Environmental Risk

The Liberty White Paper Series

Environmental Risk

Part 1

Executive Summary

Driven by stronger legislation and enforcement, the business risks arising from pollution are increasing both in scope and potential cost.

Many businesses are unaware of the dangers of **gradual pollution**. While fines and legal costs are large and increasing, clean-up costs are the major issue, sometimes running into millions of dollars and draining resources over years.

Gradual pollution coverage is not a feature of General Liability policies. As a result, many companies are exposed to uninsured environmental risk. Specialist Environmental cover may be the answer.

The Liberty White Paper Series is thought leadership material for those who manage risk. In this three part series we look at some major environmental risks and how ever tougher environmental legislation could affect Australian businesses and the people who manage them.

Pollution – defining the problem

Pollution, by its simplest definition, is something poisonous or harmful that contaminates land, water or air.

The **insurance** definition is both longer and more complicated. Pollution is "the actual, alleged or threatened discharge, dispersal, release, seepage, migration or escape of pollutants, where 'Pollutants' means any solid, liquid, gaseous or thermal irritant or contaminant, including but not limited to smoke, vapour, soot, fumes, cinders, dust, acids, alkalis, chemicals or waste. Waste includes materials to be recycled, reconditioned or reclaimed."

In our highly industrialised society, many chemicals – such as asbestos, PCBs and degreasing solvents – were used for decades before their toxic properties became known. Today improved technology and medical research capabilities mean we are unveiling more of these toxic effects and connections between chemicals and illness.

Pollution and its impact

From a risk management perspective, all sorts of businesses need to think about the consequences of generating pollution. Those consequences could include:

- Damage to property
- Land or water that needs to be cleaned or decontaminated
- Fines and penalties
- Lawsuits, defence costs and the business interruption and lost management time involved
- Business interruption while the pollution or cause of the pollution are addressed
- Sick or injured people
- Reputational damage

It's a common misconception that Australian companies have been left unscathed by environmental pollution events to date. Australian businesses have instead paid some enormous sums to address pollution in Australia. Here are a few examples:

- Remediation of a NSW regional mining site – costs expected to exceed $400 million, making it the single largest clean-up project of its type in Australia

- A major chemical company's clean-up of contaminated sites in NSW (continuing) – estimated clean-up costs of $167 million

- NSW heavy metals Smelter Remediation Project (2005) – $60 million – pollution containment project

- Homebush Bay remediation from dioxin pollution by a large chemical company in the 1950s and 1960s – estimated clean-up costs of $120 million

- Cranbourne Gas Emission Class Action against a Victorian Local Council – after a methane gas leak from a disused landfill, the Council spent approximately $42 million on rehabilitating and monitoring the landfill. The Council then faced a class action by over 700 residents, settled in 2011.

- In September 2010, a legal case was brought against a mining company over alleged lead contamination in regional Queensland. Several families sued the company, claiming some children suffered brain damage and retardation due to long-term exposure to lead.

The above examples and the following case studies exemplify just how expensive pollution incidents can be in Australia.

Case Study 1: Waste Oil Removal – South Australia

In July 2007 'a person or persons unknown' removed the ball valve and cam lock from a tank containing used motor oil at a waste removal company's recycling depot in South Australia. The oil leaked onto an adjoining property owned by BP Australia. The eventual clean-up used 650 tonnes of sand and cost Mulhern's more than $181,000.

While the initial incident was caused by an act of vandalism, it was suggested that the incident could have been minimised if the waste removal company had used some different risk management activities (such as a bund around the tank). The EPA asserted that in several respects the company had contravened the requirements of its EPA licence.

The South Australian Environment Resources and Development Court found this company guilty of ten offences and imposed fines of $460,000. This was in addition to the clean-up costs and the legal costs of both parties.

This case emphasises the wide range of potential costs associated with environmental prosecution, costs imposed even though the originating incident was the result of vandalism rather than equipment failure or human error.

Case Study 2: Toxic Leak – South Australia

An energy production company discovered toxic seepage in groundwater at its plant in South Australia in 2008 during routine monitoring. The company built a $15 million barrier to stop the oil leaking into the ocean.

The EPA imposed additional conditions on the company's use of the contaminated site and required the company to engage an auditor to independently review the works on site and its impact on remediation.

In January 2010, the energy production company revealed that the leak and the subsequent investigations and remediation had cost the company $24 million. Both the company and the EPA have indicated that it is likely to take several years to fix the leak. This drawn out process, coupled with the prospect of potential EPA fines will lead to a very expensive ordeal for this company.

How much will you pay?

The amount payable for personal injury claims is determined either by litigation or by guidelines that set the maximum compensation for various injuries. An environmental consultant is often employed to determine the clean-up costs and the extent of the clean-up work required.

Given the number of different risks and the size of the fines, remediation and legal costs involved, the obvious question for any business is "Does our insurance protect us?"

Let's have a look at some of the various risks, the insurances typically used (other than Environmental Insurance) and the coverage they provide for incidents arising from pollution events:

- Injury to employees: Workers Compensation policy, leaving common law claims still available to workers. And standard publics and products liability policies exclude cover for injury to the insured's own employees.
- Injury to 3rd parties: partial coverage under a standard public and products liability policy if the pollution is from a **sudden and accidental (S&A)** event
- Damage to your property: typically excluded under a standard Mark IV ISR Property wording
- Damage to 3rd parties' property: partial coverage under a standard public and products liability policy if the pollution is from a **S&A** event

- Clean-up of your land: typically excludes 1st party coverage under a standard public and products liability policy or standard Mark IV wording
- Clean-up of 3rd parties' land: may be some partial coverage under a standard public and products liability policy if the pollution is from an **S&A** event. Some policies do not respond to investigation or clean-up costs
- Fines and penalties: can be covered under a statutory liability policy or extension
- Lawsuits and defence costs: partial coverage may be provided for **S&A** pollution events under a standard public and products liability policy
- Business interruption impacts: typically excluded under a standard Mark IV wording or public and products liability policy

Environmental Insurance from Liberty

LIU offers Environmental Insurance products that provide coverage for third party injury and property damage, cleanup of your site and that of 3rd parties, and coverage for defence costs, business interruption and fines and penalties.

Where the gaps are commonly found:

Gradual Pollution

Companies may have some coverage if the pollution is from an **S&A** event. But that brings us to the crucial issue of **gradual pollution**.

While media attention often focuses on dramatic, highly visible S&A events like the BP oil spill in the Gulf of Mexico, much of the pollution risk faced by Australian businesses is unseen, slow and insidious.

Gradual pollution often happens underground or is the result of the slow accumulation of small pollutant quantities that turn into a big pollution problem over time.

By its very nature, gradual pollution is hard to spot and to protect against, but the consequences of gradual pollution can be financially disastrous. While fines and legal costs are large and increasing, clean-up costs are usually the major issue, sometimes running into millions of dollars and draining management time and company resources over many years.

Clean-up costs

As we shall discuss in Liberty's Environmental Risks White Paper Three, legislators around the world are enforcing tougher environmental laws on a 'polluter pays' principle. Many of those laws involve significant fines and penalties.

Are you protected?

While many companies seek to protect themselves against the financial consequences of pollution events, the toughening legislative environment and the nature of gradual pollution risk means many companies cannot rely on their existing insurances.

Many companies that could face pollution risks have S&A pollution cover built into their standard public and products liability insurance. However, some GL policies do not cover clean-up costs from S&A pollution, or only cover clean-up costs if there is S&A injury or damage. Others are simply silent on this coverage issue.

Often, for coverage under the public and products liability policy to respond, the pollution event will be tested to see if it meets these criteria:

- Sudden
- Accidental
- Instantaneous
- Unintended
- Identifiable
- Unexpected
- Happening to take place in its entirety at a specific time

There are numerous public and products liability policies in the market, with different definitions of 'sudden and accidental' – some with even more criteria than what is listed above. If any of these criteria are unmet, it could lead to denial of the claim or a lengthy dispute.

Given the risks of gradual pollution – and the uncertainties of coverage for any pollution claim via a General Liability policy, it makes sense to cover these specific risks with a tailored Environmental Insurance product.

So what does Environmental Insurance provide?

Fortunately, some insurers now offer policies carefully worded to protect companies against the financial risks involved in gradual pollution. These Environmental Insurance policies can cover sudden and accidental pollution AND gradual pollution for:

- First party clean-up costs
- First party business interruption from pollution
- Third party injury
- Third party property damage
- Third party clean-up costs
- Defence costs
- Fines and penalties (but not for criminal acts)

Environmental Insurance policies are increasingly common overseas and it is likely their use will continue to grow. Driven by increasing community concerns over environmental damage and the need to protect crucial resources, the amount of litigation – and the severity of its enforcement – is increasing. This is reflected in increased penalties, attempts to spread liability beyond the polluter and enforcement of stricter liability.

As we will see in Liberty's Environmental Risks White Paper Two, Environmental Insurance is now mandatory for some activities in some countries.

There is little doubt that environmental insurance will become an increasingly important part of businesses' risk management activities. Its growth has already been significant. In fact, the amount of annual environmental insurance premium written in the world is estimated at $5 billion. It's time for Australian companies to consider their environmental liability risk more carefully, in order to prepare for legislative changes in the future.

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Part 2

Executive Summary

When it comes to pollution and environmental issues companies face a wide range of legal risk – from State and Federal statute law, existing Common Law causes of action and continual Common Law legal developments. These legal risks are in addition to the heavy clean-up costs that may be involved in a pollution incident.

State law increasingly gives regulators the power to mandate clean-up and remediation. In some cases this action may be forced on companies who are not the 'source' of the pollution.

Rules about disclosure of pollution – or potential pollution – are getting tighter and individual directors and officers may face greater liability.

Part two: Environmental risks – the legal issues

Given global concerns about issues like climate change, environmental law is increasingly in the spotlight. In this arena, business managers need to understand environmental issues and the legal risks involved. In Part One of this White Paper Series we detailed the importance of protection against "gradual pollution", and the onus of clean-up obligations and costs. This White Paper looks at the current legal landscape and trends in environmental law in Australia. In White Paper Three, we examine trends in North America, Europe and Asia and discuss what that could mean for local businesses.

Who pays?

Who pays for the consequences of pollution?

Much of the environmental protection legislation now enacted around the world begins with the principle of 'polluter pays'. However, regulators are increasingly broadening the scope of liability for pollution and contamination. Businesses can face liability for environmental investigation and remediation costs even if the actual polluter was a tenant or the previous landowner.

Partly, this is because governments around the world don't have the funds to pay for a clean-up where the polluting party cannot. Whatever the underlying logic, increasing efforts to 'pierce the corporate veil' mean liability may now also extend from a subsidiary up to a parent company. Importantly, companies may also face legal risks if they don't disclose potential pollution.

Who do you pay?

Of course, the fines and other penalties imposed by regulators and governments are only part of the risk. If you cause pollution or are associated with causing pollution, a range of other parties could attempt to make you pay.

Under Common Law, a person or company affected by your actions – such as the release of a pollutant onto their property or into their drinking water – could seek a remedy (compensation) under the Common Law cause of action, **negligence**. The broad Common Law principle is that: "*You must take reasonable care to avoid acts and omissions which you can reasonably foresee would be likely to injure….*"

A polluter could also face action under a Common Law cause of action called **nuisance** – where an action "*involves interference with the right of a property owner to experience quiet enjoyment of their premises.*" For example, a person or company affected by spray drift, odour, or dust emissions from a factory or manufacturing plant might have a basis to sue for damages in reliance on the legal concept of "nuisance".

In April 2011, the UK High Court determined that the tort of nuisance could be used to claim damages for odours emanating from a landfill site. Their action was against the operator of the landfill site. Residents of a UK County had been complaining for 5 years of offensive odours escaping from the site. The landfill operator defended the claim on the basis that it had complied with all requirements of its operating permits and licences. The High Court held that although in that particular case the operator was not liable to the residents, there was a legal right to claim damages for the tort of nuisance in similar circumstances. The landfill operator was "therefore, potentially liable for claims in nuisance" in different factual circumstances.

Statute Law

There is also pollution-related risk under **statute law**. A statute regulates behaviour in commerce, industry and private activity. A company or individual could face pollution-related actions under a wide range of statute laws including those covering OH&S, Corporations and Workers' Compensation.

In summary, the pollution-related risks a company faces are not limited to actions by environmental regulators or governments. Neighbours, staff, the public and government bodies regulating business and employment could seek redress under Common Law or statute law.

Case Study 1: Lucas Heights

In January 2005, a pump accidentally left on overnight resulted in more than 115,000 litres of leachate from a Waste Management Centre flowing into Mill Creek near Lucas Heights in NSW.

The Centre was owned by a state owned water recycling corporation. They had sub-contracted the operation of the plant to a construction services company.

The Land and Environment court ordered the construction services company to meet cleanup costs of $82,000 and pay the prosecution's investigation and legal fees of $111,000. It also fined the company $16,000, a fine it had discounted for the company's prompt actions in fixing the leak and minimising its effects. However, this company's financial pain was further aggravated as the state owned corporation withheld payments worth more than $400,000.

In this case, the court decided that the construction services company was not the only party responsible for the pollution. The water recycling corporation was fined $75,000 and ordered to pay costs of more than $45,000 as it had failed to implement several pollution prevention measures suggested by its own risk assessment and work it had commissioned on a leak-preventing bund had failed.

In addition to highlighting the major financial cost of pollution prosecutions, this case highlights how responsibility falls on a number of parties. This creates the potential for further disruption of normal commercial operations and for costly legal disputes.

The legislative environment

In addition to the financial risks involved in the clean-up of contaminated sites (See Part One of this White Paper Series) recent legislation in various States of Australia has increased legislative risk as well.

In the following section, we take a very brief look at changes to the State legislation that could affect Australian business.

Environmental Legislation – State by State snapshot

Queensland

From 1 January 2009, Queensland's Environmental Protection Act 1994 was overhauled.

It is significantly tougher than the previous legislation, now containing a range of measures including:

- Direction notices that set out how a contravention of the law has occurred and mandate a timetable for remedying that contravention. It may set out the steps the company needs to take – such as stopping further pollution or cleaning up an existing spill.

- Clean-up notices that can require a business to:
    - prevent or minimise contamination;
    - rehabilitate the environment;
    - assess the nature and extent of environmental harm; or
    - provide information to the administering authority.

- Cost recovery notices that claim for costs incurred performing clean-up or emergency action or for monitoring compliance by the recipient of the notice. Payment must be made within 30 days or the EPA may claim the amount as a debt.

Western Australia

The Western Australian *Contaminated Sites Act 2003* (Act) came into effect in December 2006. It contains a series of tough provisions for reporting, investigation and pollution clean-up. Owners, occupiers and polluters are required to report known or suspected contamination. Failure to report can cost a company up to $1.25 million in one-off fines and there may be daily fines as well.

The WA law gives the regulator power to require investigation or remediation work to be carried out by the "person responsible for contamination" (determined by the hierarchy in the Act). That 'person' will eventually be liable for the investigation and remediation costs, but other parties can be required to take action in the short term.

South Australia

Significant changes to the *Environment Protection Act 1993* took effect on 1 July 2009. The Act already contained the provision for environmental protection orders, clean-up orders and reporting requirements similar to those in other States. The 2009 changes to the law gave South Australia a specific regulatory regime for historically contaminated sites.

The SA EPA can now issue site contamination assessment orders (SCAOs) and site remediation orders (SROs) to 'appropriate persons' (polluters and owners – in that order).

The new law also allows for voluntary investigation and clean-up arrangements with the EPA.

Victoria

During 2009, the Victorian EPA introduced "enforceable undertakings" that can be used as an alternative to prosecution. An enforceable undertaking, though voluntary, binds an organisation to carry out certain activities relating to the breach of environmental law. Enterprises may choose to accept an enforceable undertaking in preference to the risk of the time, legal costs, increased penalties and reputational damage that may come with fighting legal prosecution.

Case Study 2: Meat Rendering Company

In December 2008, a meat rendering company was prosecuted for polluting a waterway with rendered animal effluent via illegal discharges issuing from a drain on their own premises into a storm water drain.

The Victorian EPA directed the meat rendering company to block the drain and undertake an environmental audit. Further action included diverting flows and preventing drainage from the stockyard and rendering plant into the storm water system.

No conviction was recorded. However, the Court ordered the company to pay $200,000 to fund three environmental projects and pay the EPA's costs of $30,000. This approach is increasingly common – and not just in Victoria. In addition to payments to the regulator and for remediating the environmental damage, the courts may order penalty payments directed to environmental projects.

Case Study 3: Petroleum & Petrochemical Company

In 2006, a petroleum company discovered a petrol leak from a hole in a steel pipeline near one of its refineries. The leak caused approximately 486,000 litres of unleaded petrol to seep through the ground and contaminate 16 hectares over a period of more than two years.

The company was prosecuted by the Victorian EPA in 2008 and ordered to pay a total penalty of $510,000, which included an alternative penalty order for $350,000 for three community environmental projects in the area where the leak occurred. It also included the EPA's legal costs ($160,000). At the time of the hearing, the petroleum company had already spent more than $660,000 on the pipeline repair and clean-up operation, which was expected to cost them around $13 million and last until 2012.

This penalty was the highest penalty ever awarded by Victorian courts for a land-based pollution incident.

Under Victorian Contaminated Site law, the regulator can now also require financial assurance - for future cost of the clean-up and other expenses - from businesses on sites where there is contaminated groundwater or where contamination remains in place.

The Victorian experience highlights the rising cost of environmental prosecutions. During 2008/9, the largest corporate penalty imposed by Victorian EPA's was $510,000. That compares to a maximum penalty of just $161,000 in 2007/2008.

New South Wales

In 2008, NSW overhauled the *Contaminated Land Management Act 1997* – and it is considerably more stringent:

- Under the previous Act, owners or operators of contaminated land were expected to notify authorities if they "became aware" of a contamination issue. The new standard is "ought reasonably have been aware" – imposing a significantly higher onus on companies and individuals to investigate possible contamination.

- Under previous legislation, the Department of Environment, Climate Change & Water (DECCW) needed to prove 'significant risk of harm' before a site could be declared 'regulated land'. Now a Preliminary Investigation Order (PIO) is issued if the DECCW suspects the land is contaminated. The DECCW has the sole right to nominate which party – owner, tenant, notional owner – incurs that cost and responsibility. There is no regulated 'hierarchy'. As a result, landowners may be responsible for cleaning up contamination caused by their tenants or by former owners.

- The 'no knowledge' defence no longer protects directors and officers from liability for their company's actions.

Summary

In this brief look at the regulation of environmental and pollution issues, a number of things become clear. First, businesses face a range of legal threats in relation to environmental issues – under Common Law as well as from the various State and Federal environmental Legislatures.

Secondly, State regulation is getting tougher. Many states have given their EPAs the ability to mandate clean-up and remediation and the onus on disclosure is significantly tighter. Importantly, individual directors and officers are now more likely to be held accountable for breaches and penalised for breaching environmental laws by failing to voluntarily report their company's pollution events.

Last, and perhaps most importantly, environmental regulators are increasingly likely to impose remediation costs not just on the original polluter but also on new owners, parent companies and even tenants.

All these trends have major risk management implications. Companies need to bear these in mind when buying, selling, renting or using facilities that have some pollution risk, and especially when purchasing environmental insurance.

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Part 3

Executive Summary

In North America, Europe and Asia, public policy approaches to environmental issues are becoming increasingly stringent. This may foreshadow a further tightening in Australia and have implications for Australian businesses operating overseas.

Part Three: International legal trends that increase environmental risk.

Introduction

The way in which environmental issues are legislated in different jurisdictions has significant implications for business managers. In this White Paper we look at environmental legislation in North America, Europe and Asia to understand what they mean for Australian businesses operating here and overseas.

The North American Experience

Nearly one-third of Americans live near abandoned hazardous waste sites. Indeed around eleven million Americans live near what American legislation calls “Superfund” sites – the most highly contaminated locations.

In 1980, the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or Superfund) was enacted in the US. It provides for the clean-up of contaminated sites and addresses liability issues related to such sites.

Like much Australian legislation, CERCLA follows the “polluter pays” principle and allows the relevant Environmental Protection Agency (EPA) to pursue potentially responsible parties (PRPs) for clean-up expenses. However as this liability is retrospective, strict, and joint and several, one PRP may be held accountable for the entire site cleanup if the other PRPs can’t be found! During the 2008 fiscal year, the US EPA collected nearly **US$1.9 billion** from PRPs to fund clean-up work at Superfund sites. Under CERCLA clean-up remediation can often cost several million dollars, with average costs totalling $30 million per site.

While CERCLA was created to deal with already contaminated sites, the US Resource Conservation and Recovery Act (RCRA) deals with ‘active and future liabilities’. It covers licensing and financial assurance requirements and manages the issues of solid and hazardous wastes and underground storage tanks (see our discussion of gradual pollution in White Paper One).

Expensive Penalties

US penalties are severe. In 2007, America’s largest utility, American Electric Power, settled a Clean Air Act case for US$5 billion. The case involved the largest fine ever paid to the EPA (US$4.6 billion).

Case history also makes it clear that US courts are determined to find a responding party who can meet the cost of clean-up and remediation of polluted sites, regardless of whether the polluter is still the owner of the land or whether the site is still in active use. A company may not have caused the pollution, or may have purchased a company that caused the pollution. However, the buyer may still ‘acquire’ a CERCLA liability to pay for site clean-up.

For example, in November 2002, the US EPA determined that solvent and PCB contamination of the Shenago River and its banks would have to be remediated. The pollution allegedly emanated from the former Westinghouse plant in Sharon, Pennsylvania. Entertainment conglomerate Viacom, in 2002 the owner of Westinghouse, was deemed partly responsible for the clean-up and spent over US$30 million in remediation costs.

Parents, subsidiaries and piercing the corporate veil in North America

The United States v Bestfoods case suggests that a parent company may be held responsible for remediating pollution caused by its subsidiaries. This ‘piercing the corporate veil’ breaks down the business assumption that each corporation has a legal identity separate and distinct from its owners, including holding companies. That allows an action against a corporation for acts undertaken by its subsidiary.

The Court pointed out that “under the plain language of the statute, any person who operates a Polluting facility is directly liable for the costs of cleaning up the pollution. This is so regardless of whether that person is the facility’s owner, the owner’s parent corporation or business partner ....”.

This exposes a much wider range of respondents to EPA action. In Canada, that potential may be even broader. The Canadian Environmental Review Tribunal (ERT) issued three Director’s

Orders to a now insolvent Canadian company requiring investigation and clean-up of a former chemical site in south-western Ontario. Most tellingly, Director's Orders were issued to the US parent company and to directors of the Canadian and US companies in question, even though it was not them who had actually committed the polluting act.

In some jurisdictions, financial institutions may be liable for clean-up of a site if they have provided a loan and then had to take the property back because of loan default. Alternatively, they may find that the property loses substantial value when contamination occurs and, if the polluter cannot pay for the clean-up, it may cause the loan to default.

In the US, it is increasingly common for leases on industrial sites to require tenants to have environmental insurance that makes the site owner an 'additional insured'. Many financial institutions now require pollution insurance covering their interests before approving loans against commercial property.

The European Experience

In April 2004, the European Parliament and Council issued the Environmental Liability Directive (ELD). It also uses the "polluter pays" principle with the aim of preventing and remedying environmental damage. Under the ELD, the public administrator, rather than an injured third party, takes action to protect natural resources. The ELD is a minimum standard to compensate for environmental damage. While it does not apply retroactively, individual EU member states can transpose it more strictly if they choose to.

"…the Directive is described as one of the most controversial, and potentially far-reaching, pieces of environmental legislation negotiated by the EU to date".
Kevin Considine, Environmental Policy Advisor, EEF (a UK manufacturer's organisation)

The Directive seeks both to prevent damage to the environment and to remedy any damage that occurred. The Directive relates to damage to biodiversity, water and land, and noteworthy is that it is broader than pollution; it also applies to environmental damage caused by fire or flood.

When damage does occur, or in the case of an imminent threat of damage, the polluting or potentially polluting business or organisation must promptly inform the relevant authority and take steps to immediately control, contain, remove or otherwise manage the pollutants concerned. The competent authority works with the business operator to determine the measures required and may take unilateral action.

As with the US and Australian legislation, the ELD can involve businesses in the complex, costly and long-term monitoring and management of a polluted site.

The operator carrying out the damaging activity will bear the costs of these measures, irrespective of who actually carries out the remedial/preventive work. The operator may also have to pay compensation for damage to natural resources.

Case Study 1:

In October 2010, a wave of toxic red sludge inundated several towns and villages in Hungary, after a storage pond burst at an industrial site owned by MAL Hungarian Aluminium Production and Trade Company. Covering 40 square kilometres initially, 1 million cubic metres of mud inundated three villages, drowned eight people and sent more than 100 to hospital with burns caused by the high alkaline levels in the sludge. The caustic sludge killed all life in the affected rivers, and resulted in a massive clean-up to remove the sludge from the land.

The spill, considered Hungary's worst ever chemical accident, could cost MAL up to 73 million euros ($A104 million). Added to the company's woes, MAL's managing director was arrested for questioning a week after the disaster, after the last missing person's body was recovered. The Hungarian Prime Minister announced he would appoint a state commissioner to take control of MAL until all further risks at the company's sites were identified and addressed.

Another devastating pollution release occurred in 2000, where a huge spill of cyanide containing wastewater from a gold processing plant in Baia Mare, Romania contaminated over 1000 kms of waterways in 4 countries. Fish and wildlife were killed and 2.5 million people were without safe drinking water for a period of time.

Different countries, different rules

A Directive is a legislative act of the European Parliament which requires EU member states to achieve a particular result without dictating how that result is achieved. Because the EU covers some 27 countries this means a wide range of different environmental rules will greet any Australian business operating across the EU.

Under the original ELD, companies had a defence if their activity was not expected to cause environmental damage given the scientific knowledge available at the time. However, some countries – such as Poland, Hungary and Germany – do not allow this defence.

In some countries one party may bear the entire liability for damage, regardless of how small their role in causing the damage. In Hungary, which has one of the most stringent applications of the ELD, liability extends to the executives and private owners of polluting companies.

In its emphasis on remediation, the ELD shares many similarities with US Superfund legislation and with new environmental legislation in Australian states. It means businesses have responsibility for environmental damage to property they don't own – such as natural resources.

Is insurance the answer?

One very important aspect of the ELD legislation is a move to require business operators to use various financial security mechanisms – such as bonds, cash reserves or insurance – if engaged in handling potential pollutants.

The Environmental Liability Directive expressly encourages all EU Member States to develop a system for compulsory financial security. Some of the Member States who have committed to develop such systems include Portugal effective 1st Jan 2010, with some countries looking at it on a sector by sector basis (for example, mining in Hungary)

One example of this trend is the Spanish ELD laws, which made it mandatory for companies to have financial guarantees to cover the environmental liability inherent in their activities after April 2010. This guarantee could take the form of an insurance policy, bond or by constituting a technical accounting and financial reserve. An insurance policy in this case would be the most cost-effective. It's also 'balance sheet friendly', allowing much more flexibility in cash flow than a bond or technical reserve.

The UK

The UK was the first country in the world to industrialise. Perhaps that explains why it has long had strict environmental laws. The attempted gentrification of sites found to be contaminated has created an imperative for a stronger clean-up and remediation regime.

That dynamic played out in a recent and highly publicised case involving the Corby Borough Council in the UK Midlands. The Council was involved in an urban regeneration scheme and undertook to clean-up a former British Steel plant that had operated for over 30 years. The 15-year remediation was done in the 1980's and 1990's. Only recently there arose an allegation that there was a connection between the remediation work done years ago, and birth defects in the area. Local residents claimed that the toxic sludge and dust dropping from trucks that had removed contaminated material from the site led to an unusually high rate of birth defects in the Corby area.

The case, compared by many to the Erin Brockovich story in the US, has already cost the Corby Council millions of pounds. The legal costs reportedly at one stage were over £6.5M with £4.6M for the 19 claimants, with compensation costs for the birth defects (if proved), such as missing limbs, anticipated to be many millions of pounds. In April 2010, the Council settled a number of claims out-of-court for an undisclosed amount. There may be many more claims brought by other child claimants born before 1997, and residents of other housing estates in Corby and nearby areas.

The case highlights the possible extent of legal liability under British law. It is important to note the Council was not the polluter but was responsible for managing the former contaminated site.

Asia

Asia's rapid industrialisation makes it a prime candidate for environmental mishaps. However, it is interesting to note the speed with which the various Asian jurisdictions are implementing the types of environmental legislation we have been looking at in other regions.

China

In late 2005, an explosion at a petrochemical plant owned by a large Chinese Petrochemical Company on Northeast China's Songhua River caused about 100 tonnes of harmful benzene and nitrobenzene to form an 80-kilometre long pollution slick. The pollution was so severe it forced all water supplies to Harbin, a city of 3.8 million people, to be cut off for four days.

The State Environmental Protection Administration (SEPA) found the Petrochemical Company guilty of contravening the Environmental Protection Law and two articles of the law on Prevention and Control of Water Pollution.

Under Chinese law at the time, companies could only be fined a maximum of 1 million yuan (US$125,000) for causing pollution and the Petrochemical Company was fined the maximum amount. SEPA only rarely applied the heaviest penalty.

This case sparked intense discussion over who should foot the bill for cleaning up the environment in China, with many experts arguing that the Petrochemical Company fine was inappropriately low considering the losses caused by the incident. In contrast, the Chinese Government spent huge sums both during the pollution crisis and in the clean-up phase, announcing a 2006 Songhua River clean-up project with estimated costs of US$1.2 billion.

While China's environmental law has on occasion in the past taken a back seat to the cause of economic development, this pattern is now changing, with significant developments occurring particularly in the area of water pollution.

Under China's system, responsibility for contaminated land remains the responsibility of the person who caused the damage. In practice this liability is often the subject of contractual agreements and indemnities when land or operations are changing hands and sellers frequently seek to exclude pollution liability from the sale agreement. The buyer is expected to rely on their own investigations.

In early 2009, China's State Environmental Protection Agency (SEPA) announced plans to implement a mandatory environmental insurance program, designed to be fully effective by 2015. China's first Environmental Insurance claim was paid out in 2009.

What does it mean for you?

The big question is – does overseas environmental legislative activity impact on Australian businesses? The answer is – it should and it will.

As Australian companies increasingly seek to do business in the Northern Hemisphere and in Asia, the stance these regions take on environmental issues should be a key consideration.

It is equally true to say that the global move to tougher environmental law is creating its own feedback loops, with more stringent regulations in one jurisdiction then reflected in others – particularly as the developing world becomes more attentive to environmental issues.

The United States is regarded by many to have the most severe penalties for environmental mishaps. However, it's a mistake for companies to dismiss the US experience as something that will never happen in Australia. Already, Australia has seen some significant clean-up costs of close to $200 million for separate remediation sites including Homebush Bay and Botany Bay.

The United States equals severe penalties. The European Union is highly regulated and becoming tighter. China, despite its focus on economic development, is balancing this growth with protective measures for the environment. Change is happening around the world, as the impact of pollution begins to be felt more keenly.

Australian businesses therefore need to watch global trends to understand what may be coming down the pipeline in Australia. They also need to work closely with their insurers to obtain the kind of environmental cover that will protect them at home and overseas. See our White Paper Two for more detail on the current Australian environment laws.

Like to know more?

If you would like more information about Environmental Risks, about recent trends in environmental legislation or about the relevant insurance issues please contact Alan Thorn on (02) 8298 5838 or at alan.thorn@libertyiu.com.

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