# The Willis Index

Willis

## Environmental Newsletter

**The Environmental Insurance and Risk Management Quarterly**

**Autumn 2006**

# Market Conditions and Policy Limit Survey

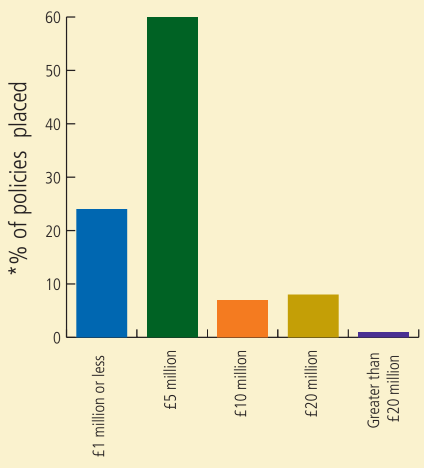
As brokers, one question we are frequently asked by clients is: "How much cover should I buy?" The very nature of environmental insurance – covering potential future clean-up costs and third party claims that are not currently anticipated – means that this is not an easy decision to make, particularly in an ever-changing legislative and litigious environment.

Environmental risks are notoriously difficult to accurately quantify, verify and manage, particularly on transactions where access and timescale restrictions may be significant. In particular, it is difficult to predict the timing and quantification of the associated liabilities, and thus the evaluation of appropriate financial provision, including environmental insurance cover. Environmental risks typically take the form of "low frequency, high severity" risks so that even where the likelihood of loss seems acceptably low, the potential magnitude of loss may still be unacceptably high. A further complication is that historic activities can present a greater contamination risk than current operations at a property, potentially warranting the use of a higher policy limit than the current site use would suggest is required.

Whilst "worst case scenarios" of clean-up costs can be estimated for most situations, it is far more difficult to predict damages that may flow from third party claims, particularly those involving class actions. What is certain, however, is that such claims have the potential to escalate to multi-million pound losses, representing a sizeable exposure to any business. The high legal defence costs that may be associated with a third party claim, whether such claim is valid or not, is also a key concern of environmental insurers, as reported in our Summer 2006 Willis Index. Whilst in the UK losses under environmental insurance policies are not known to have exceeded policy limits, insurers report that this has occurred in the US, leaving the insured liable for losses above the policy limit. This all means that clients need to carefully consider their potential exposure from third party claims and potential clean-up costs, in order to ensure an adequate level of cover is purchased.

Insurers reported that the most common policy limit being purchased for multi-year policies was in the order of £5 million or equivalent (see graph below). Annual cover is often purchased with lower limits, typically in the order of £1 million (although, given the "claims made" trigger of environmental insurance policies, it is questionable whether it is prudent to select a lower policy limit for short term policies, as a claim could occur at any time). It is evident that there is considerable spread of policy limits selected, between less than £1 million to greater than £20 million.

**Frequency of Policy Limits Selected in 2006**




***Representative figures based on responses from environmental insurers**

The Willis Index is a quarterly publication reporting on the relevant issues affecting the insurance industry and the impact they have upon our clients.

Our quarterly review provides analysis of the Environmental Insurance Market, assisting buyers and their advisors on available solutions.

Regular features include updates on the market conditions, case studies, technical analysis of coverage specifics and special features highlighting significant changes in regulation, insurance market news and forthcoming events and seminars.

**Willis voted European Commercial Broker of the Year 2006 for the second year running**

**Willis voted Best & Most Innovative Insurance Broker 2006 for the second year running**

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# Market Conditions and Policy Limit Survey cont.

There is a marked variation in policy limits selected both within and between industry sectors/projects, reflecting the wide range of applications and project drivers for environmental insurance. Insurers agreed that the highest policy limits are typically taken up for Large Scale Voluntary Transfer (LSVT) projects, with £20 million or higher commonly being purchased (see graph below). In such cases, the decision to purchase such high limits may be influenced more by the fact that local authorities typically continue to require uncapped warranties for LSVTs, rather than a technical assessment of the environmental risks associated by the portfolio. Similarly, indemnity provisions within property and corporate sale and purchase agreements commonly dictate the limit (and period) of cover that needs to be taken up.

Not surprisingly, policy limits are influenced by the nature and scale of a company's operations. For example, waste management companies operating a large portfolio of waste facilities will clearly require a higher limit than a single landfill site. Similarly, within the petroleum sector, individual petrol filling stations will typically warrant much lower policy limits than larger scale operations such as refineries.

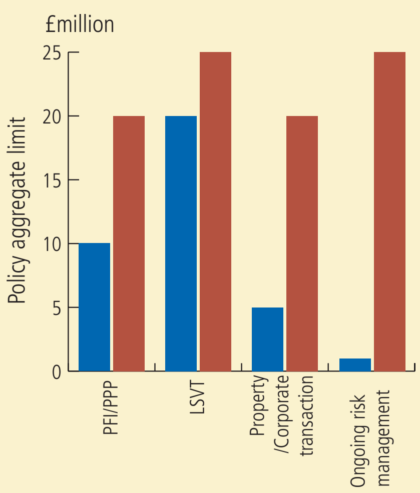
Insurers report a maximum single policy limit of £50 million having been requested this year. However, the requirement for such a high limit is rare; the days of corporates and financiers/lenders insisting on policy limits being set at the maximum available capacity seem to be over. Overall therefore, insurers reported a general rationalisation of limits, based on a technical and legal review of potential liabilities; a trend also seen by Willis recently. For some insurers the decrease in policy limits may also be partially explained by an increasing uptake of annual policies, for which lower limits are typically requested (see above). Such insurers reported that for multi-year policies there has been little or no change in the limits being requested.

Most environmental insurers are routinely able to offer aggregate policy limits of up to £20 million, which is more than adequate to satisfy the vast majority of enquiries. A total capacity in the region of US$180 million (£100 million) is available in the London Market through the use of excess layers. However, such an approach is seldom required, with excess layers being used on less than 1% of placements according to insurers. For certain risks, insurers may be unwilling to offer the full limit of cover requested, either because it exceeds the maximum capacity under their reinsurance treaty, or because they wish to limit their exposure to less than that of the requested limit. However, this has not been a significant factor restricting the take up of environmental insurance.

So what do insurers predict for the future? In general, further rationalisation of policy limits seems likely. However, in high risk sectors, particularly those that are seeing increasing claims activity such as waste management, there is increasing awareness of the potential quantum of losses that can occur. In all cases, careful consideration of potential exposures is required in order to select appropriate limits.

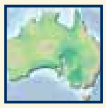
## Policy Limits Selected in Various Sectors

- "Typical" policy aggregate limit requested
- Maximum policy aggregate limit requested




# Global Case Studies

Willis provides a global resource to assist clients in managing environmental liabilities. Based in London in order to access the dominant London insurance market, the Environmental Team has developed extensive links with Willis offices and other intermediaries throughout the world, including of course our colleagues in the North American Environmental Practice. Below are just a handful of case studies illustrating the geographical spread and range of applications on which we have assisted clients recently.

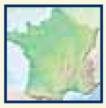


### Australia

The Environmental Team has recently assisted in scoping out the availability of environmental insurance for a major mining project in Western Australia.

### Belgium

Placement of environmental insurance for a Belgian based manufacturing company, with operations in many EU countries as well as the US.



### France

The Environmental Team were instrumental in negotiating cover for the purchaser of a French manufacturing company, enabling them to fix their maximum future exposure arising from both "known" and "unknown" contamination.

### Germany

A German private equity company routinely turns to Willis to structure environmental insurance for its corporate acquisitions and disposals.

### India

Willis is providing ongoing support to a client considering options for managing environmental liabilities at a chemical manufacturing site.

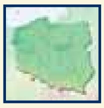
### Israel

Willis has worked closely with a local intermediary to place environmental insurance for a major oil industry operator.

# Country Profile: Australia

### Italy
The Environmental team is currently working with the Willis M&A Practice to explore environmental insurance options for a private equity purchaser of an Italian manufacturing company.

### New Zealand
The Environmental Team supported the local Willis office in structuring environmental insurance for a waste management operator to supplement the limited pollution cover provided under the client's public liability policy.



### Poland
The Environmental Team has worked closely with the local account team to place environmental insurance for a petrol filling station portfolio.

### Singapore
The Environmental Team is currently working with the local Willis office to explore the availability of environmental insurance on behalf of an oil tanker depot operator.

### South Africa
The Environmental Team has assisted a number of Willis clients seeking to manage environmental liabilities during mining operations and upon mine closure.

### Switzerland
Willis successfully negotiated environmental insurance cover for the purchaser of a former landfill site, including cover during re-development of the site to a distribution depot.

### Turkey
Willis assisted a local insurer in obtaining facultative reinsurance terms from the environmental insurance market for a major petroleum risk.

### United Kingdom
The Environmental Team routinely place environmental insurance for a wide range of projects, including property and corporate transactions, operational risks and PFI/PPP projects.

In any country, a sound understanding of the applicable environmental legislation is fundamental to the assessment and management of environmental risks, and the structuring of effective environmental insurance cover. In this article, we provide a brief overview of environmental legislation and the environmental insurance market in Australia.

## Environmental Legislation

Most environmental legislation in Australia is enacted at the State/Territory level rather than national/federal, and therefore varies regionally. However, Commonwealth legislation, notably the Environment Protection and Biodiversity Conservation Act 1999, also applies nationally. Common law principles, for example under the torts of nuisance and negligence, may also apply.

Pollution and land contamination liabilities are typically administered via civil action rather than criminal penalties and sanctions, in order to encourage the clean up of contamination. Strict (i.e. non-fault) liability commonly applies for pollution offences, for example failure to obtain, and operate in accordance with, a permit, or where pollution causes serious environmental harm.

At the national level, Commonwealth legislation is administered and enforced by the Commonwealth Department of Environment and Heritage (DEH), whilst the policies and practice of each State/Territory are co-ordinated through the National Environment Protection Council.

Environmental protection agencies within each State/Territory are empowered to require an investigation to be undertaken where they have reason to believe the land may be contaminated. The need for an investigation can typically also be triggered by a change in lease or land use. A remediation order can then be served if such investigations indicate that the land represents a "significant risk of harm" to the environment. Whilst, as in many countries, primary responsibility for contamination rests with the original polluter, owners (including mortgagees in possession) can also be held liable even if they were not responsible for the contamination. The authority will typically pursue the investigation and, if necessary, remediation of a site through "voluntary" agreements, however this does not rule out the possibility of the authority requiring further remediation if residual contamination presents a risk in the future.

## Environmental Insurance

As in the UK, traditional insurance products available in Australia such as public liability policies provide limited, if any, cover for pollution, at best offering cover for third party claims arising from "sudden and unforeseen" pollution events. Public liability cover for operations representing a relatively "high" environmental risk is likely to be subject to a total pollution exclusion. Such cover is therefore clearly inappropriate for the majority of environmental risks, particularly those associated with historic contamination which is often the key concern during transactions.

The uptake of environmental insurance products is not as prevalent in Australia as it has been in Europe and the USA. In 2003, a survey conducted on behalf of the Australian Government found that an overall lack of major exposures, absence of past litigation and claims history, and the low volumes of merger and acquisition activity at that time were considered to be key reasons (DEH, 2003). As in the UK, the market exists primarily as a deal facilitation tool for mergers and acquisitions. That said, industry sectors such as mining, waste management, engineering, construction and energy have purchased environmental insurance cover for operational risks in recent years.

Australia is certainly viewed as a potential growth market by environmental insurers, with increasing interest in the use of environmental insurance products being evident in recent years, both for risk finance and risk transfer solutions. Whilst AIG is currently the only insurer with a local environmental underwriting presence in Australia, other environmental insurers are able to offer cover through their London offices. As the insurers all have offices in Australia, policies can be issued locally if required.

Reference: The Materiality of Environmental Risk to Australia's Financial Sector.
Report prepared by Ernst & Young for Commonwealth Department of Environment and Heritage, 2003.

# Breaking News

### Willis launches Australian M&A Practice

The Willis M&A Practice, in which the Environmental Team is positioned, is now firmly established as a Global provider of transaction insurance services, after assisting on the largest management buyout in Australian history. Willis performed insurance due diligence for Kravis Kohlberg Roberts & Co (KKR) in their acquisition of Cleanaway Australia and Brambles Industrial Services.

With a portfolio that includes in excess of 100 waste facilities, Cleanaway is Australia's leading waste management operator, providing collection, materials recovery, recycling and landfill disposal services to over 65,000 commercial customers and many municipalities across the country.

The ability to draw upon the various specialist Willis disciplines, including the Environmental Team, was a key differentiator for KKR, enabling them to identify and manage risks associated with the acquisition.

Working to a tight timescale, the Environmental Team provided valuable input to the exercise, outlining environmental insurance options for managing both "known" and "unknown" contamination issues at the sites, including advising on indicative premium costings.

This input enabled KKR to understand the potential coverage and cost implications of an environmental insurance programme to be used to manage the contamination legacies and future environmental risks of the new business, helping them to proceed confidently with the bid.

# Meet the Team

### Josh Roach

With qualifications in Civil Engineering and Commerce, Josh joined Willis in 2002, prior to which he worked for a global engineering consultancy firm where he specialised in off-shore Project Feasibility and Financial Modelling. Josh now heads the Mergers & Acquisition Practice of Willis Australia, with responsibility for the delivery of due diligence and transactional product services to both corporate and private equity clientele.

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### The Willis Index

The WIllis Index provides quarterly updates on the ever-changing Environmental Insurance Market, including commentary on market conditions, case studies and insurance product developments. If you do not currently receive the Willis Index but would like to, please contact us. Back issues can be downloaded from our website: www.willis.com/services/environmental/publications





Willis is one of the world's leading risk management and insurance intermediaries. We have over 15,000 professionals in over 300 offices around the world.

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