

## FINANCIAL SECURITY STUDY 2019/2020

Valerie Fogleman, Consultant, Stevens & Bolton LLP,  
Professor of Law, Cardiff University School of Law and Politics

## TOPICS

- Project and final report
- Key issues
  - Financial security for environmental responsibilities and liabilities
  - EU and US comparisons
  - Member State mandatory financial security requirements
  - Innovations in corporate law for the remediation of environmental damage
- Recommendations
  - European Commission
  - Member States
  - Further work

## PROJECT AND FINAL REPORT

- Project
  - Objectives
    - Establish the current situation of financial security for ELD liabilities in all Member States
    - Examine the situation in the US to use as a benchmark
    - Investigate the conditions for making financial security for ELD liabilities more effective and even across the EU
    - Make recommendations to improve the situation at EU and Member State level
  - Approach
    - Legal research including legislation, guidance, articles, books and papers across and outside the EU
    - Empirical research including three questionnaires, numerous meetings and telephone calls, and over 4,000 emails to gain information from authorities, re/insurance experts, operators and other ELD stakeholders across the EU

## PROJECT AND FINAL REPORT

- Final report
  - Abstract
  - Executive summary
  - Seventeen chapters
  - Table of acronyms
  - Glossary
  - Bibliography
  - Acknowledgements
  - Annex I: Member State Reports
  - Annex II: Member State Summaries
  - Annex III: Environmental Insurance: Availability and Demand

## FINANCIAL SECURITY FOR ENVIRONMENTAL RESPONSIBILITIES AND LIABILITIES

- Financial security for environmental responsibilities
  - Generally required for specified obligations under an environmental permit
    - EU examples include the Landfill Directive (closure and post closure), and the Extractive Waste Directive (closure, post closure and rehabilitation)
    - Individual Member State examples include the Industrial Emissions Directive (returning site to a ‘satisfactory state’), the Seveso III Directive, and waste operations
  - Types of acceptable financial security instruments
    - Bank guarantees, dedicated bank accounts, and bonds are the most popular
    - Insurance is not applicable except, e.g., for the costs of closure of a landfill exceeding estimated costs
      - Insurance covers fortuities, not certainties
  - Generally not controversial because measures required by permit conditions will inevitably occur

## FINANCIAL SECURITY FOR ENVIRONMENTAL RESPONSIBILITIES AND LIABILITIES

- Financial security for environmental liabilities
  - Voluntary
    - Insurance is the only applicable financial security instrument
    - Operators do not set money aside in dedicated bank accounts, trust funds, etc., or obtain bank guarantees or bonds if they not required to do so
      - No benefit; would suffer only a financial detriment
  - Mandatory
    - Various financial security instruments and combinations of them
      - Insurance and bank guarantees are the most popular
      - Other instruments include a charge over property (may be limited), and a dedicated bank account
  - Generally controversial because an environmental incident may not occur

## ELD AND US ENVIRONMENTAL LEGISLATION

- Focus on Comprehensive Environmental Responsibility, Compensation, and Liability Act (CERCLA or Superfund)
  - Similarities, but also major differences, to ELD
  - Key reason for development of US environmental insurance market
- Mandatory financial security requirements
- Developments in environmental insurance markets

## ELD AND US ENVIRONMENTAL LEGISLATION

- ELD

- Two liability systems
  - Annex III operators: strict liability for preventing and remediating land, water, and biodiversity damage
  - Non-annex III operators: fault-based liability for preventing and remediating biodiversity damage
- Primary, complementary and compensatory remediation for water and biodiversity damage
- Not retroactive

- CERCLA

- Two liability systems
  - Strict retroactive (and prospective) liability for remediating contamination caused by releases of hazardous substances
  - Strict prospective liability for damage to natural resources caused by releases of hazardous substances
    - Restoration to their baseline condition
    - Acquisition of equivalent natural resources if restoration is not possible
    - Loss of use between damage to a natural resource and its restoration or replacement



## ELD AND US ENVIRONMENTAL LEGISLATION

- ELD

- Liable persons
  - Operator is the only person with primary liability
  - Potential for secondary liability (e.g., owners and occupiers, but rare in Member State legislation transposing the ELD)
- Thresholds for land/soil, water and biodiversity damage

- CERCLA

- Potentially responsible parties (PRPs)
  - Current owners and operators of ‘facilities’
  - Owners and operators of facilities when ‘hazardous substances’ disposed of or treated
  - Persons who arranged to dispose of or treat a hazardous substance (generators)
  - Transporters
- No thresholds for contamination or damage caused by hazardous substances

# ELD AND US ENVIRONMENTAL LEGISLATION

- ELD

- Enforcement
  - Operator whose activity has caused an imminent threat of, or actual, environmental damage must prevent or remediate it
  - Competent authority requires an operator to do so if the operator has not already done so
  - Operator proposes remedial measures to competent authority
  - Competent authority determines which measures the operator must carry out

- CERCLA

- Enforcement of clean-up actions
  - Notice letter
  - Unilateral order to clean up
  - Fine for non-compliance with an order up to \$53,907 (EUR 49,708) per day
  - Treble damages if EPA cleans up a site
  - No challenge to liability until the EPA enforces an order or seeks to recover its clean-up costs
  - Re-openers

## EU AND US MANDATORY FINANCIAL SECURITY REQUIREMENTS

- US mandatory financial security requirements include
  - Hazardous waste treatment, storage and disposal facilities
    - Operational phase: third-party claims for bodily injury and property damage
    - Closure and post closure: remediation measures
  - Underground storage tanks
    - Remediation measures and third-party claims for bodily injury and property damage
  - Offshore oil and gas facilities and vessels
    - Remediation measures, 'damages' including claims for property damage
  - *Ex post* environmental damage
    - Remediation measures
  - Legislation sets out detailed specifications and templates for each type of financial security instrument

## EU AND US MANDATORY FINANCIAL SECURITY REQUIREMENTS

- EU mandatory financial security requirements include
  - Landfill Directive
    - Closure and post closure measures
  - Extractive Waste Directive
    - Closure, post closure and rehabilitation measures
  - Directive on the geological storage of carbon dioxide
    - Closure and post closure measures, EU Emissions Trading System obligations
  - Bank guarantees are the most common mandatory financial security instrument followed by dedicated bank accounts
  - Other financial security instruments and mechanisms are also acceptable depending on the Member State

## EU AND US ENVIRONMENTAL INSURANCE MARKETS

- Developments in US environmental insurance market
  - Main drivers include
    - Onerous nature of CERCLA which led, and still leads, to a demand for environmental insurance especially in commercial transactions
    - Mandatory financial security requirements for environmental liabilities
  - Demand is for stand-alone environmental insurance policies due to
    - Absolute/total pollution exclusions in general liability policies and property policies
    - General unavailability of environmental extensions to general liability or property policies for remediating pollution and other environmental damage
  - Wide range of stand-alone environmental insurance policies
  - 2019: approximately \$2 billion (EUR 1,846,070,000) in annual premiums

## EU AND US ENVIRONMENTAL INSURANCE MARKETS

- Developments in EU environmental insurance market
  - ELD led more insurers to enter the environmental insurance market
    - But still small compared to the US environmental insurance market
  - EU mandatory financial security requirements are not a driver because they cover only environmental responsibilities, not environmental liabilities
    - Mandatory financial security for ELD liabilities in Member States that have introduced it is a driver
  - Insurance for environmental liabilities
    - Stand-alone environmental insurance policies
    - Environmental extensions to general liability policies
    - Environmental extensions to property policies

## EU AND US ENVIRONMENTAL INSURANCE MARKETS

- Large operators with sites and/or operations in more than one Member State
  - Stand-alone environmental insurance policies are widely available for all ELD liabilities
- Operators with sites and/or operations in a single Member State
  - Stand-alone environmental insurance policies
    - Large variation
    - Not available in some Member States
    - Even when available, cover is sometimes limited to sudden and accidental pollution

## EU AND US ENVIRONMENTAL INSURANCE MARKETS

- **General liability policies**
  - Provide cover for third-party claims for bodily injury and property damage (and sometimes other harm) caused by the acts or omissions of an insured
  - Do not provide cover for any ELD liabilities, remediating pollution or on-site damage
  - Almost always have a pollution exclusion that bars cover for claims from pollution with the exception of sudden and accidental pollution (qualified pollution exclusion)
- **Environmental extensions (except Austria and Germany)**
  - Nearly always provide cover only for remediating pollution that has migrated off-site from a sudden and accidental incident on an insured's site and only if legislation other than the ELD requires its remediation
  - Nearly never provide cover for ELD liabilities except as above
  - Generally have low – or very low – sub-limits of liability



## EU AND US ENVIRONMENTAL INSURANCE MARKETS

- **Property policies**
  - Provide cover for loss of or damage to property (e.g., buildings, other structures) covered by the policy (called 'insured property'; does not include land)
  - Do not provide cover for off-site pollution or other environmental damage
  - Often have an absolute or qualified pollution exclusion
- **Environmental extensions**
  - Nearly never provide cover for ELD liabilities

## EU AND US ENVIRONMENTAL INSURANCE MARKETS

- Widespread lack of knowledge by operators, brokers and other ELD stakeholders about
  - ELD and/or other environmental liabilities and how they interact with each other
  - How the ELD or other environmental liabilities can apply to a business' operations
  - Scope of cover provided by environmental insurance, especially general liability and property policies and extensions to them
    - Tendency to consider that their scope is much broader than it actually is
    - Availability may depress demand for stand-alone environmental insurance policies even if a business recognises that its operations may cause environmental damage

## MEMBER STATE MANDATORY FINANCIAL SECURITY REQUIREMENTS

- ELD liabilities
  - Czech Republic
  - Portugal
  - Slovakia
  - Spain
- Hybrid system of ELD liabilities and environmental responsibilities
  - Ireland
- Provisions in national legislation requiring mandatory financial security for ELD liabilities
  - Italy
  - Poland

## MEMBER STATE MANDATORY FINANCIAL SECURITY REQUIREMENTS

- Other environmental liabilities and responsibilities
  - EU legislation with no financial security requirements and national legislation
    - Integrated pollution and prevention permits including permits under the Industrial Emissions Directive
      - Cyprus, Finland (compensation), France, Ireland, Italy, Malta, the Netherlands (being introduced), Poland (some permits), Sweden
    - Seveso III Directive
      - Finland (compensation), France, Ireland, Italy, the Netherlands (being introduced), Slovakia, Sweden
    - Waste activities
      - Belgium (soil pollution), Croatia, Cyprus, the Czech Republic, Denmark (pollution from oil tanks), Estonia, Finland (compensation), France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, the Netherlands, Poland, Spain
  - Increasing trend towards mandatory financial security for environmental liabilities and responsibilities

# INNOVATIONS IN CORPORATE LAW FOR THE REMEDIATION OF ENVIRONMENTAL DAMAGE

- Queensland, Australia
  - Queensland Environmental Protection (Chain of Responsibility) Amendment Act 2016
    - Adopted on 27 April 2016
    - Introduced in response to an increasing number of companies that had encountered financial difficulties and had not taken measures to prevent or remediate environmental damage from their sites
    - Intended to capture ‘artificial corporate structures and profit-shifting enterprises’ that actively avoid their environmental obligations
    - Authorises the Department of Environment and Science to order a ‘related person’ of the operator of a facility that is considered to be a high risk to carry out specified measures such as remediating the land or providing financial security for such remediation if the operator fails to do so
    - ‘Related persons’ are holding companies, owners of land in some cases, and associated individuals and companies

## INNOVATIONS IN CORPORATE LAW FOR THE REMEDIATION OF ENVIRONMENTAL DAMAGE

- Ontario, Canada
  - Officers and directors of a company may be liable for remediating environmental damage caused by the company if it becomes bankrupt or does not otherwise have funding to pay for the remediation
    - 2004: Northstar Aerospace, which operated a manufacturing facility, discovered that groundwater migrating from its site into a residential area was polluted and notified the Ministry of Environment
    - Northstar voluntarily began to remediate the pollution
    - 2012: Ministry became concerned that Northstar did not have sufficient funds to continue remediating the pollution and ordered it to continue remediating and provide C\$10,000,000 (EUR 6,661,150) in financial security to the Ministry to ensure funding of future measures
    - Northstar became bankrupt
    - Ministry claimed against Northstar's directors and officers on the basis that they knew about the pollution when remediation was being carried out; case settled for C\$4,750,000 (EUR 3,165,282)

## RECOMMENDATIONS

- European Commission
  - The following two measures are not recommended
    - Introduce harmonised mandatory financial security
      - Premature because it would be difficult if not impossible for operators in some Member States to obtain insurance or perhaps any other financial security, to comply with the requirements
    - Establish an EU fund for industrial disasters
      - Premature in the absence of environmental insurance in many Member States to form the underlying tier below the threshold of the fund
  -

## RECOMMENDATIONS

- European Commission (continued)
  - The following measure is recommended
    - Consider an EU wide training programme, especially for small and medium sized operators and brokers, loss adjusters and other ELD stakeholders to raise the level of awareness and knowledge about liabilities under the ELD and other environmental legislation, corporate risk management and environmental risk management



## RECOMMENDATIONS

- Member States
  - The following two measures are recommended
    1. Member States that have not introduced mandatory financial security for ELD liabilities
      - Consider extending existing mandatory financial security requirements for waste activities, pollution prevention and control permits and Seveso III facilities to include requirements for liabilities under the ELD
      - Requirements could be phased in gradually and/or at the discretion of competent authorities based on risk assessment of individual activities
    2. Consider imposition of secondary liability if the operator becomes insolvent or otherwise cannot pay to remediate or prevent further environmental damage caused by it
      - Laws of some Member States (e.g., Austria, France, Spain) already include provisions that may impose secondary liability on other persons such as directors and officers and parent companies

## RECOMMENDATIONS

- Further work
  - The following three measures are recommended
    1. Encourage enforcement of the ELD by making it easier for competent authorities to enforce it
      - The project would compare and analyse similarities, differences, overlaps and gaps between national legislation and ELD legislation in each Member State to describe how the ELD complements national legislation and when it should be enforced in lieu of, and/or together with, national legislation
      - Insurers will not develop and market stand-alone environmental insurance policies if there is little or no demand for them
      - Operators will not purchase policies if the risks covered by them are not being enforced or enforcement is lax
    - Purpose: increase enforcement of the ELD which will increase demand for insurance for ELD liabilities, which will in turn increase its general availability

## RECOMMENDATIONS

- Further work (continued)
  2. Review measures taken by Member States and organisations in them to encourage operators to carry out risk assessments for environmental damage (linked to recommendation for an EU wide training programme above)
    - Examine established risk management frameworks and standards
      - Many small and medium sized operators do not have environmental managers and many do not recognise that their activities may cause environmental damage
      - Many operators do not understand the scope of cover provided by environmental extensions to general liability policies
    - Purpose: provide operators, particularly small to medium sized operators, with the necessary tools to assist them in understanding their exposure to environmental liabilities, establishing appropriate measures to prevent and protect them from environmental damage, and to understand how to transfer part of the residual risk to insurers

## RECOMMENDATIONS

- Further work (continued)
  3. Protect the environment and the public purse from the externalisation of liabilities for environmental damage under the ELD
    - Operators can avoid liability for the costs of preventive and remediation measures by, among other things, entering into insolvency, including liquidation, proceedings
      - Some Member States have legislation to prevent them doing this
    - Examine procedures in reviewing financial security instruments and mechanisms submitted to competent authorities under mandatory financial security systems, as well as insolvency issues, to ensure that the instruments and mechanisms are secure, sufficient and available when required
  - Purpose: examination of the above and related issues so as to suggest best practices to ensure that taxpayers are not required to pay to remediate environmental damage