Environmental Liability in the European Union: How the (re)insurance industry is developing solutions in a fast-evolving context

As awareness of environmental issues has grown stronger, over the past 30 years the European Union has created legal standards to protect citizens and mitigate the effects of pollution. All of these measures have had a significant influence on industry, increasing the scope of liability and consequently bringing about noteworthy changes for (re)insurance. One of the latest regulations is the European Environmental Liability Directive, the main objective of which is to hold operators legally and financially responsible for preventing and remedying environmental damage caused by their activities.

We propose to address this issue in this newsletter, which presents the main features of the Directive and its implications for public entities and the industrial sector. We will also analyze a number of insurance solutions through examples.

EU Environmental Liability Directive: main features and objectives

The Environmental Liability Directive (2004/35/EC) has introduced important new elements relating to protection and remediation into European environmental law. The various transposed laws of member countries have (almost all at this stage) turned the wording of the Directive into national laws and regulations, with various specific features. In spite of these marginal variations, environmental legislation in Europe is now far more coordinated than it was before the Directive.

The driving force of the ELD is the “polluter pays principle”, together with the introduction of administrative liability, which is enforced by the Public Authorities in each country as defined by national laws. The main focus of the Directive is the protection of nature using measures designed to prevent or remedy damage caused to protected species and natural habitats, notably “Natura 2000” sites. In the first instance, the “polluter pays principle” requires Public Authorities to identify environmental accidents and those responsible for them: the operator responsible for the polluting accident must be identified and is responsible for the environmental consequences. The ELD defines the concept of environmental damage as the “serious impairment (reduction) in ecological function of protected species and natural habitats, surface and ground water, land and soil that threatens human health”. The Directive explicitly mentions a trigger date for the inclusion of environmental accidents under its coverage: 30/4/2007, which was the official deadline for the transposition of the Directive into national laws. Therefore, the Directive does not target historical pollution.
Parallel to the central action of the Public Authorities, the role of certain Non-Governmental Organisations may become increasingly relevant, as they are entitled to raise issues regarding potential environmental damage which could lead the relevant authorities to take action.

The target of the ELD is the cost of restoring the "baseline" condition of the natural environment, i.e. the situation as it existed before the accident. The Directive is very detailed in describing the forms of possible remediation that may be ordered by the competent Public Authorities, which may be split into three categories defined as:

- **Primary** remediation: measures that restore the damaged environment to "baseline" conditions;
- **Compensatory** remediation: action taken to compensate interim losses of natural resources and services that occur from the date of damage up to the full effect of primary remediation. These actions aim to compensate for the reduced efficiency of ecological resources.
- **Complementary** remediation: measures that may be ordered by the competent Public Authorities, which may be split into three categories defined as:

The entity entitled to claim is the Public Authority identified in the transposed law (for example in France this is the Président), who has the authority to search for environmental damages as defined above, to identify the operator responsible and to order the necessary remedial actions.

It is important to note one specific feature of the powers attributed to the Public Authorities in the context of the ELD: they fall under the general category of administrative law, as in fact the ELD has created a new form of administrative liability which is distinct from traditional civil Third Party Liability. The main aim of the ELD is the protection of nature, where there is no third party involved who can claim from a civil liability point of view. This results in decisions by the Public Authorities that do not have a financial impact per se and that are not discussed in the civil courts. These decisions primarily encompass an order to act, to do something to remediate. Such decisions will of course lead to further expenditures for the liable operator, as they will initially consist of preventive measures (in the event of serious and imminent threat to human health), neutralization costs, clean-up, and then all the concrete actions to be taken to restore the baseline condition (remediation as mentioned above). However, there is no third party indemnity involved.

It should be noted that ELD considers that all operators undertaking an economic activity, therefore all professionals, craftsmen and so on could be potential targets of the Directive as polluters.

**Environmental losses: Case studies**

**August 2009 – France.** Rupture of an oil pipe in the French nature reserve at Coussouls de Crau, bordering the Camargue national park. The area is home to rare birds (and is a Natura 2000 site), both elements being key environmental resources protected under the Environmental Liability Directive. 3,000 cubic metres of oil were spilled over two hectares of soil. An emergency plan was activated, clean-up operations have been completed. The remediation measures will constitute a case study on ELD application once completed. Cost is not yet available.

**February 2010 – Italy.** Following an accident caused by the sabotage of an oil depot (formerly a refinery) near the town of Monza (north of Milan), 3,000 tons of polluting material flowed into the nearby river Lambro, a tributary of the Po. The polluting material was largely composed of diesel oil, combustible oil and to a non negligible portion of liquids contaminated by hydrocarbons and minerals.

A containment effort was initiated immediately and substantial amounts of the dispersed polluting material were cleaned up in the following weeks. The filters of a downstream power station partly helped to stop the flow. The case is complicated by the alleged criminal intent of third parties; it will constitute another test case for remediation measures.

**Decision of the cour d'appel** on the Erika tanker, which sank off the coast of Brittany in 1999. Although outside the scope of the ELD (occurrence prior to 2007 and off the coast in the ocean), both the initial decision in 2008 and the appeal in 2010 recognized the existence of an ecological loss resulting from an environmental damage, thereby giving the right of recovery on a civil basis to local councils (Non-Governmental Organisations already had this right in the “Code de l’Environnement”). This is a very interesting case as it shows the complexities of a clear distinction between third party and Environmental Liability in the approach taken by jurisprudence.
It does make a distinction, however, between two types of activity:

- The first type is activity with a high pollution potential, as included in the Annex III of the Directive, where the legal system is one of no-fault liability once the polluter has been identified.
- The second type of activity encompasses all other cases. In this second category, the Public Authorities must more classically prove the link between any environmental damage and the operator.

Most transposed laws voted by the EU States have merely reproduced the wording of the Directive into their respective national legislation. The only flexibilities permitted by the wording of the Directive relate to the possible introduction of the “state of the art” and the “permit of activity” defence, which have been adopted according to national preferences and may therefore create, in certain cases, differences in terms of how the operator is treated depending on the national legislation to which it is exposed. This may particularly apply to transborder accidents. On the other hand, certain States have used their transposed laws to introduce further elements that may create even more problematic overlapping between the civil Third Party Liability system and the remediation system under the administrative liability set out by the ELD. There has been an example of this in France, where article 5 of the 2008 transposed law allows local councils to claim for indemnities against polluters under a civil law system, as the representatives of damaged local interests in a sort of collective “pain and suffering” third party award.

Finally, the courts were already using elements of the ELD even before the national laws were transposed, by applying them in different contexts. A significant example of this trend is the 2010 judgement of the French cour d’appel judgment over the sinking of Erika tanker off the Brittany Coast in 1999, which confirms and extends the court’s initial decision made in 2008. In this case, certain sums of money have been awarded to local authorities and Non-Governmental Organisations to indemnify ecological damage.

**Implications of the ELD from a risk management point of view:**

**the operator and the Public Authorities**

The “polluter pays principle” is not new in terms of existing environmental policies throughout the world. It actually originated in the United States in the 1980s, at the time of the legislation implementing CERCLA and Superfund. However, one of the aims of the US legislation was the depollution of the historical contamination. The EU legislation, on the contrary, has proved over the years to be more inclined towards controlling pollution at the source. This difference in orientation has clearly led to a much higher interest in Europe for loss prevention measures and organisation, thereby implicitly stimulating an appropriate environmental Enterprise Risk Management (ERM) approach from operators.

In general terms, environmental literature focusing on risk management starts from a conceptual model that tries to identify the schematic relationship between possible sources of environmental damage, its pathways and its resources. In this analysis, the potential sources are the “operators”, which face liability on no-fault (annex III) and on negligence base. Pathways are the mechanisms that link the environmental damage to the contamination of potential resources singled out by the Directive such as protected species and natural habitats, ground waters (covered by the Water Framework Directive – WFD), and land contamination that may endanger human health.

In the context of the above model, we will try to analyze the duties of the operator as well as those of the Public Authorities, attempting to turn the risk management and organisation approach implied by the ELD’s new administrative liability into a more explicit concept. One of the first duties of any operator is the identification of environmentally sensitive items that may be affected by its operations, which means in the first instance identifying the potential resources as per the ELD and the possible pathways that could reach them. This is different from the Third Part Liability (TPL) approach, where the potential TPL claimant is *a priori* unknown.

Consequently, one of the duties of the operator consists of defining a process by which to assess the potential risks placed by its activities on the resources. This can be achieved through ELD-oriented questionnaires and environmental audits, as well as by extended risks monitoring. Concretely, this activity should result in a set of preventive actions to be taken against potential damages to both nature and human health.
In the event of actual or likely environmental damage, the next step for the operator is the obligatory notification of the Public Authorities. The aim of this communication is to coordinate immediate clean-up and future remediation measures. Consequently, the operator is obliged to execute the remediation plan defined by the Public Authorities and to keep them updated with regard to any progress made.

Throughout the above process, the operator must introduce ERM measures that will facilitate its responsiveness in the event of environmental damage: these may include introducing environmental guidelines at a company level, setting up of emergency and contingency plans, and regularly training employees. Above all, a consistent commitment from top management will be necessary to ensure that the organisation acts in a coordinated way according to the established environmental ERM.

An area of observation that remains relatively untested is that involving the duties of the Public Authorities, along with their transition to the new role envisaged by the Directive. In fact, the Public Authorities play a key role in terms of the efficacy of the ELD, which implies the burden of creating a set of criteria regarding intervention in the event of environmental damage as well as ERM procedures. Above all, the Public Authorities will be required to act swiftly once an environmental event hits its competence area. They will give the operator a list of predefined steps to take and will use a reference grid to monitor its achievements.

The role of the Public Authorities will involve a considerable effort in terms of proactively monitoring Natura 2000 zones (which represent 20% of the EU’s territory), in order to react swiftly and also to contribute to the definition of the baseline conditions of natural habitats. This will be crucial in terms of executing concrete remedial steps, since the restoration of the baseline existing at the trigger date defined by the ELD (30/4/2007) is the ultimate goal of the action enforced by the Public Authorities.

A measure of restoration to baseline conditions: Habitat Equivalency Analysis

The Habitat Equivalency Analysis (HEA) is a methodology used to determine compensation for damage caused to natural resources. This theoretical approach has been used by the European Union to draw up the remediation steps envisaged by the ELD.

The underlying concept is that the public can be compensated for past losses of habitat resources through habitat replacement projects.

The object of the restoration is the baseline, which is defined by the economic literature as the condition of the natural resources and services that would have existed had the accident not occurred. Conceptually, the components of a natural resources claim are twofold: the cost of restoring the baseline and the compensation for interim losses. The logical steps of a remediation approach are:

- quantification of the losses due to the accident
- quantification of the gains from the habitat replacement project
- determination of the size of the replacement project
- calculation of the cost of the replacement project.

Adjusting the size of a restoration project implies calculating that the present discounted value of the project gains equals the present discounted value of all interim losses.

The HEA technique steps in at this stage, as its aim is to calculate the value of the service previously rendered by the damaged environment and lost as a consequence of the damage suffered, compared to all costs necessary to reproduce the situation of capacity of nature to render the same service to the environment as before the accident. It is not, therefore, a matter of giving value to nature, but of assessing the cost involved in restoring the capacity of nature lost in the accident. This approach compares the levels of service before and after the environmental loss. For the model to work properly, there should also be an agreement on the appropriate discount rate to use.

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Possible insurance solutions

The insurance sector is not new to dealing with risk transfer in relation to pollution risks and for many years has offered a wide range of third party and first party products. However, the newly introduced Environmental Liability, which is not a third party type of civil liability, requires adaptations to existing programs or entirely new products, which are already partly developed in several markets.

• General Third Party Liability (GTPL): Traditionally, the GTPL policy is meant to indemnify identified third parties for bodily injury and property damage in the event of an environmental damage. It usually has, with variations according to market practice, a sub-limit intended for what are known as sudden, unintended and unexpected polluting events. It is not designed for environmental damage, where there is no identifiable damaged claimant, but for nature. So-called gradual pollution is excluded.

• Environmental Impairment Liability: Various markets offer products that cover identified third parties as well as ELD under a dedicated policy. These products have proven to be potentially efficient in the new context of administrative liability introduced by the ELD as they cover the two most important aspects of environmental damage: damage to nature / protected species on the one hand and bodily injury and property damage to identified third parties on the other. It is also important to note that a traditional GTPL policy is not sufficient for ELD coverage, amongst other reasons because ELD cover, not being civil liability, may not be protected by GTPL reinsurance treaties. Besides, the ELD does not differentiate between sudden and gradual environmental damage per se, which makes for another reason why the ELD is excluded from traditional GTPL treaties. Moreover, claims handling does not follow the traditional GTPL civil liability approach: the claim and the responsible party are determined by an administrative body and not by transaction between the parties or by a civil court. Another relevant aspect to note is the lack of experience in terms of ELD claims, cost remediation and the appropriate limits to buy. All this culminates in the need for a dedicated ELD product as opposed to a GTPL policy with a sublimit. In various markets the products offered by the local markets may already be very advanced and comprehensive.

• Professional Indemnity: the operator in the ELD claim may also be a professional who is party to an economic activity (e.g. engineers). It is important to have a specific product covering the environmental liability for professionals involved in activities/works/constructions exposed to pollution. There are examples of similar products in the European markets.

• Motor and Transport: given the definition of operator in the Directive, the transportation of goods may constitute a major source of losses. In fact, a Motor Third Party Liability policy may be triggered on a pollution event in the case of identified third parties, but would need a specifically designed section in the case of ELD losses given their administrative origins.

• Product Liability: this is a special case, since products as such are not directly covered under the Directive. However, in the event of an environmental damage, it is entirely possible that an operator, liable under administrative liability, may by way of recourse sue the producer of the defective product that has allegedly caused the pollution. This is a particularly tricky case, as environmental liability may arise as part of traditional third party liability. Following the same reasoning mentioned above with regard to the lack of experience on ELD claims, it would seem reasonable to handle also these environmental product liability claims under specific products, as well as in terms of dedicated reinsurance treaties (pools or other specific treaties or sections).
Finally, we touch upon two first party insurance products, which may become more widespread in the new context:

- The first is insurance for first party clean-up costs which is designed to cover the effects of pollution on the insured’s own site.
- The second is the clean-up cost cap which protects against clean-up cost overruns arising from a planned and budgeted decontamination as well as against newly (unknown when setting the clean-up budget) found pollution conditions that are not discovered until the clean-up plan is actually implemented.

Taking into account the specificities of environmental risks and the difficulties involved in covering them through standard commercial means, some countries have considered market responses with the setting up of pools, as a way to gain experience and provide the market with a capacity which otherwise would not be available to commercial companies. Such initiatives can be found in France with ASSURPOL, in Spain with PERM and in Italy with Pool Inquinamento.

## Conclusion

As a member of the United Nations Global Compact, SCOR is committed to supporting a precautionary approach to environmental challenges and to undertaking initiatives designed to promote greater environmental responsibility.

Hence SCOR has defined a set of basic principles guiding its underwriting policy with regard to Environmental Impairment risks, which seek to respond to the demands of insureds to increasingly severe environmental legislation. Environmental damage coverage is viewed as a tool by which to improve industry standards to meet increasing environmental responsibilities and social demands for a sustainable economy.

SCOR has set up basic requirements for including such liabilities on its balance sheet, as far as risks located in Europe are concerned:
1. Ability to steer, control and monitor capacity and accumulation.
2. Adequate design of coverage to deal with long-tail and heritage aspects linked to Environmental Impairment (EI).
3. Expertise in the underwriting of complex risks and the handling of EI claims on the insurance side.

The above requirements are ideally met in Pool solutions and therefore SCOR is a member of the French ASSURPOL, the Spanish PERM and the Italian Pool Inquinamento.

In 2007, SCOR has set up a dedicated group to ensure that the above requirements are met. This group continues to give advice on insurance products and how best to reinsure them, so as to acquire the risks and claims handling experience necessary to further improve such products in the future.

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