

INTERNATIONAL CORPORATE LAW

Incorporating

environmentrisk

April 1994



Spain

Law and
recession

Planning Europe's information highways

The way ahead for dispute resolution

A EUROMONEY PUBLICATION

PLUS Environmental and Competition
Law Yearbooks

Pollution gives general insurers cold feet

With the recent House of Lords ruling on *Cambridge Water Company Limited v. Eastern Counties Leather plc* (9 December 1993), the responsibilities of landowners with respect to *foreseeable* contamination has been reinforced. The ruling underscores the need for buyers of land to ensure that appropriate levels of environmental enquiry are made during the early stages of property transactions.

Unfortunately, it is unrealistic to expect that the full extent of environmental liabilities will be identified as part of a routine environmental site investigation. There are typically cost and time limitations to such projects, and even where comprehensive studies are conducted, involving detailed soil and groundwater sampling and analysis, there often remains a level of uncertainty. The potential presence of latent or unanticipated subsurface conditions and their impact on neighbouring properties is a particularly difficult issue.

While not a cure-all, specialist environmental insurance policies which have been offered in England since the early 1990's, (typically by American-based insurers) can provide landowners with an added level of protection against the costs of:

- potential third party claims; and
- clean-up operations mandated by regulatory agencies.

The success of these policies in England has not as yet matched that of the US, perhaps due in part to the lack of regulatory predictability and the absence of appropriate environmental standards.

Until the early 1970s, the majority of US insurers provided corporate general liability (CGL) policies (similar to public liability policies in England) which covered all types of pollution incidents. With the barrage of environmental claims in the late 1960s and early 1970s, US insurers decided to limit environmental cover to those incidents which would be considered *sudden and accidental*, such as an unintended, discrete spill of chemicals at a factory. *Gradual* incidents of pollution such as those resulting from an underground storage tank which leaked petrol over a number of years, and thus contaminated the surrounding environment, would no longer be covered.

It is reported that over 400 court cases ensued between insurers and their insureds, each one involv-

Stacy Clark explains that the high risk involved in covering environmental risks is giving rise to the development of specialist insurers

ing an insured attempting to prove that their sudden and accidental cover applied to their particular pollution problem. As a result of the confusion over the wording, and the inconsistent rulings handed down by the courts, insurers decided in 1985 to eliminate pollution cover altogether. With this move, specialist environmental insurance became a niche market for many US insurers.

During the 1980s, and following the introduction of the US Superfund Act, a number of specialist policies were developed including environmental impairment liability (EIL) insurance, which protects landowners against property and bodily injury losses resulting from pollution emanating from their sites. These policies are written based upon the results of a detailed environmental study, which underwriters then use to quantify a site's likely environmental impact on neighbouring and downgradient properties.

In the 1990s, due to greater regulatory predictability, environmental remediation insurance (ERI) policies were developed to cover the costs of on-site clean-ups. These policies cover contamination which is discovered on-site after the effective date of the policy, and is subject to a similar survey documenting the extent of existing contamination at the property.

Success of policies in the US

According to Bill McElroy of Zurich Insurance in New York City, the ERI policies they offer are their most successful product on the market, and are particularly popular among lenders who want to protect the value of land which is provided as security by their borrowers. Some major lending institutions, including Fleet Bank of Rhode Island actually require clients borrowing over \$1 million to carry ERI insurance.

Beki Sullivan, an underwriter with The ERIC Group, Inc., an insurance company based in Englewood, Colorado, indicated that the majority of her clients, primarily large property developers, are also requesting remediation insurance cover. One of ERIC's clients, the super-retailing giant K-MART, carries ERI coverage on all properties they develop and operate, regardless of how low the environmental risks may appear to be.

In addition, a growing segment of their business is

Environmental insurance

from developers aiming to insure sites which have already been remediated to a pre-specified *acceptable* standard. In these cases, the ERIC Group develops tailor-made policies to cover any residual risks associated with these sites.

US regulatory trends

The remediation of contaminated land to an acceptable rather than ideal standard is a growing trend in the US. In Massachusetts, for example, the Department of Environmental Protection (DEP) has taken the practical view that contaminated properties located in areas of low environmental sensitivity (those areas which do not pose a significant risk to human health or the environment) should require clean-up standards which are less rigorous than those applied to more sensitive properties (such as residential sites or properties located near drinking water supply wells, sensitive ecosystems or other protected areas).

This pragmatic approach to land management, which involves looking at both the intended use of a site and the environmental sensitivity of the area, may well provide a valuable example for England. Here, while much of the country has housed former industrial and commercial operations, which have left a legacy of contaminants in soils and water, the *real* risks posed by the presence of these contaminants in the environment will, nonetheless, vary significantly from site to site. Being able to properly account for these variances is an important commercial exercise for insurers and property professionals alike.

Specialist insurance

In 1981, general insurers followed the advice of the Association of British Insurers (ABI) and withdrew cover for gradual pollution from their public liability policies. Subsequent recommendations from the ABI concerning the removal of the remaining sudden and accidental cover have not, as yet, been forthcoming. As a result, many insurers continue to expose themselves to potentially devastating losses. Supplemental premiums are not charged for the sudden and accidental cover provided, and no detailed environmental enquiries are conducted to identify those sites which pose the greatest risks to insurers.

According to Brian Street, the director of ECS Underwriting in London, general insurers are becoming aware of the risks they



run. Several companies have recently withdrawn the sudden and accidental cover from the existing policies of industries which could potentially generate high levels of contamination. As a result, a growing number of businesses are interested in obtaining cover offered by ECS and AIG Europe (UK) Limited. These companies are strategically set up to take advantage of the removal of sudden and accidental cover, and to provide environmental insurance on a broader scale once the sudden and accidental cover is completely withdrawn from public liability policies, as it recently has been in France.

The directors of several British companies have indicated that obtaining specialist environmental cover can be difficult, depending on the type of site involved and the extent of historical industrial operations located at and near the property. The specialist insurers may well find that the commercial viability of underwriting policies for a broad range of industrial sites will increase once a practical, predictable policy on land management and reclamation is introduced in England.

Several attempts have been made by the English government to establish a policy aimed at identifying sites which require remediation, but there is still no coherent strategy or programme to tackle this fundamental task. Proposals for the development of a register of sites which had been subject to contaminative uses were dropped. This was partly due to the fact that they failed to consider the actual levels of contamination

Though providing *sudden and accidental* cover, many insurers continue to expose themselves to potentially devastating losses

ICRCL guidelines applied in isolation can put exaggerated emphasis on one issue, or fail to identify an important problem

present, and whether such levels posed a risk to human health or the environment.

Unfortunately, the lengthy debate over the proposals and the widespread concern that they would blight property values across the country promoted misguided and generalized views on the risks associated with former industrial land. As a result of this, the predictability of England's environmental policy was once again questioned, and some specialist insurers hesitated to provide cover on sites occupied by industrial businesses, regardless of whether an environmental problem actually existed. The March 1994 governmental consultation paper on contaminated land provides a summary of some of the key issues involved in addressing the problem, but does not outline the criteria required to assess whether a site actually warrants remediation.

Need for English standards

Insurers, property investors, and lenders in England understandably require a yardstick against which to measure the significance of various types and levels of contamination, and a system whereby associated risks can then be assessed. The business community would benefit from an environmental policy which includes the development of standards for a wide range of contaminating substances which are common to England's commercial and industrial trades. This would allow insurers, lenders and property professionals to:

- measure levels of environmental risk;
- target remedial programmes to match the risks; and
- allocate the costs of any real remaining risks into the underwriting deal.

It is widely recognised that the standards should somehow relate to the sensitivity of the site and the proposed end-use.

The currently accepted method of assessing environmental risks on property is limited to an evaluation of soil quality. It involves comparing contamination levels from all properties (irrespective of their former or current uses) to the limited set of target parameters developed by the Interdepartmental Committee on the

Redevelopment of Contaminated Land (ICRCL).

Because the ICRCL criteria provide guidance only for heavy metals and contaminants found at former gas works sites, they are of limited relevance to many properties in England, particularly those where organic chemicals are used and

stored (such as petroleum refining and distribution sites and semi-conductor manufacturing sites). As a result, the application of the ICRCL guidelines in isolation can lead to analyses which either exaggerate the significance of a particular issue or fail altogether to identify an important environmental problem.

In addition to devising soil standards which are applicable to a wider variety of substances, guidelines for the interpretation of groundwater quality are needed because it is the groundwater, not the soil that acts as a medium which transports subsurface contaminants from one site to another.

In fact, the Cambridge Water Company case was about precisely this situation; contamination of an abstraction borehole by pollutants which had migrated over one mile through groundwater. Therefore, the integrity of the groundwater can be the most important environmental issue to consider when reviewing the risks posed by a particular property. The majority of environmental reports which I am asked to review by insurers and lenders oddly fail to address this important issue altogether.

The issue of land contamination is becoming more prevalent in property transactions and more important for industry, and specialist insurance will be one of the mechanisms available for businesses to cover their risks. However, the insurance market will take note of the lessons learned in the US, and will be unlikely to provide broad and affordable cover without quantifying exposures on a site specific basis and seeking some governmental criteria on *how clean is clean?*

Stacy P Clark is an American environmental geologist working as a consultant on Whitegate in East Keswick, Leeds. She has 10 years' experience in advising lenders, insurers and developers on the commercial risks associated with contaminated land. ■

Reprints

The articles in *International Corporate Law* offer contributors an effective marketing instrument. These can be professionally and attractively produced for distribution to your clients.

For details of prices and specifications, contact Tim Richardson
Telephone: (44 71) 779 8685
Fax: (44 71) 779 8932