

Risk management for an enlarged EU

In cooperation with Economist Corporate Network and Economist Intelligence Unit

Environmental liability

EU ENVIRONMENTAL legislation is complex, consisting of 300 legal acts that have to be transposed into law and implemented in the new member states. The eight new Central European member states have already transposed the bulk of the acquis. But this is only the start.

The EU estimates that implementing environmental law in the new member states requires investment of €80-110bn, or just over €1,000 per new EU citizen. This represents approximately one sixth of the average annual per capita GDP in these countries.

Of that amount, 40% will be directed at reducing air pollution, 40% for water and waste water management and 20% for solid and hazardous waste management. Investments will also be needed to set up administrative and enforcement structures.

Key areas of business impact

According to the latest Cape Survey¹, 35% of companies in the new member states are not yet compliant with the environmental acquis, rising to 40% among SMEs. Companies have been struggling to identify which specific EU legislation is



applicable to their business activities, trying to identify and track relevant environmental laws impacting their operations.

For manufacturing and raw materials firms, the most cost-intensive environmental directives are those dealing with direct pollution prevention and

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¹"Corporate Readiness for Enlargement in Central Europe. A company survey on the state of preparations for the single market 2004", Eurochambres and SBRA, 2004



Executive summary

What company directors need to know:

- The new EU member states will need to invest €80-110bn to implement the 300-plus legal acts of the environmental acquis. This is an EU estimate and at the conservative end of the scale translates into just over €1,000 per new EU citizen, or approximately one sixth of the average annual per capita GDP of these countries.
- Even identifying which of the laws are relevant to a particular commercial activity requires time and resource from businesses.
- Still, the majority of companies in the new EU member states are compliant with the environmental acquis; 35% of companies in the new member states are not yet compliant, rising to 40% among SMEs.²
- The new Environmental Liability Directive, adopted in April 2004, introduces the “polluter pays” principle throughout the EU and broadens the concept of liability to include damage to habitats and protected species, as well as the more ‘traditional’ liabilities associated with soil and water contamination.
- Compulsory from October 2007, firms will have to acquire Integrated Pollution Prevention and Control (IPPC) permits for most new and existing industrial installations.
- Enforcement and monitoring of environmental controls remains mixed, but CEE governments and NGOs are busily building capacity. Companies should not expect lax controls to endure and should plan for greater disclosure requirements.
- In fact, there is concern from some companies that CEE governments may apply environmental liabilities by the book, rather than pragmatically, in an attempt to raise revenue through fees and taxes.

²“Corporate Readiness for Enlargement in Central Europe. A company survey on the state of preparations for the single market 2004”, Eurochambres and SBRA, 2004

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emission controls, packaging waste and the contamination of sites. The key piece of legislation for CEE companies here is the **Integrated Pollution Prevention and Control (IPPC) directive**, which is a cornerstone of EU environmental legislation. It aims to prevent or minimise air, water and soil pollution caused by emissions from industrial installations. By October 2007, most existing and all new industrial plants which are controlled by the Directive across the EU-25 will need IPPC permits. Four new member states (Poland, Slovenia, Slovakia and Latvia)

have been granted longer transition periods for specific installations.

IPPC permits will be issued by national, regional or local authorities. To obtain a permit, companies must address the complete environmental performance of the plant. This includes emissions to air, water and land, generation of waste, use of raw materials, energy efficiency, noise prevention, accidents and risk management. Permits are granted on the basis of operations being in line with Best Available Techniques (BAT). This means the processes employed are the most efficient and progressive techniques

available within the sector – including the use of best available technology.

Other areas of EU environment legislation which will impact businesses in CEE include the following:

■ **Waste management**

Packaging waste is an area of environmental law which will require considerable investment in the new member states. In the EU-15, targets for recovery (50-60%) and recycling (25-45%) have been met, but problems remain in interpreting the law in different member states. Some countries are suspected of using stringent waste management requirements as a hidden market protection tool.

■ **Environmental liability**

The EU passed a major new directive on environmental liability in April 2004. The new directive introduces the “polluter pays” principle, holding companies liable for any environmental damage they cause. The directive is comprehensive and covers not only contamination, but also damage to protected species and natural habitats. Member states will have three years, until 30 April 2007, to transpose the directive into national law.

■ **Soil contamination**

The new liability directive requires decontamination of land until it no longer poses any significant risk to human health or damage to habitats or protected species. Such remedial works can result in significant cost. The directive will only apply to ‘new’ contamination conditions. With regard to pre-existing damage, however, the European Environment Agency estimates there could be well over a million contaminated sites in the EU-15 alone. Total clean-up costs could amount to as much as €106bn, with average costs per company running into millions of euros. While the new liability directive may not be retroactive, IPPC investigations may uncover such contamination, resulting in



INTEGRATED POLLUTION PREVENTION AND CONTROL (IPPC) REQUIREMENTS

IPPC requirements do not apply to all industries. Those that are affected are listed in annexe 1 of the directive.

IPPC obligations for the operator:

- All appropriate and preventive measures are taken against pollution by using Best Available Techniques (BAT)
- No significant pollution is caused
- Waste production is avoided in accordance with the Directive on waste
- Energy is used efficiently
- Measures are taken to prevent accidents and limit consequences
- Measures are taken after cessation of activities to avoid pollution risk and return site of operation to a satisfactory state
- Emission limits are observed according to Directives on emissions

Country-by-country information:

- Check IPPC website for competent IPPC authority in your country – www.europa.eu.int/comm/environment/ippc/ippc_links.htm or contact your local Ministry of Environment for information on IPPC regulators
- For existing installations, please check transition periods for your country of operation. Consult your local IPPC office or Ministry of Environment.
- Consult the special IPPC office in your country for further permit requirements
- Contact the European Commission’s Joint Research Centre – www.eippcb.jrc.es – for specific BREF industry reference documents as well as applicable industry sectors

For the IPPC permit application the operator has to provide information on:

- The installation and its activities
- The raw and auxiliary materials, other substances and the energy used in or generated by the installations
- The sources of emissions from the installation
- The conditions of the site of the installation
- The nature and quantity of foreseeable emissions and their significant effects on the environment
- The proposed technology for ensuring compliance
- Where necessary, measures for the prevention and recovery of waste generated by the installation
- Further measures planned to comply with the basic obligations of the operator
- Measures planned to monitor emissions into the environment

companies being forced to address this legacy on sites where significant impacts are seen or suspected.

■ Hazardous substances


Companies handling dangerous substances will also have to implement the Seveso Directive, which sets out protection against accidents involving such substances. This calls for the creation of safety management systems, emergency plans, spatial planning, inspections and public information. At this point the directive only relates to chemical companies, but there are plans to extend it to other industries as well.

Companies should also be aware of the new Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) Directive which has been issued in Brussels for consultation. This new directive may introduce stringent new controls on the use of hazardous substances.

■ Environmental assessments

Manufacturing and processing firms looking to launch new projects will have to perform the EU's environmental impact assessment (EIA) or strategic environmental assessment (SEA) before authorisation is given. These will often involve some type of citizen consultation.

Enforcement and monitoring capacity

 **THE EFFECTIVENESS** of enforcement and monitoring is patchy across most of CEE, but companies should not expect this situation to last long. Inspection offices are being strengthened and monitoring systems for air and water quality extended.

Enforcement efforts are currently hampered by insufficient funding and staffing, particularly at the local level, as well as a lack of co-ordination between enforcement bodies. Poland, for example, is still trying to fill 2,500 new public service positions in the area of environmental protection. It should be noted that this situation is not solely confined to the new member states, but is also true of certain long-standing EU members.

Monitoring standards in CEE countries are currently below those in the EU-15. A study conducted by environmental consultants RPS and the Environmental Policy Council³ for the European Commission shows that around 500 waste samples were taken and analysed in the Flemish region of Belgium alone in 2001, more than the total of samples taken in the new member states.

The study also finds that fines and sanctions do not offer deterrence to illegal waste disposal. As it is, only in the Czech Republic and Poland are official warnings issued. The average fine in new member states is a mere €200 – not enough to deter illegal waste activity. The Czech Republic is alone in the region in imposing stiff fines – of up to €300,000 – along with criminal prosecution.

This state of affairs will begin to change soon as CEE governments – at the national, regional and local levels – utilise EU funds to build monitoring capacity and adapt European best practice in crafting more comprehensive enforcement guidelines and procedures.

³“Developing Capacity in Implementation and Enforcement through the AC-IMPTEL network.” EU Commission, December 2003

NGOs and public access to information

Firms operating in CEE will also face scrutiny from a new corner – non-governmental organisations (NGOs). The Commission has started funding NGOs to play an active role in enforcing and implementing the EU environmental acquis. Previously weak in Central and Eastern Europe, local NGOs are slowly growing in strength and will receive a boost from EU financial support.

The new environmental liability directive explicitly empowers NGOs to call for public authorities to act. Should the authorities refuse to act, or should an NGO disagree with the chosen action, judicial review proceedings may be started.

Companies and public authorities alike in CEE will also have to get used to expanded public access to environmental data and activity. In February 2004, the European Environmental Agency, the EU's public information portal for environmental information, launched a new transparency initiative, the European Pollutant Emission Register (EPER). This survey of industrial emissions into air and water is intended to provide the public with information on the presence and distribution of contaminants. Not only could this result in the exposure of significant polluters, but it is likely also to create public pressure on them to upgrade their environmental facilities. The next report, which will include the new member states and is based on research findings from 2004, will be published in 2006.

EPER represents a departure in the EU. Its database can be accessed by anyone who wants to search for data on companies, pollutants, an industry sector or a particular location. The data is provided by member states, which have to gather emission data on industrial sectors and individual operators and report to the Commission. Governments and companies in CEE can expect the expanding legion of NGOs to take full advantage of this new window.

ONE TO WATCH FOR ...

On 1 January 2005, the EU's CO₂ emissions trading scheme is launched. The EU target is to reduce CO₂ emissions to 8% below its 1990 level by 2012.

In order to comply with new emission limits agreed according to Directive 2003/87/EC, a company has two main options:

- invest in new technologies to reduce their emissions beneath their allocated limit (or invest in reduction technology in developing economies and bank the credit)
- exceed their emissions limit and purchase units to balance the excess.

If a company does not meet its targets, financial penalties will be applied. The requirement to balance the excess will still exist.

Companies that emit below their limits can bank the excess or sell these units on as a new revenue stream. Installations initially covered are those from industries that emit high levels of CO₂, including energy, ferrous metals, minerals and pulp and paper production.

Emissions trading will require all installations to examine and manage their total carbon emissions to avoid financial penalties, ensure business continuity and avoid unwanted press and pressure group attention.

Risk awareness

IRRESPECTIVE OF the previously patchy legislative and enforcement regimes in CEE, local and international companies clearly perceive environmental protection as an important company commitment. For many multinational companies it forms part of their Corporate Social Responsibility (CSR) activities. Besides, the sums can work in two directions. Less waste means less waste disposal cost; better energy efficiency means lower utility bills.

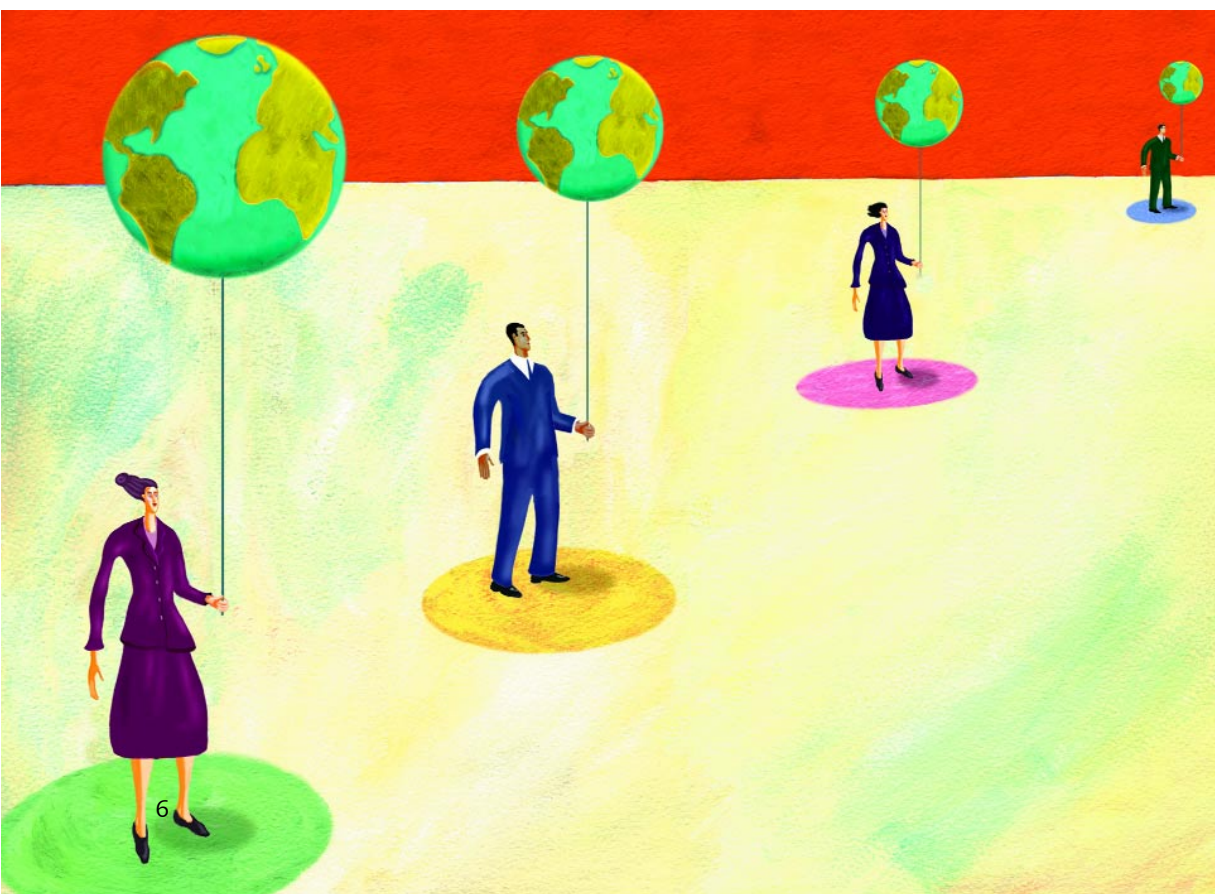
Large firms – particularly in heavy industry – have dedicated departments dealing with environment health and safety. In other companies without specialised departments, managers report spending an average of 5-10% of their time on environmental issues.

Overall, multinational companies in Central and Eastern Europe are well prepared and apply accepted international environmental standards. “Multinationals have been working with EU environmental standards since they entered the region at the beginning of the 1990s,” says a senior manager at an international cement

manufacturer operating throughout CEE. “Hefty capital investments were needed for upgrading installations and these were budgeted long-term.” Multinationals can, of course, always draw on expertise from their western European operations, which local firms don’t have access to. The latter tend to rely on industrial associations for information on industry-specific compliance issues.

Awareness is also high among local firms, but compliance is clearly a burden for many. A senior executive at one Hungarian chemical company reports that implementing the EU’s body of environmental law is taking significant amounts of money and time – even after accession.

All the firms interviewed for this report have been updating their environmental management systems and putting in place measures to reduce waste production and volumes of pollutant emissions. A Czech chemical firm has spent around €8m in environmental investments over the past eight years. A Slovak gas distribution company has also invested several million euros.



Implementation

ENERGY, MINERAL and chemical firms see the IPPC directive as probably the key compliance challenge.

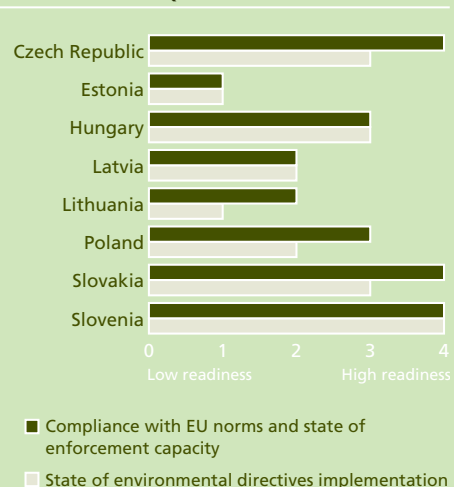
- An executive from a Czech chemical company says they have already obtained an IPPC permit for one of their plants, but will have to obtain further permits by 2007.
- The same Czech chemical company confirms that complying with the Seveso Directive on preventing hazardous accidents has led it to set up an emergency system (Integrated Rescue System) and its own company fire brigade. The company also has a TRINS centre (Transportation, Information and Emergency system) where exercises and test drills are practised in case of emergencies.
- Another chemical company in Hungary upgraded its first plant according to IPPC requirements in the framework of an EU-funded twinning programme, where it worked with a partner with experience in applying the IPPC directive. But this company must still upgrade the rest of its plants.
- The environmental manager at a multinational cement company identifies the difficulty of detecting pollution legacy on sites which have been owned by the company for over 100 years. The company recently divested operations in Bulgaria and in the process uncovered extensive site contamination. It had to invest heavily to clean up the site.

Paradoxically, despite years of lax controls, there is a worry among the business community in CEE that the new member states will implement the EU environmental laws more rigidly than in the EU-15, going by the letter rather than the spirit of the law. The manager of a packaging producers' association, for example, is worried that the new EU members are using environmental

regulations as a way to increase their revenues through further fees and taxes for waste management. "New member states are proving to be more imaginative in finding ways to apply environmental legislation than old member states", he says.

The manager at a multinational company in the mineral industry sees the same tendency to implement everything by the book. He believes the authorities in the EU-15 are more pragmatic when dealing with industry. In Central Europe, officials interpret the law too literally, he says, producing red tape and bureaucratic obstacles when granting permits. "Authorities in the new member states have definitely not built up the capacity, know-how and culture for processing permit applications pragmatically," according to this manager.

ACCESSION COUNTRIES' READINESS FOR ENVIRONMENTAL ACQUIS



Source: ECN (Estimates based on research and interviews)

CHECKLIST OF KEY RECOMMENDED ACTIONS

Management systems

- Appoint a senior/ Board Director to chair an internal environmental committee and take responsibility for environmental issues
- Publish an environmental 'Mission Statement' that explains internal goals for all parts of the business
- Publish an Environmental Policy designed to meet the objectives of the Mission Statement
- Use the environmental committee to oversee compliance of all parts of the business with stated internal safety goals
- Monitor environmental related decisions in courts to understand how regulations are being enforced
- Monitor future changes to regulations at the local and European level.

Risk assessment process

- Implement a process for identifying all potential environmental exposures. This is most effectively done via a process of environmental audit where compliance status and the potential for releases of contaminants are assessed
- Quantify the potential impact of environmental liabilities using measures for impact and frequency that are meaningful to all functions within the business (Key Performance Indicators), eg:
 - Instances of non-compliance with regulations resulting in actions raised by the authorities
 - Losses related to environmental issues greater than a set level of materiality
 - Reduce energy use by a defined target – e.g.10%

- Prioritise remedial action/ risk management investments based on these measures and the findings of the audit process
- Report back to the Environment Committee for approval and budget.


Record keeping

- At each site in one easily accessible internal library of information, maintain clear records of all environmental related information (certain information will be required to be maintained under law), including:
 - All environmental monitoring data on air, water and waste emissions
 - Inventory of hazardous materials present, location, volumes, storage methods
 - Details of potential receptors for contamination
 - Releases of contamination
 - Plans of site utilities including drainage and all underground plant
 - Details of historical and neighbouring site uses
 - Communications with the relevant regulators.

Training

- Provide training at all levels in the following aspects of environmental management:
 - Environmental Legislation
 - Environmental Management and Assessment.

Risk management and insurance strategies for managing environmental liability

 **THE INSURANCE** market for environmental liability is fairly new in Europe and products have only been available since the early 1990s. To the extent that coverage does exist, industrial firms in CEE generally feel that the insurance industry is covering less risk while increasing premiums. “We understand that the insurance companies have seen the big impact that industries can have on the environment and they are very cautious,” says the manager of a multinational company in the industrial mineral sector. This perception is common, but options do exist for accessing insurance capacity that provides value and addresses real contamination risk.

Current best practice in managing environmental risk and providing the basis for insurance underwriting includes a Phase 1 assessment, which is carried out by a reputable environment consultant. ISO 14001 credentials are helpful, but not enough to secure a positive response from insurance providers. Attention is placed on corporate attitude towards environmental issues – in other words how visible are environmental issues within a company? The integration of environmental issues into corporate strategies, policies and programmes are key factors considered by insurers. Underwriters look at several aspects including internal and published company information on the environment, as well as competencies and responsibilities.

The options available to companies who are seeking to use insurance as part of their risk management strategy fall into two groups:

- Locally available insurances
- The International Contamination Insurance Market

Locally available insurances can be provided by in-country insurers as part of a wider liability package. It must be stressed that this option is becoming less common as general insurers retreat from offering contamination cover due to the presence of a specialist international market. Additionally, this type of insurance is often limited to contamination which results from a ‘sudden and accidental’ act. Therefore, a spill from a ruptured surface storage tank would be covered, but leaks from underground pipes and tanks (which more often result in a greater loss) would not be covered.

Another local option in certain countries, for example the Czech Republic, is to utilise a local pool of contamination insurance. In this case a group of local insurers, who are wary of offering contamination cover, can pool their resources into a single special purpose entity offering specialist cover. Again it should be noted that this cover tends to be limited when compared with that available on the international market, but it also tends to be cheaper. Any companies seeking such cover should carefully review the cover available and compare this to the risk that they seek to address through insurance.

The international market comprises a small number of multi-national insurers who have specialist teams of environmental underwriters to provide specific contamination insurance. These insurers offer cover for new and pre-existing conditions, including cover for on-site contamination and contamination which has migrated off-site. These insurers offer broader cover than the local markets, higher limits and longer policy terms. There is a growing network of underwriters across Europe who can service this market and at present there are no territorial restrictions in their offering.

Further sources of information:

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This paper is the fourth in a series of five to be published by Marsh in co-operation with the Economist Corporate Network and the Economist Intelligence Unit. The papers address the risk management implications of EU enlargement for businesses operating in the eight accession countries of Central and Eastern Europe. After the introductory paper to the series, the second paper focused on consumer protection and the third on employee protection. The final paper will address directors' and officers' (D&O) liability.

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