ENFORCEMENT UNDERTAKINGS: THE SHIFTING LANDSCAPE OF ENVIRONMENTAL CRIMINAL LIABILITY

Insurance response to environmental enforcement undertakings

www.bclplaw.com

INTRODUCTION

In recent years, there has been a fundamental change in the way that breaches of environmental law in England and Wales are dealt with.

This change is summarised as follows:

(a) The number of prosecutions is decreasing;

(b) The quantum of fines, where prosecutions do take place, is increasing; and

(c) The use of alternative enforcement options (in particular, enforcement undertakings) is increasing.

Many of the changes have been the result of legislative, policy and guidance reforms (targeted especially at the Environment Agency, but also with potentially wider reaching implications for other regulators).

In this article, we focus on the rise in the use of enforcement undertakings, and on the associated insurance implications.

ENFORCEMENT UNDERTAKINGS

Enforcement undertakings are a form of "civil sanction" introduced by the Regulatory Enforcement and Sanctions Act 2008 (which implemented reform recommendations associated with a flexible approach to regulatory sanctioning/enforcement).

They can be used by environmental regulators (in particular the Environment Agency, but also Natural England and Natural Resources Wales) as an alternative to prosecution in relation to certain alleged environmental offences.

It is important to highlight at the outset that the enforcement undertaking pathway is not available for all alleged environmental offences (although the scope for following this pathway has been expanded over the years – for example, very significantly, in respect of environmental permitting offences). The Environment Agency publishes Offence Response Options documents which list out categories of offences for which the enforcement undertaking pathway is available.

An enforcement undertaking is, in essence, a binding agreement in relation a breach of environmental law created by a voluntary offer from the potential offender and subsequent acceptance of this offer by the relevant regulator. Once accepted, the regulator cannot then prosecute for the breach of environmental law.

The potential offender's voluntary offer should include a range of different actions which the offeror proposes to take to secure future compliance, remediation/restoration, consultation with and compensation of those affected, environmental benefit/improvement, and payment of the regulator's costs. The regulator considers the offer in the round, and decides whether to accept or reject. Offers in respect of breaches that are expressly denied, or that have resulted in very serious pollution incidents or that involved intentional conduct, are unlikely to be accepted.

The Environment Agency regularly publishes transparency data regarding enforcement undertakings it has accepted. From this data, it is possible to review previous examples of actions which offerors have proposed to take. In general, they contain reasonably generous offers to:

- Take steps to ensure that the breach does not recur (e.g. fixing faulty equipment, introducing new procedures, staff training);
- Remediate any pollution and restore the environment;
- Identify, consult with and compensate affected third parties (e.g. local angling clubs);
- Make donations to charities aimed at relevant environment improvement; and
- Pay the EA's costs.

Enforcement undertakings have become very popular because they sit well with both regulators and the regulated community.

- Regulators like them because of their "reverse regulatory" nature, i.e. that, rather than the regulator actively expending effort to investigate and pursue enforcement action against the passive regulated sector, the regulated sector actively comes forward itself with a proposed suite of appropriate actions for the regulator's acceptance. Regulators also like them for the wide environmental benefits that are created – far wider than could be created by enforcement powers used in the traditional way.
- That enforcement undertakings are popular with environmental regulators is demonstrated by the following comment from Peter Kellet, Director of Legal Services at the Environment Agency: *"If an offender offers an EU and it is accepted by us it binds the offender into putting things right quickly and locally by preventing a recurrence often while making a substantial donation to an environmental restoration project linked to the offence. The evidence is astonishing. Where EUs have been accepted (and we don't accept those that are too serious or will not prevent a recurrence for example) then there has been almost no reoffending, save only for large water companies who appear to continue to offend. We will continue to prosecute the most serious offences but EUs offer a regulatory intervention that is far faster in dealing with the offending behaviours and putting things right locally in our communities."*[1]
- Regulated companies like them because they provide an opportunity to actively manage the ramifications of a potential environmental offence quickly, finally and with minimum disruption and adverse publicity. The alternative is a long period of uncertainty while the regulator investigates and decides how, if at all, it wishes to enforce, and the financial and publicity repercussions of a prosecution.

Enforcement undertakings now outnumber prosecutions. Although not formally confirmed by any statistics, it seems very likely that some are being offered and accepted in relation to breaches that would never otherwise have resulted in formal regulatory prosecution or the formal use of remediation powers. In other words, the regulated community is "over offering" in order to take control in relation to their environmental breaches.

---

1 https://www.castledebates.org.uk/storage/events/1581938558a_Peter%20Kellet%20UKELA%20Law%20Society%20Slides%20%20Final.pdf

Despite the benefits, popularity and flexibility of following the enforcement undertaking pathway (where available) for an alleged environmental offence, there are several practical questions raised by the nature of enforcement undertakings conceptually when it comes to insurance.

INSURANCE IMPLICATIONS

The rise of enforcement undertakings (and the decline in the number of prosecutions for environmental offences) presents important questions for insurance:

a) To what extent are enforcement undertakings insurable in principle?

b) Are enforcement undertakings covered by existing insurance policies available in the London market?

To what extent are enforcement undertakings insurable in principle?

Whilst losses arising from civil liability (breach of contract, tort) are insurable, it has long been a rule of UK public policy that fines and penalties for breaches of criminal law are uninsurable. This raises the question as to whether enforcement undertakings are civil or criminal in nature.

They are an example of a civil sanction, introduced by the Regulatory Enforcement and Sanctions Act of 2008. If we look at the origins of civil sanctions (Regulatory Justice: Making Sanctions Effective, 2006[2]) they have, at least in part, a deterrent and punitive rationale. Enforcement undertakings only come about where an environmental offence may have been committed by an offender and, when accepted, render the relevant non-compliance immune from prosecution. Countering these arguments is the fact that they are termed "civil" sanctions (not "criminal" sanctions) and they are not described as 'fines' or 'penalties' in the regulations that introduce them. Hence, there are jurisprudential arguments either way as to their nature and so, in the absence of case law, there must be an overarching question mark as to whether enforcement undertakings really are insurable at all.

Looking from another angle, a fundamental requirement of insurance is that cover is only available for fortuitous losses – i.e. losses which fall outside the insured's control. If a business approaches an environmental regulator to obtain an enforcement undertaking, it is difficult to see how the costs arising from this process can be fortuitous. Hence, the only enforcement undertakings which are insurable as a matter of principle would seem to be those that are offered in response to a definite steer by an environmental regulator, and where criminal sanctions are a clear alternative. It is apparent that relatively few enforcement undertakings are currently being offered in these circumstances.

A final point to note here is that, even if enforcement undertakings are insurable in principle, the relevant regulator may not be impressed to learn that the burden of an enforcement undertaking will be passed from offender to insurer. In some cases, it may not be convinced that the offender is learning its lesson, and refuse to sanction the enforcement undertaking. There is no firm indication from the regulators yet as to what their stance might be here but, if they take routine exception, any cover that does exist in principle for enforcement undertakings could be rendered meaningless in practice.

Are enforcement undertakings covered by existing insurance policies available in the London market?

Standard environmental insurance policies currently available in the London Market do not specify that cover is provided for the costs arising from enforcement undertakings. Consequently, there is uncertainty as to whether existing policies would respond to the potentially insurable losses related to an enforcement undertaking. The following considerations are of note.

Cover only usually triggers where a formal notice or claim has been served on the insured by a third party or environmental regulator (e.g. Environment Agency, Natural England). This could

[2] Regulatory Justice: Making Sanctions Effective, Professor Richard Macrory, November 2006

arguably be satisfied for enforcement undertakings initiated or suggested by the regulator where criminal sanctions are a clear alternative, but not in situations where the insured has taken the initiative.

Another aspect is that as the analysis in Section 2 shows, enforcement undertakings encompass a broad range of expenditure. Some of these types of loss are the same as ones which the London Market covers when legal liability is incurred by an insured – e.g. the cost of remediating pollution, restoring environmental damage, civil and criminal legal defence costs, and paying the reasonable enforcement costs incurred by an environmental regulator. However, some elements of enforcement undertaking expenditure are not similar to those usually covered, and very likely fall outside of cover, in particular:

The making of donations to local charities and other local organisations. Donations are of uncertain amounts and vary from case to case (from £5k to £400k in the EA's published list of undertakings[3]). The methodology for determining how much the polluting party should offer to donate to a local charity is neither apparent nor explained in the publicly available information. Hence, an insurer would not be able to estimate the maximum probable loss (which is used to calculate premiums) relating to the payment of a donations, making them uninsurable in practice.

The costs of an insured taking precautionary measures to avoid recurrence of pollution incidents. For parties which have caused or allowed pollution to occur in the past, this expenditure would be prudent but it would also be discretionary (i.e. not required as a matter of law). Consequently these preventative costs cannot be recouped from insurers. Insurance provides indemnity for losses which have materialised – not the costs of avoiding future losses.

POINTS FOR INSURERS, INSUREDS AND BROKERS TO NOTE

Enforcement undertakings are becoming a well-used alternative to criminal sanctions in the environmental sphere. Business have taken to them, due to the enforcement certainty that they provide, and are increasingly happy to offer them even for the most minor of infringements that might not normally attract significant attention. Regulators, for their part, seem happy with this direction of travel.

Businesses do need to be careful, however, at least as far as insurance is concerned. As the above paragraphs indicate, they should not assume that enforcement undertakings are covered by environmental policies. Subject to enforcement undertakings being treated as civil in nature, and to regulators being comfortable with insurers "picking up the tab", neither of which are a "given", it is concluded that:

a) Proactive enforcement undertakings are not insurable. Triggered by the insured, the element of fortuity (an essential aspect of insurability) is absent. Nor would they be insured under standard policy terms, as there is no formal notice or claim.

b) Reactive enforcement undertakings could be insurable in principle, as there is a greater element of fortuity. Further, they could be insured under standard policy terms, as there may arguably be a formal notice or claim.

c) Some costs comprising enforcement undertakings (e.g. remediation costs, regulator's enforcement costs) are covered under standard policy terms.

[3] https://www.gov.uk/government/publications/environment-agencys-use-of-civil-sanctions/enforcement-undertakings-accepted-by-the-environment-agency

d) Other costs (e.g. donations to local charities, precautionary measures) are not covered under standard policy terms.

Insureds and their insurance brokers should check how insurers view expenditure arising under their existing environmental insurance policies. Brokers would be well advised to check this point not just for the benefit of their clients, but also to protect themselves against the risk of being sued if they negligently fail to identify it as a risk of concern.

Environmental insurers should consider their approach to enforcement undertakings carefully. Sitting alongside traditional criminal, civil and regulatory liabilities, enforcement undertakings are a new (and arguably very important) exposure, and it may be sensible for a variety of reasons to consider extending cover to match it by adding an endorsement to the policy to make it clear that, and how, this protection is provided. This is easier said than done, however, as certain aspects of an enforcement undertaking do go completely against the grain of traditional insurance principles and coverage. Blanket cover would be very difficult indeed to offer, but perhaps cover for limited aspects of enforcement undertakings agreed in certain circumstances, at least to the fullest extent permissible at law, with full insurer oversight, could be offered.

Co-authored with Ashfield Risk Transfer Solutions:

BCLP are very grateful to Stephen Sykes (Ashfield Risk Transfer Solutions) for his contributions in co-authoring this briefing.

Getting in touch

When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

London
Adelaide House, London Bridge
London EC4R 9HA England

Aidan Thomson
Tel: +44 (0)20 3400 4075
aidan.thomson@bclplaw.com

Sam Levy
Tel: +44 (0)20 3400 3082
sam.levy@bclplaw.com