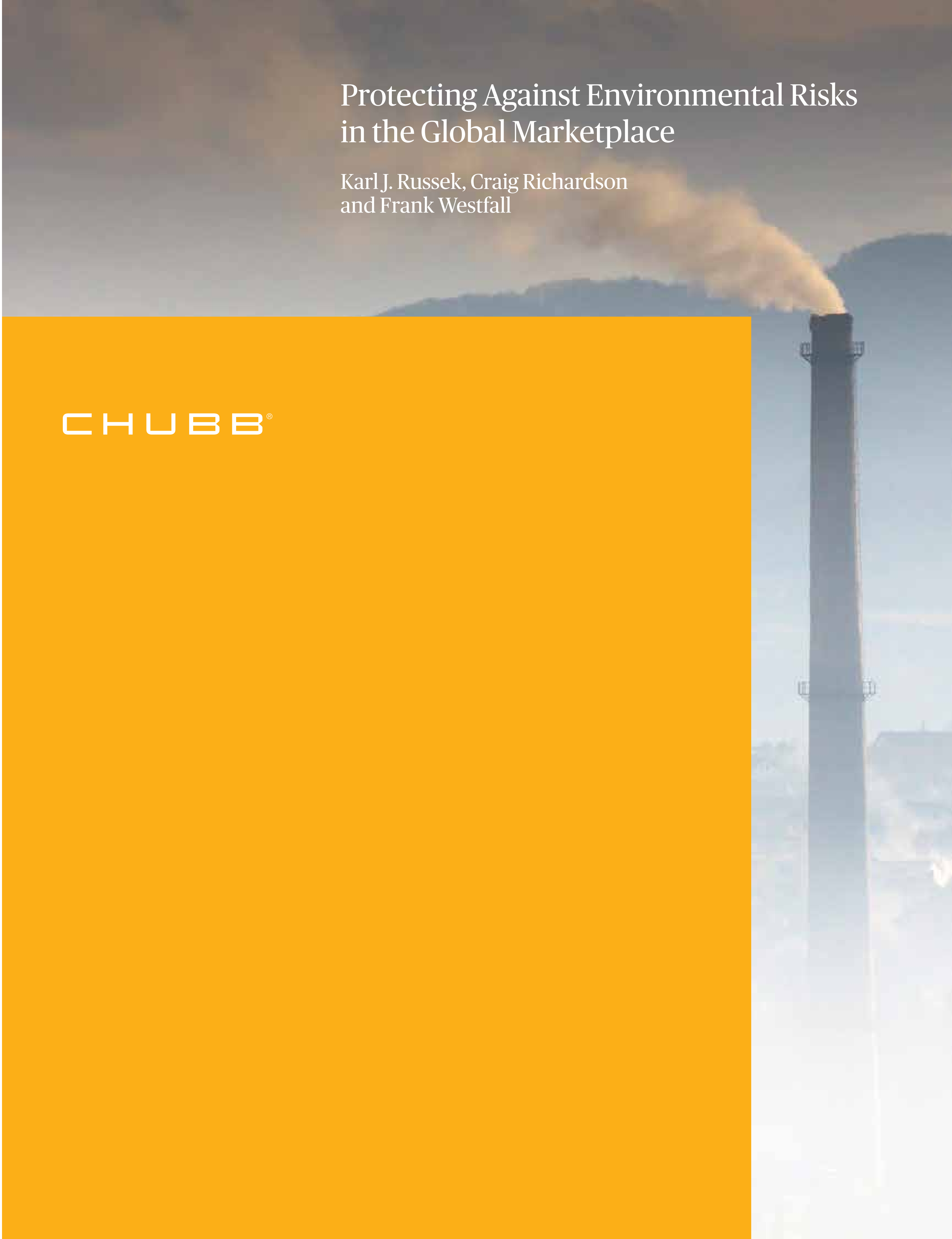

Protecting Against Environmental Risks in the Global Marketplace

Karl J. Russek, Craig Richardson and Frank Westfall

CHUBB®

To protect their investments, companies should consider premises pollution policies that provide coverage for the first-party costs of environmental remediation as well as the potential third-party liabilities arising from on-site incidents.

Businesses today are reaching for opportunities by expanding operations in emerging markets around the world. Many will benefit from the potential for growth. However, new risks, including environmental exposures, must not be overlooked. A pollution incident can seriously damage a company's investment in its own plant and property, necessitate an expensive clean up, result in significant fines, and cause lasting harm to its reputation. While U.S. businesses are accustomed to dealing with strict environmental regulations at home, more countries around the world, including emerging markets such as China, are tightening their own laws. In addition, environmental laws are continuously evolving, particularly in the United States and Europe, and the costs of failing to meet those standards is rising.

Before opening or expanding operations in a foreign country, companies should perform stringent due diligence to make certain they do not acquire environmental problems and to ensure that their operations conform not only to local laws in all the countries in which they operate, but also to global best practices. While U.S. companies may focus on potential liability claims, the more likely danger for most businesses is a pollution incident that damages their own property and which must be cleaned up, often at great expense. While companies may expect these exposures to be covered under their standard umbrella or commercial general liability insurance policies, they are typically excluded.

To protect their investments, companies should consider premises pollution policies that provide coverage for the firstparty costs of environmental remediation as well as the potential third-party liabilities arising from on-site incidents. Because environmental laws are constantly changing, that coverage should be adaptable and provide protection for changes in regulations as well. Companies may want to consider coverage that provides expert help in a crisis to manage any resulting threat to their reputation. Besides the financial and regulatory concerns, more businesses are realizing that environmental stewardship of their land and property simply makes long-term economic sense in terms of protecting asset values and their own valuable reputations.

Global Economy, Global Environment

For many U.S. companies, foreign operations have become an integral part of their overall business. Over the last quarter century, the value of U.S. overseas investments has soared more than fifteen-fold, reaching $4.1 trillion in 2011.[1] The trend is not limited to the developed world. Increasingly, companies from emerging economies such as Brazil are also expanding globally. "More and more, products are 'Made in the World,' and no longer "Made in the U.K." or "Made in Switzerland," World Trade Organization (WTO) Director General Pascal Lamy said in his February 2013 speech in Switzerland. "The production of goods and services today is multi-located...."[2] The WTO estimates that the value of world merchandise exports rose 20 percent in 2011 to $17.8 trillion.[3]

The rise in global trade has coincided with a growing awareness among peoples and governments of the environmental impacts that development may bring. Countries that have rushed to industrialize are increasingly looking to address the environmental impacts of that development, often under pressure from a rising middle class. China, which has vaulted to become the world's second largest economy over the last few decades, is moving to address some of its intractable pollution problems. Even countries with well-established environmental regulations, such as the United States, continue to strengthen those laws. In Europe, companies face not only European Union-wide environmental regulations, but also varying laws in each of the member states. All around the world, however, the environment has become a more pressing concern.

The Changing Environmental Landscape

Looking around the world, businesses seeking to expand face a constantly changing environmental landscape. In the European Union (EU), the Environmental Liability Directive (ELD) has established a common baseline across all 27 member nations, but significant differences remain in each country's laws and in the way they apply the ELD.

The ELD, which entered into force in 2007, enshrines the "polluter pays" principle, seeks to prevent damage and calls for remediation in kind where necessary. One of the key aspects of the ELD is that it extends beyond primary remediation to "biodiversity" damage. That requires the operator to either restore the damaged natural resources or to recreate a similar resource nearby or at a similar site.

Restoration may prove to be a long and expensive process. In France, a ruptured oil pipeline in 2009 released more than 4,000 cubic meters of crude oil over five acres of the environmentally sensitive Coussouls de Crau reserve that is a refuge for rare birds and other species in Provence.[4] The clean-up involved removing surface oil and contaminated ground to a depth of 40 centimetres and trucking it to a treatment center, and drilling dozens of wells to bring up oil that had seeped into the ground water table beneath. Total restoration could take from 10 to 50 years.[5]

In Europe, companies not only have to take into account the varying rules in each nation, but also regionally within those nations (e.g., within each of the German states or within England, Scotland, Wales and Northern Ireland of the U.K.).

While the ELD sets a common standard, it does not preclude member states from having stricter requirements and it gives them significant leeway in implementing the rules, including requirements for financial assurance.[6] To date, only a minority of EU members have enacted laws requiring compulsory financial assurance, including Bulgaria, the Czech Republic, Greece, Hungary and Portugal. Spain is expected to require companies to perform their own risk assessment and decide what amount of financial security is necessary. Other countries may require a dedicated limit of insurance for pollution exposures, but those limits may vary significantly.

The EU is also taking a harder look at offshore areas. Early in 2013, the EU reached a tentative agreement on stricter rules for offshore oil and gas operations that would make companies fully liable for environmental damage to protected marine species and natural habitats. The ELD would encompass all EU waters, including the exclusive economic zone extending about 370 km from the coast.[7]

In China, whose capital city, Beijing, is often shrouded in heavy smog, pollution has become a major issue and a growing source of public discontent. The country's new premier, Li Keqiang, promised in March 2013, that the government would take a tougher stance on pollution, and days later the country imposed stricter fuel economy standards for cars.[8] China now requires some heavy industries, such as mining, smelting and chemical production, to have environmental insurance to provide compensation for damage from environmental accidents. Petrochemical companies and others whose operations involve hazardous waste are encouraged to be insured.[9] In addition, a proposed law in China would require businesses that cause accidents related to air pollution to pay for all economic losses without limit.[10]

Elsewhere in Asia, other developing countries are looking at updating and strengthening their own environmental laws. There is also increased awareness of environmental risks in the Middle East nations that have seen a great deal of infrastructure development. Additionally, environmental regulations are also becoming a bigger focus in Latin American nations such as Chile and Brazil. In some cases, employees can risk jail time as well as fines in connection with pollution incidents. Brazil, for instance, recently dropped criminal charges against two U.S.-based oil companies and some of their employees in a case stemming from a 2011 offshore oil spill. The charges of "crimes against the environment" carried potential jail terms of up to 31 years.[11] A civil suit seeking roughly $20 billion in damages continues, although a far-smaller settlement has been discussed.[12]

Even in nations with well-developed environmental laws, regulations are being constantly updated and amended. In the United States, for example, recent rules have targeted mercury emissions from coal-fired power plants. For that reason, businesses have to be concerned, not just about their obligations under current standards, but also the effect of more stringent standards in the future. Levels of pollutants that are currently designated as acceptable later may be ruled unacceptable.

Companies also may face significant fines or be required to bear the brunt of the cost of mitigating the environmental damage to neighboring properties.

A Road Map for Expansion

Before venturing into new markets, it is crucial to understand the environmental risks. In addition to evaluating existing local regulations, companies should strive to understand how they are applied in practice and assess any pending laws that might come into force after operations begin. For companies looking to expand operations in a particular country, the process may be easier because they already have local experience. Still, they should evaluate the entire process, from permitting to the implementation of their business plan, so that they comply with local or country regulations.

Expanding or opening a new plant typically means acquiring new property, which may have an unknown environmental history. Because no company wants to acquire an expensive environmental liability, it is important to learn as much as possible about the history of the property, how it was used in the past and any pollution incidents associated with it. This can be a difficult process outside the United States because records may not be readily available. For example, a property in Europe may have been used as a foundry two centuries ago and could have unrecognized environmental issues. Before purchasing a site, the company may want to conduct a standard Phase I environmental assessment of the property in order to identify and evaluate the potential risks.

In addition, companies need to think through their operations to make sure that they will comply with all permit requirements. For instance, in areas such as annual emissions testing and waste generation reporting, failing to report waste handling properly or failing to comply with permits could create significant regulatory and reputational risks.

In many cases, a company may be making an investment in a foreign country, but it may not have operational control due to local legal limitations on foreign direct investment. Those limitations often result in complicated partnership structures that are required with local government and other entities, which should be carefully evaluated for attendant risks.

While operations in other countries can create significant opportunities for growth, they often require stricter due diligence than for analogous operations in the United States. To evaluate those exposures, companies can seek out experts who have experience in evaluating and mitigating overseas environmental, health and safety exposures. They should look for experts with local experience and staff, and a working knowledge of the time and cost necessary to maintain compliance with current regulations.

Whatever the local regulatory scheme, companies should seek to follow global best practices. That helps to demonstrate to local stakeholders that the company is responsible by applying global environmental, health and safety standards. A crucial aspect of this is to make adequate financial provisions in the case of an incident so that it can be handled in a way that both minimizes environmental damage and provides security to the local stakeholders that might be affected.

Protecting Valuable Investments

While U.S. companies may view environmental insurance primarily as a means to protect against the risks of lawsuits and legal judgments tied to pollution, the more likely danger for most businesses operating in foreign countries is the cost of cleaning up an accidental spill or leak of pollutants on property owned or leased by their local affiliates. Relying on a liability only policy may prove to be an expensive mistake.

After an explosion at a British paint storage facility in East Yorkshire, England, in May 2003,[13] the company sought to recover roughly $1.1 million (£770,000) in cleanup costs incurred by the Environment Agency and the company itself under a government work order. The company sued its insurer seeking to recover the costs under a liability only policy, but in a decision that turned on the legal meaning of "damages," the court ruled that the cleanup costs were not insured as a liability for damages under the policy.[14]

For companies that have made a significant investment in overseas plants and property, it makes sense to protect those assets, as well as to guard against the larger danger that pollution incidents may pose, with a premises pollution liability policy. Such policies can be structured to cover both first-party, on-site cleanup costs and third-party bodily injury, property damage and cleanup costs. As such, they include coverage for cleanup of affected media such as soil and ground water on the site, as well as the liabilities that may arise from that same polluting event.

First-party pollution coverage offers a means of protecting property value, which may represent a large portion of the total value of the entire business. Unaddressed pollution or contamination on-site, can dramatically reduce the value of the property, and thus the business itself. Companies routinely protect their physical property against risks such as fire and storm damage, but may not recognize that pollution incidents can result in expensive cleanup costs and ancillary property damage associated with performing the cleanup. A spill of pollutants that remains within a property's boundaries often must be cleaned up to protect workers and prevent further damage to soil and groundwater. These costs can easily run into the hundreds of thousands or even millions of dollars and may possibly bankrupt the company.

In the Netherlands, the first phase of a cleanup after a massive 2011 fire that destroyed a chemical packing plant near Rotterdam is estimated to cost 100 million euros ($130 million).[15] The company filed for bankruptcy seven months after the fire,[16] which started when a worker used a gas burner to thaw out a pump.[17]

In addition to the environmental damage, a spill or leak of hazardous substances may also degrade the value of the property if it is not cleaned up properly. Should the company later decide to sell the property, it will be more valuable if the proper remediation measures have been taken.

Companies also may face significant fines or be required to bear the brunt of the cost of mitigating the environmental damage to neighboring properties.

A spill from a waste reservoir at a Hungarian alumina plant in 2010 allowed millions of gallons of caustic red sludge to flow through nearby villages, killing 10 people and injuring 120. The company was fined more than $630 million for environmental damages.[18] The Ministry of Rural Development said the recovery, reconstruction and mitigation of environmental damages cost the state more than $175 million, including nearly $100 million for the environmental mitigation.[19] (At $1 = 213.75 forints, current rate 237)

Of course, companies dealing with unexpected clean-up costs could be faced with associated legal actions as well, which is why first-party clean-up coverage should be coupled with liability coverage. The company could be implicated by a regulatory agency or another third-party and have to respond to associated legal claims. While legal costs would likely be less in Europe and other less-litigious areas than the United States, they could still prove substantial.

Companies will want to make sure that their insurance policies will be legally enforceable with respect to exposures in a particular country whose laws may be very different from the United States or European law. The policy wording needs to be consistent with local exposures, and any legal defense provided pursuant to the coverage should be experienced in that particular country.

Meeting the Global Environmental Challenge

As businesses seek to take advantage of the new opportunities opened up by today's global economy, they need to be aware of not only the traditional risks associated with operating in a new country, but also the increasing environmental exposures.

Before opening or expanding operations in another country, it is imperative to perform strict due diligence on the property and to evaluate the current and likely environmental regulatory regime. To protect their reputations and their businesses, companies should strive to run their operations around the world, not only in accordance with local laws, but also with global best practices.

While third-party liability concerns remain a significant risk in the United States and abroad, companies should not overlook the more likely possibility of a pollution incident on their own property that requires an expensive clean-up. Companies that are unprepared to meet that expense put their investment in plant and property at risk, jeopardize their own reputations and possibly the business itself.

Still, liability may play a meaningful role and businesses should seek out premises pollution policies that include liability coverage. Besides unexpected spills and accidents, companies should take into account changes in environmental regulations and stricter enforcement that may require costly remediation work for previously conforming property or operations and make sure that their policies provide coverage for changes in regulation.

The global economy has opened up new markets and new opportunities for businesses around the world. At the same time, countries around the world are putting an increased focus on protecting the environment. Businesses that are prepared to meet expanding environmental challenges are most likely to succeed in the new global marketplace.

About the Authors:

Craig Richardson is Executive Vice President, Chubb Environmental. With more than 20 years of underwriting and claim experience in the environmental insurance arena, Mr. Richardson joined legacy ACE in 2008. He currently leads Chubb's North America Environmental business line.

Karl Russek is Senior Vice President, of Environmental Risk or Chubb Overseas General. Mr. Russek has more than 20 years of experience in the insurance industry and environmental liability as well as the environmental engineering and regulatory community.

Frank Westfall is Vice President of the environmental division of ESIS Health, Safety, and Environmental Services. Mr. Westfall has worked in the environmental consulting industry since 1989, with his primary emphasis in hazardous and other regulated materials inspections, project design and remediation program development and oversight.

Endnotes:

1. http://www.fas.org/sgp/crs/misc/RS21118.pdf
2. Lamy, Pascal, WTO Director-General “The new mapping of international trade,” Speech at the École Polytechnique Fédérale de Lausanne,” Feb. 26, 2013, http://www.wto.org/english/news_e/sppl_e/sppl267_e.htm
3. “International Trade Statistics 2012,” World Trade Organization, p. 24, http://www.wto.org/english/res_e/statis_e/its2012_e/its2012_e.pdf
4. Davies, Lizzy, “Ruptured oil pipe floods acres of French nature reserve,” The Observer, Aug. 8, 2009, http://www.guardian.co.uk/world/2009/aug/09/burst-oil-pipeline-france
5. Parpaleix, Jean-:Luc, “Comment la marée noire de la Crau a disparu,” Provence.com, May 16, 2012, http://www.laprovence.com/article/economie/1743414/comment-la-maree-noire-de-la-crau-a-disparu.html
6. European Commission, “Questions and Answers Environmental Liability Directive,” http://europa.eu/rapid/press-release_MEMO-07-157_en.htm?locale=en
7. “Commissioner Oettinger welcomes political agreement on offshore legislation,” European Commission, Press Release, Feb. 21, 2013, http://europa.eu/rapid/press-release_IP-13-149_en.htm
8. “China’s new premier vows to tackle pollution, offers few details,” Reuters, March 17, 2013, http://www.reuters.com/article/2013/03/17/us-china-parliament-environment-idUSBRE92G02S20130317
9. Chuin-Wei Yap, “China Mandates Environmental Insurance for Heavy Industry,” Wall Street Journal, Feb. 21, 2013, http://online.wsj.com/article/BT-CO-20130221-707283.html
10. Wu Wencong, Zhao Yinan, “Polluters might face bigger fines,” China Daily, March 2, 2013, http://www.chinadaily.com.cn/cndy/2013-03/02/content_16268616.htm
11. “Brazilian judge dimissses criminal charges against Chevron and Transocean over oil spill, “ Associated Press, Feb. 21, 2013, http://www.foxnews.com/world/2013/02/21/brazilian-judge-dismisses-criminalcharges-against-chevron-and-transocean-over/
12. Blount, Jeb, “Chevron, Transocean say Brazil drops criminal oil spill charges,” Reuters, Feb. 21, 2013, http://in.reuters.com/article/2013/02/20/us-chevron-brazil-charges-idUSBRE91J17Z20130220
13. “Blast rocks Yorkshire paint factory,” Daily Telegraph, May 23, 2003, http://www.telegraph.co.uk/news/1430923/Blast-rocks-Yorkshire-paint-factory.html
14. Bartoline Ltd v Royal & Sun Alliance Insurance plc, Queen’s Bench Division at Manchester (Mercantile Court) [2006] EWHC 3598 (QB)
15. “Moerdijk clean up to cost 100 million euros,” Radio Netherlands Worldwide, June 8, 2012, http://www.rnw.nl/english/bulletin/moerdijk-clean-cost-100-million-euros
16. “Moerdijk blaze - lessons to be learned,” Radio Netherlands Worldwide Aug. 24, 2011, http://www.rnw.nl/english/bulletin/moerdijk-chemical-fire-reports-draw-lessons
17. “Chemie-Pack managers held not responsible for fire,” Radio Netherlands Worldwide, July 21, 2011, http://www.rnw.nl/english/bulletin/chemie-pack-managers-not-held-responsible-fire
18. “Hungary villages heal slowly from red sludge spill,” Reuters, Sept. 28, 2011, http://www.reuters.com/article/2011/09/28/us-hungary-sludge-idUSTRE78R1RJ20110928
19. “Government spent 38 billion forints for recovery following the Red Sludge Disaster,” Hungary Ministry of Rural Development, Oct. 5, 2012, http://www.kormany.hu/en/ministry-of-rural-development/news/government-spent-38-billion-forints-for-recovery-following-the-red-sludge-disaster

About Chubb

Chubb is the world's largest publicly traded property and casualty insurance group. With operations in 54 countries, Chubb provides commercial and personal property and casualty insurance, personal accident and supplemental health insurance, reinsurance and life insurance to a diverse group of clients. Chubb Limited, the parent company of Chubb, is listed on the New York Stock Exchange (NYSE: CB) and is a component of the S&P 500 index.

Chubb is the marketing name used to refer to subsidiaries of Chubb Limited providing insurance and related services. For a list of these subsidiaries, please visit our website at new.chubb.com. Insurance provided by ACE American Insurance Company and its U.S. based Chubb underwriting company affiliates.

The opinions and positions expressed in this report are the authors' own and not those of Chubb. The information and/or data provided herein is for informational purposes.

Contact Us

Craig Richardson
Executive Vice President
O 678.795.4388
E craig.richardson@chubb.com

Chubb. Insured.℠

04/2013