforcement was increased by $32 million, or 5.7 percent, to about $600 million.

"The Budget reflects this Administration's strong commitment to vigorous enforcement of our nation's environmental laws," the EPA noted in its 2010 budget summary, "and ensures that the EPA will have the resources necessary to maintain a robust and effective criminal and civil enforcement program."[14]

Premises Pollution Coverage

While demand for environmental insurance has been driven, to a large extent, by concerns about liability, particularly in the United States, companies may be more likely to face the unexpected expense of cleaning up after an incident on their own sites. This is a risk that insurers are increasingly willing to underwrite, due to the experience they have gained, as well as greater environmental engineering expertise. This kind of premises pollution coverage includes the clean-up of pollution to soil and ground water on the site, as well as the liabilities that may arise.

Outside the United States, where few countries have the same culture of liability, first-party pollution coverage offers a means of protecting property value. While companies in East Asia, for instance, may be very careful about purchasing traditional property coverage, due to requirements from their banks and lenders, they may have much less interest in other coverage, including general liability and first-party pollution policies.

However, property represents a large portion of the total value of the entire business. And unaddressed pollution or contamination on-site can dramatically reduce the value of the property, and thus the business itself. Insurance coverage that protects the property against damage from pollution, and covers the cost of clean-up, is analogous to a fire policy that covers the cost of rebuilding. This is a step beyond the traditional view of environmental insurance as a means to fill a gap in a general liability policy. The premises pollution policy acts essentially as a hedge against unforeseen, but not uncommon, instances where businesses are faced with an unplanned premises pollution expense.

Such policies would for instance, respond in cases where a leaking tank was discovered. Although the clean-up may never extend beyond the site itself, and no outside parties may suffer damage, the policy would still respond and cover the cost to clean up and remediate the property, thus restoring its value and making the insured whole.

Although cases where contamination is contained on-site may not cause any outside harm, there is still, in many cases, an administrative responsibility, and possible liability involved. In the United States and many other parts of the world, mere knowledge of pollution, beyond a certain threshold, might bring a responsibility to clean up and remediate the site. In some countries, there may be an affirmative responsibility to act. In others, businesses would be required to notify the government, which would then decide what course of action to take.

In the United States, of course, the responsibility for cleaning up pollution at a site isn't limited to those who caused the damage. The current owners may find themselves responsible for cleaning up pollution that was left by others, should the former operators no longer exist or be insolvent. For instance, if a bank is now situated on a property that was formerly an industrial site, and none of the former operators are available to pay for the clean up, the current owner could find itself having to bear the cost. Just the fact of ownership or tenancy might lead to being held financially liable for the clean up.

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Of course, companies dealing with unexpected clean-up costs could be faced with legal action as well, which is why first-party clean-up coverage should include liability coverage. The company could be implicated by a regulatory agency or another third party, and have to respond to both legal and administrative actions. Historically, legal defense costs have been a major factor in driving companies to buy environmental insurance coverage. In the United States, it is estimated that anywhere from forty percent to sixty percent of overall remediation costs is related to legal defense expenses. While those costs would likely be less in Europe and other less-litigious parts of the world, they could still prove substantial.

Conclusion

Around the world, pollution and the environment remain key concerns for the public, for business, and for governments. Insurance for environmental risks has developed since the 1980s, largely as a response to third-party liability concerns. Those risks can, of course, be substantial due to ever-tighter environmental standards, worldwide. Businesses, however, are more likely to face the unexpected expense of cleaning up pollution on their own property than to be faced with a massive third-party lawsuit. While every responsible business strives to avoid accidents, spills and leaks can still happen. The cost of cleaning up a site after a spill of pollutants can be very high. And just as a business may not have enough ready cash to rebuild a major plant after a fire without insurance, it may not have the wherewithal to fund the remediation of one of its sites.

Besides unexpected spills and accidents, businesses also have to worry about tightening environmental regulations and stricter enforcement that may require costly remediation work on property that had been compliant. In the United States, in particular, businesses may find themselves held liable for cleaning up legacy pollution issues for which they were not responsible, but they acquired along with the property.

Changing regulations and heightened enforcement are just two reasons for businesses to seek coverage for on-site clean up costs. Another is that property is often a major asset, and the value of that property will be impaired if adequate remediation is not taken. While protecting their property, businesses should not neglect liability concerns. For that reason, companies should seek premises pollution policies that include liability coverage.

Because of the way environmental insurance developed, it often is thought of as a means of guarding against third-party lawsuits. While lawsuits linked to pollution or environmental damage can be a major concern, third-party liability is only part of the problem. Businesses also need to insure against the more likely scenario of first party clean-up costs

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