



Insurance cover for
environmental liabilities in
M&A transactions:
W&I and EIL policies



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In acquiring a business or assets, a buyer can be exposed to substantial environmental liabilities arising from historical activities carried out on site prior to completion. In addition, significant environmental exposures may also arise from the activities carried out by the target company post completion. Insurance can assist buyers in this regard via the use of Warranty and Indemnity (“W&I”) or Environmental Impairment Liability (“EIL”) policies. This note provides information about the differences in scope of coverage offered by W&I and EIL policies for environmental exposures in the context of M&A transactions.

When the business being acquired operates in the manufacturing, energy, industrial, chemical, mining or waste management sectors environmental exposures are intrinsic and can be material. However, risks may also arise in relation to operations that may not be immediately considered as involving significant environmental risks as, for example, on real estate, renewables and hospitality transactions.

Liabilities for remediation and clean-up costs and claims arising from third party bodily injuries and property damages from activities causing pollution on, under and migrating from the target site can be associated with ongoing or historical operations, and may be transferred to the buyer as a consequence of the sale of the target site. Arranging for appropriate environmental insurance to be put in place can provide buyers with a higher level of recourse and avoid protracted negotiations on the apportionment of environmental liabilities.

1. W&I and environmental liabilities

Due to the difficulty in identifying the exact point in time when the “polluting event” originated and to the gradual effect that polluting events have over time (often referred to as “long-tail” nature of such risks), the W&I insurance market has traditionally been reluctant to provide coverage for such exposures, limiting the cover provided to the mere legal issues relating to pollution (i.e. compliance with laws, regulations and permitting) if duly investigated in the course of the buyer’s due diligence.

Only in recent years, with the increase in competition in the W&I market and the subsequent increased flexibility of the W&I offering, W&I insurers have gradually started to change this trend covering unknown pollution exposures subject to certain conditions (i.e. a balanced suite of environmental warranties being negotiated, the target/site/plant being considered low risk, and, in renewable energy transactions, a clean phase I environmental due diligence report being available and/or the plant/site being located on a greenfield site). Despite this, the cover provided for pollution by W&I insurers is still limited with W&I insurers normally “cherry picking” the warranties and targets that they are willing to cover.

2. EIL policies: market awareness and comparison with cover in W&I policies

EIL policies have been offered by the European insurance market for about two decades. Market awareness of environmental issues has increased due to the increasing number of US investors in Europe (who are used to getting significant recourse in the US for historic environmental liabilities), the entry into force of the EU Directive 2004/35/EC and the overall tightening of regulatory environmental frameworks at the national level. As a consequence of such increased awareness, the EIL market has grown steadily and gained a level of stability and maturity, with EIL policies being now available in almost all EU markets. Awareness has also increased the need for the parties to manage environmental liabilities in M&A transactions, leading to a significant growth in number of EIL policies bound in relation to M&A transactions year on year.

Often used in combination with W&I policies and to integrate the gaps in cover of pre-existing public liability or property insurance products, EIL policies can provide cover for both unknown and known risks falling under the following liability regimes:

- contaminated land;
- water pollution;
- environmental damages; and
- civil liabilities arising from pollution.

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Liabilities arising from the above regimes can be covered by two different types of EIL policies:

- site pollution policies: covering potential pollution risks at a specific site or location; and
- contractors’ pollution policies: covering potential pollution risks caused by development works.

The table below illustrates the major differences in environmental cover provided under W&I policies and EIL policies:

	W&I policies	EIL policies
Insured	<ul style="list-style-type: none"> • Buying entity or selling entity under the SPA. Interest in the policy can be assigned to others (e.g. lenders). • Policy only transfers in onward acquisition if the new buyer acquires the buying entity under the original SPA. 	<p>Policy can insure on a site-specific basis and cover can be extended to parties with an interest (e.g. buyer, seller, lenders, or contractors). The major benefit (particularly in cases where a portfolio is being sold) of having the target insured is that in the event of an onward sale of either the insured site(s) or certain specific sites the policy transfers as part of the target’s assets to the new buyer.</p>
Basis of cover	<ul style="list-style-type: none"> • Limited to breach of warranties on a contractual damages basis. • Coverage is only as broad as the warranties that are negotiated. • Defence costs are covered. 	<ul style="list-style-type: none"> • No relationship with the SPA. Trigger is the occurrence of a pollution related event covered by the policy. EIL policies provide cover for: <ul style="list-style-type: none"> - Clean-up costs - Remediation costs - Property damages costs - Bodily injury costs <p>The scope of cover extends to changes in law, legal defence costs and business interruption costs.</p> <ul style="list-style-type: none"> • Policies can be improved over time (e.g. if an exclusion has been included because of the identified existence of a contingent risk, the policy can subsequently be “updated” and the cover improved if sufficient information to give the insurer the comfort required to cover such exposure becomes available at a later stage or if the risk is adequately mitigated/remedied).
Target sectors	<ul style="list-style-type: none"> • W&I insurers typically will only cover low risk sectors e.g. renewables. • Clean environmental DD and balanced suite of environmental warranties typically required (see section 1 above). 	<ul style="list-style-type: none"> • EIL markets underwrite businesses from all sectors irrespective of the specific risk profile of that sector. • EIL insurers analyse the DD and will specifically flag known pollution events to be covered or excluded.
Risks covered	Historical unknown risks only.	<ul style="list-style-type: none"> • Both historical and future liabilities. • Cover for both known and unknown risks.

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Commercial Terms	<ul style="list-style-type: none"> • Limit of cover for the environmental issues is either set at the W&I policy limit or at a sublimit thereof. • Excess set at W&I policy excess. Typically sizeable (e.g. 0.5-1.5% of Enterprise Value). • De minimis applies • Premium: <ul style="list-style-type: none"> - operating businesses: 0.8-2% of limit insured. - renewables and real estate: 0.5-1% of limit insured. 	<ul style="list-style-type: none"> • Limits can be set per site or aggregated under an umbrella policy covering all sites. • Low excess levels usually matching the materiality threshold applied in the due diligence (i.e. from £5,000). • No de minimis. • Premium significantly cheaper than for W&I policies (typically in the range of £50,000 to £200,000).
Period of cover	2 to 5 years.	<ul style="list-style-type: none"> • Typically 5 to 10 year although cover can be offered for up to 15 years in some cases. • Cover can be offered on an annually renewable basis.
Standard exclusions	<ul style="list-style-type: none"> • Known matters. • Disclosed items. • Contents of DD reports (and of data room). • Forward looking warranties. • Losses related to sanctioned people or countries, criminal fines or penalties or punitive damages. • Standard SPA limitations (e.g. change of law, change of use, buyers voluntary acts). 	<ul style="list-style-type: none"> • Fines and penalties. • Change of use. • Redevelopment and voluntary investigations.

3. Examples of EIL policy use – case studies

Below are three examples of recent transactions which illustrate the use of EIL policies:

- **acquisition by a PE Fund of a chemical business with a long operational history (>EUR3bn).** The buyer was required to provide assurance to lenders that the environmental risks were adequately covered. However, the buyer had limited access to the target business. An EIL policy was put in place to cover the environmental risks at the site. Post completion the buyer gained access to further information and was able to remove some of the exclusions that were initially imposed at signing;
- **acquisition by a corporate of a steel stockholding business owning a site in an environmentally sensitive location with a long history of steel work.** Past site investigations identified a known issue relating to a former chimney base used to store waste oils. No further site investigations were completed as part of the acquisition due diligence and the waste oil issue remained a potential liability, the presence of which could not be ascertained. In this instance, an EIL policy was purchased

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and both unknown and known risks (the waste oil issue) were transferred from the target to the insurer subject to the site remaining in use;

- **acquisition by specialist real estate developers of a closed power station(>EUR50m)**. The seller required all environmental liabilities to be passed on to the buyer, but was concerned that the buyer would not have the financial strength to bear such liabilities, in which case such liabilities would have been transferred back to the seller. EIL insurance was put in place to back the buyer's indemnity, including additional cover in relation to any buyer's liabilities associated with taking over an environmental permit and carrying out demolition works (which involves significant volumes of asbestos).

4. EIL underwriting process

The underwriting process is generally more straightforward than the W&I underwriting process. Although the length of the process will depend on the nature of the risk, the EIL underwriting process is structured as follows:

1. execution of a confidentiality undertaking with us;
2. provision of information to us relating to the activities of the target (e.g. information memorandum, teaser etc.), the SPA (or understanding of intent for the transfer of environmental liabilities), and any available due diligence environmental documentation (e.g. reports, desktop surveys, etc.);
3. risk marketing exercise:
 - we select the most suitable insurers to approach in respect of the transaction and enter into a confidentiality undertaking with them;
 - we send a request for terms or "submission" to the selected insurers;
 - we produce a report detailing all of the terms received and the cover positions offered by each insurer. The report will also include a recommendation based on the pricing and scope of coverage offered;
4. selection of the insurer by the client;
5. assessment by the insurer of the documentation provided by the client and, where necessary, issuance of questions or request for additional information/clarification;
6. negotiation of the policy; and
7. inception of policy at signing/completion.

The whole process normally takes between 5 and 8 working days.

For more information on EIL policies, please contact:

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