

## ENVIRONMENTAL INSURANCE: A SUITABLE FINANCIAL SECURITY TO COVER ENVIRONMENTAL LIABILITY

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According to the 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, an operator causing environmental damage or creating an imminent threat of such damage should, in principle, bear the cost of the necessary preventive or remedial measures. Consequently, its Article 14 provides that Member States shall take measures to encourage the development of financial security instruments and markets by the appropriate economic and financial operators, including financial mechanisms in case of insolvency, with the aim of enabling operators to use financial guarantees to cover their responsibilities under this Directive. Insurance is a very appropriate financial security in order to provide effective cover for financial obligations under this Directive.

### **Environmental liability and environmental damage**

The Directive seeks to ensure that an operator (natural or legal, private or public person) who, in the course of the occupational activity, causes environmental damage is held financially accountable. Thus, it also aims to minimize the risks of environmental damage occurring and, consequently, to reduce exposure to financial liabilities.

The Directive refers to liability for environmental damage, understood as damage to protected species and natural habitats, as well as to water and soil. Regarding the scope of application of this liability, the Directive specifies in Article 3.1(a) that it will apply to environmental damage caused by any of the professional activities listed in Annex III. In this Annex, the professional activities considered hazardous and likely to cause environmental damage are listed. For such activities, objective liability is established, and in order to address this liability, the need to promote the development of financial guarantee instruments is proclaimed.

In the other hand, the Directive points out that it will be also applied to damage to protected species and natural habitats caused by any occupational activities other than those listed in Annex III, and to any imminent threat of such damage occurring by reason of any of those activities, whenever the operator has been at fault or negligent. So, in this last case, it does not establish an objective liability.

Finally, it must be said that this Directive aims at preventing and remedying environmental damage and this does not affect rights of compensation for traditional damage granted under any relevant international agreement regulating civil liability. Therefore, this

environmental responsibility does not interfere with civil liability for environmental damage to individuals' private property, which is the subject of private law.

In short, what is important to emphasize is that operators should have a financial guarantee to cover the objective environmental liability inherent in the activity they intend to carry out. However, despite the clarity of the objectives pursued in this Directive and the much-needed protection of the environment, its results have not reached the expected levels in light of the reports and evaluations carried out after its approval, mainly because it does not establish that these measures must be adopted on a mandatory basis. Deficiencies in its implementation have been identified, and the variability between Member States in terms of its application is highlighted. In this context, it is recommended, among other measures, that it be reviewed and transformed into a European Union regulation in order to achieve more uniform application by Member States without compromising the proper functioning of the internal market. In particular, it is necessary to address the problem posed by the insolvency of operators or the fact that a system of financial guarantees is not made mandatory in relation to certain activities.

### **Some types of financial guarantees other than insurance**

In the Spanish case, Law 26/2007, of October 23, on Environmental Liability transposed this Directive. In order to ensure the repair of environmental damage and cover the costs, its Chapter IV required operators carrying out the activities described in Annex III to establish a financial guarantee. As it has already been highlighted, its purpose is to ensure that the operator has sufficient financial resources to cover the costs arising from the adoption of measures for the prevention, avoidance, and remediation of environmental damage. At this point, the spirit of this Law is to contribute more effectively to achieving the objectives of the Directive, since the establishment of this type of guarantee allows for the remediation of environmental damage and, in turn, promotes preventive measures to avoid such damage from occurring.

This regulation includes three types of financial guarantees: the subscription of an insurance policy with an insurance company; obtaining a bank guarantee issued by a financial institution authorized to operate in Spain; and the establishment of a technical reserve through the allocation of an *'ad hoc'* fund to cover potential environmental damage resulting from the activity, with investments backed by the public sector. These types of financial guarantees can be alternative or complementary to each other. In fact, the most common combination consists of taking out insurance and establishing a bank guarantee.

The bank guarantee must be provided by banks, credit cooperatives, mutual guarantee societies, or financial credit institutions. This type of guarantee allows the guarantor to advance the amount that the economic operator must bear to repair the damages, when he does not assume this obligation. Subsequently, the guaranteed operator, who has benefited from the advance payment by the guarantor, must reimburse the corresponding amount to the guarantor financial institution. This figure has gained little prominence in

practice. In fact, it presents some disadvantages. First of all, the possibility that the guaranteeing bank may be forced to make the payment without entering into a discussion aligns with the nature of environmental liability contained in the LRMA, but, in turn, it could even discourage preventive or damage-reducing actions by the economic operator whose activity causes the harm. From the guarantor's point of view, providing coverage for a long period of time, the complex assessment of environmental risks, and the potential risks being covered complicate the provision of this type of guarantee. Finally, the Spanish regulations governing this figure set out typical rules of insurance practice, which are not very suitable for this type of personal guarantee.

On the other hand, Spanish regulations allow for the possibility of establishing a technical reserve to repair the environmental damage resulting from the exercise of its activities. This provision foresees that the operator sets up a technical reserve that actually functions as a self-insurance, since the operator will ultimately bear directly with its own assets the adverse effects caused by the risk. The establishment of a technical reserve therefore implies the immobilization of economic resources that cannot be allocated to other purposes. Ultimately, although this type of guarantee encourages prevention since the operator can avoid using the reserve if no damage occurs, the immobilization of the asset by the operator is unattractive. In this sense, it is a type of guarantee with little success in practice.

Finally, Spanish regulations provide that the financial guarantee can also be established through an insurance policy taken out with an authorized insurance company. The specialties of environmental liability insurance are determined by the type of asset to be protected, since we are dealing with natural resources, but also by the claim of the affected third party, which could be either the public administration or relevant associations or supranational organizations. In addition to this, one must consider the existence of other particularities such as the temporal scope of liability, strict liability, and the exclusions and limitations established by the law. Another element that characterizes this type of insurance is the existence of the Spanish environmental risk Pool. This Pool is an Economic Interest Grouping that was established in 1994 to manage a reinsurance agreement for the joint underwriting of environmental risks. Currently, this agreement brings together insurance and reinsurance companies with the aim of offering insurance policies tailored to the coverage needs of operators who may be held liable for causing environmental damage. Without prejudice to the concerns that may arise from the collaboration between insurance entities and the centralization of information from the perspective of competition law, the initiative and the project developed by the Pool should be applauded, since environmental liability is not only strict and unlimited, but both the prevention mechanisms and the determination of damage entail extraordinary complexity and can be of such a high value that it would be difficult for a single insurance company to cover their repair, taking technical reserves into account. Ultimately, environmental liability insurance is a specific type of insurance contract aimed at covering environmental damage resulting from the economic or professional activities of the economic operator. This

measure, along with the regulations established in the Spanish legal system, makes it an appropriate tool to cover environmental liability.

In addition, this must be added to the existence of the Environmental Damage Compensation Fund (FCDM). This Fund is administered and managed by the Insurance Compensation Consortium (CCS) independently, both financially and accounting-wise, from the overall activities carried out by the Consortium. The Fund is constituted with contributions from operators who take out insurance to cover their environmental liability, through a surcharge on the insurance contract premium. The FCDM aims to expand coverage for environmental risks once the operator's activity ceases, extending to damages caused during the policy period that manifest or are claimed later, with a limit of 30 years from the termination of the damage-generating activity. It is a very useful instrument to ensure coverage for damages caused by an operator's activity; however, the Fund is not linked to any type of financial guarantee, as it is funded solely by the surcharge on the premium corresponding to the insurance contract to cover their environmental liability. Consequently, the existence of the Fund linked to the purchase of an insurance policy reinforces the idea of insurance being the most suitable financial guarantee to ensure coverage of environmental liability.

To conclude, it is important to emphasize the significance and suitability of the insurance contract for covering environmental damages in light of the Spanish regulation. Additionally, it is proposed to introduce the use of the surety insurance contract among the types of financial guarantees. Finally, it should be taken into account the use of artificial intelligence and the information it provides, manages, processes, and analyzes should be considered, as it can impact prevention systems and risk management tools. In this regard, the parametric policy could be a suitable solution to cover environmental liability.

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