

Environmental Risk Part 1



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The Liberty White Paper Series



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.

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.

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 public 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.

If you would like to know more about these policies contact Cami Mok 02 8298 5853 or at cami.mok@libertyiu.com

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.

Like to know more?

In Part Two of Liberty's Environmental Risks White Paper Series we look at where the liability falls under environmental litigation.

In Part Three we look at Australian and global legislative trends that increase companies' environmental risks and how insurance helps companies manage those risks.

If you would like more information about Environmental Risks and the relevant insurance issues please contact Cami Mok 02 8298 5853 or at cami.mok@libertyiu.com.