

Cleaning up the corporate act

It is a near certainty that companies in Europe will face an even tougher regime over the next decade as regards their environmental liabilities. **Mathew Hussey** looks at what may lie ahead



If the latter years of the last century were marked by a belated realisation that the damage wreaked by man on the environment could not be maintained without disaster resulting, the first decade of the 21st century has seen more concerted efforts to effect a remedy. The worry is that the action plans devised so far are a case of too little, too late. As the second decade approaches, what developments can the business world expect over the next 10 years in the way of new environmental legislation? Will the insurance market be able to take advantage of opportunities to develop new services

and products in the environmental field? And which exposures will put the onus on companies to improve their risk management practices?

Most companies are seeking ways to better manage operations to increase energy efficiency and reduce waste. Certain areas, such as reduction of energy use and waste, will always be issues that need to

be tackled and managed appropriately. In other areas the liabilities created may, however, be managed by a combination of risk management and insurance. Some risks technically cannot be 'managed out'.

Environmental regulation continues to drive risks and the insurance markets have reacted. For example where a site or business may be impaired, with latent liabilities relating to contaminated land, insurance can be acquired. The market in this fairly well-established area of risk continues to diversify.

The recent introduction of the Environmental Liability Directive (ELD) has undoubtedly created an increased awareness of operational environmental risks across the European Union. The insurance markets have reacted with specific ELD policies and insurers report take up across the EU of these relatively new products.

It is not easy to assess what might occur over the next 10 years in terms of environmental regulation, risks and new environmental products but consideration of incoming legislation often, if not always, points the way.

Legal drivers *

Companies need to be aware of liabilities that may arise under emerging legislation such as the Environmental Liability Directive, Water Framework Directive and Carbon Reduction Commitment (see opposite). Consequently, the importance of transactional environmental due diligence (EDD) has grown steadily as the financial and reputational cost of not identifying actual and potential risks prior to acquisition have become better understood.

There have been some notably large liabilities arise for unwary purchasers in the past; as Lloyd's oldest surviving insurance broker my own firm has advised on deals in which major liabilities have been identified in a rigorous EDD programme. Usually a deal can be struck using creative risk management techniques, but occasionally the identified issues have been show stoppers.

Some environmental liabilities are statutory or regulatory in nature and may require certain mandatory actions to be taken, such as the remediation of contaminated land, or stopped such as suspension of operations in breach of conditions of an environmental permit. But it should also be remembered that



there may also be common law claims of negligence or nuisance.

While warranties and indemnities may be on offer they can prove of little value to the purchaser given the likely poor financial status of the seller. If the company is insolvent no warranties will be given by the insolvency practitioner, and no contingent or ongoing liabilities can remain with the seller.

Apart from the legal drivers mentioned above – clients, especially funders, are now saying that further security is required. Funders will be more cautious and demanding in tight markets. Consultants' and contractors' indemnities and warranties are primarily based on fault and negligence occurring, which is often difficult and costly to prove.

Rather than paying for, and chasing, everyone else's insurance, clients may start to seek an insurance policy that actually insures the site/project – be it construction of a wind-farm through to a large-scale contaminated land site development.

Insurance policies are based on financial loss occurring and can streamline the process should a claim occur. Also, instead of chasing multiple parties, an insurance policy means there is only one party involved. Importantly, insurance companies are designed to take risks, monitor for credit rating and are regulated by the government in terms of solvency.

To that end it may be expected that single project and owner-controlled insurances will increase in development over the next 10 years as companies understand the risks behind solvency. Directors' and Officers' Liability (D&O) cover can also be expected to continue to evolve as increasingly the legal duties upon executives in the environmental arena appear to grow more onerous.

Insurance has begun to develop in the world of climate change. Aside to cover for the construction of wind-farms, waste to energy plants, biomass and other 'green energy' schemes some insurers in the more standard day to day business activity areas are offering policies that will, for example, reinstate buildings to low-level carbon use and offset carbon generated from travel.

The more complex climate change insurance risks have yet to be tackled, such as 'hedging' against carbon costs in terms of credits or accounting and assessment of or impact on business due to climate change and adverse conditions. This will doubtless be an area where products will develop, but it will take time.

Prediction of future discovery risks in terms of science (excluding the linking of a specific disease to a chemical/agent or new 'greenhouse agent') or a change in public perception or politics is always a challenge. Some environmental policies can provide comfort in this area for 'unknowns'. ■

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Emerging Environmental Legislation

(1) **Environmental Liability Directive** (2004/35/EC) which reinforces the "polluter pays" principle, makes operators financially liable for actual or threatened damage to habitats and species protected by EC law and on sites of special scientific, damage to water resources, and land contamination, has finally been implemented by the UK under the Environmental Damage (Prevention & Remediation) Regulations 2009 (SI 2009/153) which came into force on 1 March 2009.

(2) **Water Framework Directive** (2000/60/EC) which aims to improve and integrate the way water bodies are managed in Europe and requires EU member states to reach "good" chemical and ecological status in inland and coastal waters by 2015, was transposed under the Water Environment (Water Framework Directive) (England and Wales) Regulations 2003 (SI 2003/3242). It came into force on 2 January 2004. Assets purportedly cleaned-up may be revisited if they adversely impact relevant waters.

(3) **The Climate Change Act 2008** (c.27) establishes the framework for introducing the Carbon Reduction Commitment ("CRC"), which introduces a new cap and trade scheme for the non-energy intensive sector. A consultation on The Carbon Reduction Commitment was Order 2010, published in March 2009 and closed in June, with any resulting changes expected by the end of the year.

The CRC, a cap and trade scheme, aims to keep greenhouse gas (GHG) emissions below a government-set maximum level ("the cap") and increase energy efficiency by obliging scheme participants to sell or buy "allowances" representing the right to emit a certain amount of GHG ("the trade") to the level of their cap. The less GHG emitted, the fewer allowances participants will need to purchase.

From April 2010 any "organisation" that in the "Qualification Period" of 1 January and 31 December 2008 used over 6,000 MWh of electricity as measured by half-hourly meters will be subject to the CRC. So a company spending £500,000+ on electricity is likely to be subject to the CRC. This is likely to catch 5,000 organisations responsible for around 10% of total UK CO2 emissions.

Who is caught?: Private and public sector organisations alike. Where organisations are part of a group of companies (using modified Companies Act 2006 definitions of parent and subsidiary undertakings) it is the group as a whole which is assessed, not each individual member. Landlord and tenant organisations will also be caught, but the rules differ as responsibility falls to the counter party to the energy supply contract.

The CRC aims to be virtually revenue neutral, with the costs of purchasing allowances recycled back to participants according to their relative performance in a public league table. In the earliest years of the CRC, only early action to increase energy efficiency or generate renewable energy for internal consumption can influence an organisation's position in the table, and thus the sum returned to the participant. So well thought through early action should not only save money in reduced energy and CRC allowances costs, but ensure a higher return from the recycling.