The Environmental Damage Compensation Fund

Belén Soriano Clavero
Deputy Director for the Technical Area and Reinsurance
Consorcio de Compensación de Seguros

The **Environmental Damage Compensation Fund (the FCDM for the Spanish)** was conceived as a necessary supplement to the financial guarantee that is implemented by means of an insurance contract to protect those operators with the most potential to be polluters, in certain circumstances, with respect to their environmental liability obligations.

This article analyses the legal framework for environmental liability, the financial guarantee and the Environmental Damage Compensation Fund based on the provisions in both European and Spanish legislation.

Remedial measures are intended to restore damaged natural resources or provide an equivalent alternative. As established in article 20 *et seq.* of the Regulations, remedial measures may be of three types: (i) primary, with restoration of natural resources to their basic state; (ii) supplementary, when restoration is not possible, or it takes too long or primary remedy is very costly; and (iii) compensatory, to make up for the provisional loss of natural resources during recuperation thereof.

Liability can be enforced on the operator up to 30 years after the day upon which the event which caused the environmental damage has completely come to an end.

The European Environmental Liability Directive

The Environmental Damage Compensation Fund resulted from the financial guarantee required of operators of professional activities under **Directive 2004/35/EC of the European Parliament and of the Council, of 21 April 2004, on environmental liability with regard to the prevention and remedying of environmental damage.**

This regulation advocates for an administrative regime of strict and unlimited environmental liability should be built into the legal systems of Member States.

The core principle of the Directive is that the operator who causes environmental damage should be declared liable from a financial standpoint (recital 2 of the Directive).

Recital 27 of the Directive refers to the need for Member States to encourage operators to use appropriate insurance or other forms of financial security to provide them with cover against enforceable financial obligations that they might face.

Article 14 of the Directive titled "Financial Security" includes the following aspects:

- It urges Member States to encourage financial operators and institutions to develop financial security instruments and markets to enable operators to cover their responsibilities under the Directive.
- It alludes to reasonable costs and conditions of insurance and other forms of financial security.
- It sets out the approach of the financial security: (i) gradual application; (ii) with a ceiling for the financial guarantee, though not on liability; and (iii) the exclusion of low-risk activities.

On the other hand, article 17 of the Directive determines the scope of temporal application, with obligations arising from the norm being exempted where more than 30 years have passed since the event that caused the damage.

Finally, we should point out that the Directive establishes a special regime for the most potentially hazardous activities (those listed in Annex III) in contrast to other activities as regards the kind of liability (strict or direct), the type of obligation, and preventive, avoidance and remedial measures.

There is therefore no reference at all in the Directive to setting up a fund, although it does actually define elements that will be decisive to creating one:

- Financial liability is discussed.
- There should be financial instruments, with specific mention being made of insurance, capable of responding to such liability.
- Liability extends to 30 years after the occurrence of the event responsible. This temporal reference is key to having a fund available for specific cases to supplement cover from insurance policies.

Pursuant to this Directive, approval was given for both **Law 26/2007, of 23 October, on environmental liability and the Regulations partly implementing Law 26/2007, of 23 October, on environmental liability** (Royal Decree 2090/2008, of 22 December).

Environmental Liability in Law 26/2007 and Royal Decree 2090/2008

For the purposes of examining the scope and functioning of the Environmental Damage Compensation Fund, we now move on to describe the decisive aspects of environmental liability as mentioned in the Law and the Regulations that supplement it.

1. **Sphere of application** (article 3 of the Law) **and Purpose of remedy** (article 20 et seq. of the Regulations).

   The scope of application of the legislation is:

   - For those activities in Appendix III of the Law: strict liability and regarding measures to prevent, avoid and remedy environmental damage.

   - For activities other than those listed in Appendix III, there are two options:

     - Direct liability (where intent, fault or negligence are involved) and regarding measures to prevent, avoid and remedy environmental damage.
     - Strict liability and regarding measures to prevent and avoid environmental damage, without including remedial measures.

   Preventive measures are those taken in response to an event or omission that represents an immediate threat of environmental damage with the aim of preventing such damage as far as possible.

   Avoidance measures are those that, after the environmental damage has occurred, are aimed at limiting greater environmental damage.

   Remedial measures are intended to restore damaged natural resources or provide an equivalent alternative. As established in article 20 *et seq.* of the Regulations, remedial measures may be of three types: (i) primary, with restoration of natural resources to their basic state; (ii) supplementary, when restoration is not possible, or it takes too long or primary remedy is very costly; and (iii) compensatory, to make up for the provisional loss of natural resources during recuperation thereof.

2. Temporal scope of environmental liability (article 4 of the Law).

Liability can be enforced on the operator up to 30 years after the day upon which the event which caused the environmental damage has completely come to an end.

Financial guarantee in Law 26/2007 and Royal Decree 2090/2008

Having covered the basic aspects concerning environmental liability, we look now at the features of the financial guarantee as a prelude to moving on to an analysis of the Environmental Damage Compensation Fund.

1. Setting up a mandatory financial guarantee (article 24 of the Law) **and the mandatory financial guarantee and notification to the competent authority** (article 33 of the Regulations).

The operators in Appendix III of the Law, with the exemptions in article 28 thereof, are obliged to engage in a contract for a financial guarantee for the sum that results from the environmental risk assessment carried out by the operator in line with the methodology referred to in the legislation.

The amount of the mandatory financial guarantee shall include the cost of primary remedy as well as the costs of damage prevention and avoidance. This sum does not imply any ceiling on the liability of the operator, which, as both the Directive and the Law establish, is unlimited. For this reason, operators under the obligation may voluntarily secure their financial liability for a sum in excess of the amount arrived at in their environmental risk assessment. However, the guarantee voluntarily entered into under contract shall not be subject to the requirements and special characteristics defined in the Law with respect to the mandatory financial guarantee.

By the same token, other operators who are not obliged to set up financial security may voluntarily enter into financial guarantees against environmental liability under contract, which likewise shall not be subject to the requirements and special characteristics defined in the Law with respect to the mandatory financial guarantee.

2. Liability covered by the guarantee (article 25 of the Law).

The mandatory financial guarantee must be specifically and exclusively used to cover the environmental liability of operators on the terms indicated by the Law, and separately from other civil, administrative or any other nature liability.

3. Forms of financial guarantee (article 26 of the Law).

The options for the financial instruments that can be used alternatively or as a supplement to cover the mandatory financial guarantee are:

- Taking out an insurance policy: in this case, with a contribution to the Environmental Damage Compensation Fund and including the entitlements coming with such a contribution.
- Obtaining a bank guarantee.
- Setting up an underwriting reserve.

4. Guaranteed parties (article 27 of the Law).

The guaranteed parties are the operator and also sub-contractors, professional partners and the owner of the facilities.

5. Exemptions from setting up the mandatory financial guarantee (article 28 of the Law).

The following operators in Appendix III are exempt from setting up the mandatory financial guarantee:

- Those whose remedial costs are assessed at an amount fewer than 300,000 euros.
- Those whose remedial costs are between 300,000 and 2,000,000 euros, provided that they are members of the EMAS (Eco-Management and Audit Scheme) system or the UNE-EN ISO 14001 (Environmental Management System) standard.
- Those that use phytosanitary products and biocides for agricultural and livestock ends or forestry-related ends.
- Others defined in regulations.

6. Costs covered (article 29 of the Law).

The mandatory financial guarantee must cover the costs of prevention, avoidance and primary remedy.

7. Quantitative limits for the guarantee (article 30 of the Law).

Regardless of the result of the environmental risk assessment carried out by the operator, the mandatory financial guarantee may not exceed 20,000,000 euros, although this does not exempt operators from covering the full costs of prevention, avoidance and primary remedy.

8. Guarantee period (article 31 of the Law) **and Continuity of the cover under the financial guarantee** (article 39 of the Regulations).

The guarantee must have been set up from when the requirement for it becomes effective according to the regulatory framework in effect up until cessation in the activity.

Should the option of taking out an insurance policy have been chosen, the operator shall have to prove: (i) that the insurance policy is in effect and (ii) that there is no misalignment among the various policies relative to the cover periods.

9. Limitations on the temporal scope of the guarantee (article 32 of the Law).

The financial guarantee set up must bear liability for environmental damage that meets the following conditions: (i) it begins in the guarantee period and (ii) the damage becomes evident and the claim against the operator takes place within the guarantee period or the three years following the end thereof.

The basic time references for environmental liability and the mandatory financial guarantee are:

- The operator is liable for environmental damage up until 30 years after the pollution event ceases.
- Operators who are obliged to enter into a contract for a financial guarantee must have it available from when it is required of them up until they cease in their activity.
- The mandatory financial guarantee must bear liability for events causing damage that begin in the guarantee period and become evident and are claimed up to three years after its period in effect ends.
- Should the option of insurance policies be chosen, they must be designed in such a way that there are no gaps in coverage while the activity continues or up to three years after it ceases.

One can therefore note that there is a misalignment between, on the one hand, the cover from policies in mandatory environmental liability insurance, which are effective for up to three years following cessation in activity, and, on the other hand, the temporal scope of environmental liability in the Law, which extends up to 30 years after the pollution event ends even if the activity in question has ceased.

Given this situation, the need arises to create a fund to provide for environmental damage associated with activities that have ceased when the pollution event has taken place within the operator's time in activity but has only emerged after the three-year period during which (as a minimum) they have to be covered by insurance policies.

The Environmental Damage Compensation Fund in Law 26/2007 and Royal Decree 2090/2008

The Environmental Damage Compensation Fund: features

The Environmental Damage Compensation Fund of the Consorcio de Compensación de Seguros (article 33 of the Law and article 44 of the Regulations).

The functions which the Consorcio de Compensación de Seguros (CCS) performs can be of two kinds: insurance-related or other non-insurance public duties.

In the case of its insurance-related functions, these have to be envisaged in the Legal Statute or approved by the Board by a majority of two-thirds of its members.

In the case of its non-insurance public functions, these have to be assigned to it by legislation under article 16. e) of the Legal Statute of the CCS.

In this context, Law 26/2017 assigns to the CCS, as a non-insurance function, the administration and management of the Environmental Damage Compensation Fund, keeping it independent both in financial and accounting terms from the other activities performed.

Pursuant to the aforementioned article 33 of Law 26/2007, the CCS acts as a mere administrator and manager for the Environmental Damage Compensation Fund, the resources of which are independent in a financial and an accounting sense from the other activities in which it engages. Thus, the CCS will not have to defray any payment regarding environmental damage that is charged to the assets of any of its other activities.

Similarly, if we delve deeper into its non-insurance side, we find that the Law stipulates the benefits from the Environmental Damage Compensation Fund are ultimately limited to the whole sum lodged in it.

In accordance with Ministerial Order ARM/1783/2011 of 22 June, as well as with Ministerial Order APM/1040/2017 of 23 October, the mandatory financial guarantee and, therefore, the Environmental Damage Compensation Fund progressively came into effect as from 30 October 2018.

The Environmental Damage Compensation Fund: contributions

The Environmental Damage Compensation Fund of the Consorcio de Compensación de Seguros (article 33 of the Law and article 44 of the Regulations) shall be set up using contributions from those operators who, through being obliged to set up a financial guarantee, take out insurance.

Contributions are remitted by the insurers together with the tariff rates that they apply to their insured for the mandatory financial guarantee cover. In all cases, the beneficiaries and recipients of the Environmental Damage Compensation Fund's resources are exclusively the operators.

The Decision by the Directorate General for Insurance and Pension Funds of 31 October 2018 endorsed the setting of the levy for contributions to the Environmental Damage Compensation Fund at 8 % of the amount of the tariff rate that insurers charge their insured for mandatory financial guarantee cover. This contribution applies to policies that are renewed or taken out from 30 October 2018.

The Environmental Damage Compensation Fund: purpose

The Environmental Damage Compensation Fund of the Consorcio de Compensación de Seguros (article 33 of the Law and article 44 of the Regulations).

The Environmental Damage Compensation Fund is used to extend the cover under insurance policies and on the same terms thereof for activities that have ceased and which have incurred liability for environmental damage caused during the valid life of policies but which become evident or are claimed against after the periods for emerging or claiming that are allowed under the policy (minimum of three years). Furthermore, claims have to be made over the course of, at most, a number of years equalling the time over which the insurance policies were valid, starting from when the effective period of the last policy ended and with a ceiling of 30 years, meaning that the guarantee period of the Environmental Damage Compensation Fund is limited to 27 years for each operator.

The following are excluded from liability for the Environmental Damage Compensation Fund:

- Activities where there was no insurance policy that was valid at the time when the activity ceased.
- Damage caused after cessation of the activity by reason of facilities' abandonment with potential to pollute.
- Damage that would not have been covered had the policy been valid.

The cover from the Environmental Damage Compensation Fund shall, at most, be the arithmetic mean of the sums assured in the last five annual insurance payments starting from the year in which the environmental damage occurred.

Under the Decision of 31 October 2018 by the Chairperson's Office of the Consorcio de Compensación de Seguros endorsing the modelling for the loading in favour of the Environmental Damage Compensation Fund and establishing the procedure for statements and the remittance of monies, insurers have to furnish the CCS with the conditions in the policies for the purposes of cover from the Environmental Damage Compensation Fund.

The Environmental Damage Compensation Fund: present situation

The Environmental Damage Compensation Fund was created following the passing of Ministerial Order APM/1040/2017 of 23 October establishing the dates for setting up obligatory financial guarantees.

The incorporation of insurance policies into the Environmental Damage Compensation Fund is being carried out progressively.

Thus, those activities in Appendix III that are categorised as having priority level 1 in Ministerial Order ARM/1783/2011 have to have a mandatory financial guarantee from 30 October 2018 and contribute to the Environmental Damage Compensation Fund in the context of the first issuance or renewal that takes place as from that date; those classified as priority level 2 will join from 30 October 2019 and, for activities in priority level 3, approval still has to be given for the relevant ministerial order that sets the date where after it is obligatory to obtain a financial guarantee under contract.

In the next few years, it will become possible to run an assessment of the evolution of the Environmental Damage Compensation Fund, being it created as an environmental policy instrument linked to the insurance industry via the policies of insurers and the management and administration of it by the CCS.