



The Centre For Business Relationships,
Accountability, Sustainability and Society

WORKING PAPER SERIES No. 30

Bank Lending and Environmental Liability



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Abstract

This paper reviews the increasing attention given by banks to environmental considerations in the course of bank lending. Proceeding from an examination of legal liabilities, the paper concludes that prospects of liability falling on the bank, while not impossible, are remote, assuming that the bank acts responsibly. On the other hand, indirect impacts of liability rules - such as the impact of laws on a client's ability to repay a loan - are increasingly pervasive. This is true to the point that prudent lending policy must take account of environmental considerations.

About the BRASS Centre

In 2001, Cardiff University won £3.1 million in research funds from the Economic and Social Research Council to develop a Research Centre for Business Relationships, Accountability, Sustainability and Society (BRASS). The Centre is a joint venture between the University's Schools of Business, City & Regional Planning and Law. It brings together the three Schools' existing research expertise on issues of sustainability, business ethics, company law, corporate reporting and business communication.

The Centre started work in October 2001 under the leadership of Professor Ken Peattie of the Business School, Professor Terry Marsden of the Department of City and Regional Planning and Professor Bob Lee of the Law School. The funding of the Centre covers an initial five-year period, but this should just mark the beginning of BRASS' contribution to creating more sustainable and responsible businesses locally, nationally and globally.

Published by

The Centre for Business Relationships, Accountability, Sustainability & Society (BRASS)
Cardiff University
55 Park Place
Cardiff CF10 3AT
United Kingdom
<http://www.brass.cf.ac.uk>

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ISBNs 1 904393 64 0 (print)
1 904393 65 9 (web)



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Introduction

Economic and environmental considerations are inevitably inter-related. In general terms the use of the environment by business as a receiving medium for industrial wastes and by-products creates an obvious example of a social cost. To date, although there has been control of such activity in the form of authorisations to pollute, only very recently have there been moves to internalise environmental costs. Even now, while there have been moves to advance the 'polluter-pays' principle and to make increasing use of financial and market instruments to ensure responsible environmental behaviour, corporate accounting for environmental activity is in its infancy.

For the last ten years, those involved in corporate finance have been more concerned about environmental costs and liabilities.¹ But there has been a feeling that these would arrive with some big bang, and the fact that this has not happened has given way, at times, to complacency. Environmental regulation is incremental. Targets are rarely relaxed. They simply become tougher. Politicians proceed at a rate which seems politically feasible, but increasingly, as with climate change; the evidence shows that this may not be quick enough. Scare stories from the USA have led to lenders pursuing passing concerns with some element of environmental regulation, which is perceived as having a potential direct impact on the banking sector itself. Of much greater concern should be the continual move to call business into account for the true cost of its activity upon the environment, because of commercial consequences of such regulation.

Credit risk

Slowly, the impact of environmental regulation is beginning to affect the viability of business. To take an example from the UK, the introduction of air pollution controls in the Environmental Protection Act 1990 (EPA) had a major impact on foundries leading to the closure of some 25% of such facilities in the UK. Those businesses regulated under Integrated Pollution Control (IPC) suddenly found that the cost of authorisation alone for a complex process was a major impact on the business. IPC has now given way to its new European variant, the Integrated Pollution

¹ B Richardson 'Ethical Finance in Britain: A Neglected Prerequisite for Sustainability' (2003) 5(2) Environmental Law Review 109.

Prevention and Control (IPPC) provided under the European Union Directive 96/91.² The Directive has been transposed into UK domestic law by the Pollution Prevention and Control (PPC) Act 1999 and subsidiary legislation, the Pollution Prevention and Control (PPC) Regulations 2000, SI 1973 as amended.³ The system of IPPC drags yet more enterprises into its net with effect from October 1999 and applies to new or substantially changed installations and also to existing installations from no later than October 2007.

At the heart of the old IPC regime was the concept of BATNEEC – the use of best available techniques not entailing excessive costs. Through this device there is an implied operating condition always to use the best procurable technology to minimise pollution. The proviso about excessive cost is of little practical use to new projects which are being funded, and in relation to existing operators, it affects the time at which the measures will be required, rather than the requirement itself. Nonetheless under the IPPC, the present concept is that of BAT (Best Available Technology)⁴, in spite of Parliamentary attempts to restore the NEEC. In fact this does not mean that costs to industry will not be taken into account, but it is an indication of the worries of the industrial lobby in the continual upgrading of requirements.

In all areas of environmental regulation, there are now regular processes of change with major sectoral impacts. The scrap metal industry was brought clearly within the realm of waste regulation for the first time in 1994, and the impact on that sector is still being felt as slowly the regulatory noose tightens.⁵ In general terms it has led to a restructuring of the metal recycling industry as smaller units have closed as they were ill-equipped in terms of location and resources to meet the conditions attaching to waste licensing. Some of the major waste definition cases have involved this sector See *R (on the application of Mayer Parry Recycling Ltd) v Environmental Agency* (C444/00) 2004 Env. L.R 6. Geography may make a difference especially proximity to groundwater following the Groundwater Regulations 1998, which took

² It is expected that Directive 96/91 would be fully implemented in all EU member states by October 2001

³ The PPC regulations implements Directive 96/91 in so far as it applies to installations in England and Wales. Separate regulations apply to installations in Scotland and Northern Ireland and to the offshore oil and gas industries. See DEFRA Integrated Pollution, Prevention and Control: A Practical Guide, Edition 3 2004.

⁴ This is based on the BAT reference documents (BREF) developed by the EU for each section covered by IPPC. Up to date versions of these documents can be obtained from the European Integrated Pollution Prevention Bureau Website at <http://eippcb.jrc.es/pages/FActivities.htm>

⁵ On 3 November 2003, the End of Life Vehicles Regulations 2003 (SI No. 2635) came into effect. It transposes relevant provisions of The End of Life Vehicle (ELV) Directive (2000/53/EC) into UK law. The ELV directive sets a target for 95% of vehicles by weight to be reused or recovered (including energy recovery) by 2015.

effect on 1 January 1999.⁶ These regulations implement a European Directive of 1980, which the UK Government resisted by inactivity to the point at which the European Commission commenced Court proceedings against it. This seeks to protect groundwater from pollution by potential releases of substances which could prove dangerous to groundwater. Looking to the future, it is already possible to predict stricter controls on certain sectors. The increasing concern at the impact of endocrine disrupters⁷ could lead to the banning of certain substances (as with CFCs) and even the closure of businesses.

Along similar lines, the EU is increasingly concerned with integrated product policy. This is an attempt to create supply loops whereby industries putting goods on the market take responsibility for their recycling upon disposal by the consumer. These measures also concern themselves with product design and composition. This can lead to certain manufacturing processes having to undergo radical revision. Regulatory compliance costs should not be underestimated. The Food Standards Agency recently estimated that the costs of new EU labelling regulations, introduced amid concerns in relation to the use of genetically modified organisms in foodstuffs, would shift the cost of food labelling from £90m to £720m on the back of traceability requirements in the new Regulation.⁸

Environmental taxes are one of a number of ‘so-called’ market instruments introduced to influence behaviour in relation to environmental pollution. Certain of these (such as aggregates tax) may affect particular industrial sectors. Others (such as landfill tax) may be more widespread in their impact, significantly heightening costs to all commercial and industrial users of landfill disposal. The fact that regulation can cause significant distortions in markets is well illustrated in the waste sector at present. The EU Landfill Directive demands that co-disposal of different sorts of waste must cease. By the end of 2004, it will no longer be possible to dispose of hazardous waste by land filling this with other wastes.⁹ In due course this will heighten the price of disposal of hazardous waste, which, one imagines, will largely be to incineration rather than to

⁶ The Regulations extend long-standing controls over discharges, in particular those contained in the Water Resources Act 1991, to hitherto unregulated disposals to land. See DEFRA (2001) Guidance On The Groundwater Regulations 1998. Available at <http://www.defra.gov.uk/environment/water/ground/guidance.htm>

⁷ Ongoing work is being carried out by the European Commission on the impact of endocrine disrupters on human health and the environment. See the ‘Second Implementation Report of the Community Strategy for Endocrine Disrupters’ SEC (2004) 1372.

⁸ See Regulatory Impact Assessment - Food Labelling (Amendment) (England) Regulations 2003, Monday April 2003. Available at <http://www.food.gov.uk/foodindustry/regulation/ria/ria2003/foodlabelling2003riafinal>

landfill.¹⁰ In the interim, however, gate prices for landfill disposal have fallen sharply as operators seek to use up spare landfill capacity before the deadline. Hazardous waste incineration options have declined, even though in due course these will be in high demand.

It is important, in this context, to look beyond UK regulation, much of which implements international agreement planned over many years. There are many examples of major business consequences flowing from environmental concerns, including (*inter alia*) the phasing out of ozone depleting substances, the redesign of vehicles and electrical equipment, the changes in the market for fuels, and the growth industries built on recycling or recovery at the same time as the reduction of the market in packaging materials. Nor are we only concerned with regulation. There has been a rapid growth of toxic tort claims based upon alleged environmental disorders. There is also talk in Australia about future mobile phone litigation¹¹, on the basis of suggested adverse health effects associated with their use. In short there is little room for those concerned with business finance to ignore the widespread impact of environmental concerns and the consequent regulation of activity.¹²

Security risk

Turning to a more particular problem for lenders, environmental due diligence has become a more significant element in commercial transactions. The reason for this is not surprising and relates to the adverse consequences of poor environmental management, and the huge costs associated with environmental clean-up. Lenders naturally like to take comfort in the value which attaches to the business assets and will generally seek security over them. Devaluation of such security could have a major impact on the banking community. There remains a capacity for this to happen across certain business sectors, if the true cost of environmental liabilities attaching to the business was calculated, as those who advocate green accounting would wish.

⁹ The Landfill (England and Wales) (Amendment) Regulations 2004 (SI 2004/1375) transposes the criteria and procedures on acceptance of waster at landfills as contained in Council Decision 2003/33/EC (the Decision).

¹⁰ See the Landfill (England and Wales) (Amendment) Regulations 2005/1640 which further amends the Landfill (England and Wales) Regulations 2002 (SI 2002/1559).

¹¹ See 'Cancer Watch on Mobile Phones' Sunday Herald Sun, August 10, 1997 quoted in Electronics Forum 1(3) Article 14. The paper reported that a large Australian law firm, Slater and Gordon was preparing for action against mobile phone makers on behalf of people claiming to have contracted cancers or other illnesses from regular mobile phone use. However the Australian Communications Authority in 2001 issued a Guidance Document titled 'Mobile Phones: Your Health and Regulation of Radiofrequency Electromagnetic Radiation.' stating that there was no substantiated evidence to establish that mobile phones caused harmful health effects. Discussed in D Maisch, 'Children and Mobile Phones... Is There a Health Risk? The Case for Extra Precautions.' (2003) 22(2) Journal of Australasian College of Nutritional & Environmental Medicine 3 at 7.

Socially responsible investing (SRI) and social, ethical and environmental disclosure (SEED) are becoming increasingly important issues for business in the UK. The government has been putting increasing pressure on companies to improve disclosure in these areas. Tony Blair challenged the top 350 companies to produce social and environmental reports by the end of 2001, (of which only a quarter did so) and in September 1999, the Combined Code, commonly known as the Turnbull Report¹³ was issued, to which all UK listed companies must comply. Following this, measures were introduced to encourage SRI in the form of the Pensions Review. The Pensions Review, effective as of July 2000, called for institutional investors to consider their position on SRI, and introduced a legal requirement to disclose statement of investment principles to articulate their stance on the matter.¹⁴

The role of financial institutions has been recognised in the London Principles. These have been commissioned by the Department for the Environment, Food and Rural Affairs (DEFRA) and carried out by the Corporation of London and Forum for the Future's Centre for Sustainable Investment. These were produced in time for the World Summit on Sustainable Development in 2002 and identify the role of UK financial services in progressing sustainable development, with particular attention being given to the role of SRI and SEED. Elsewhere in the City, the Association of British Insurers (ABI) has recently issued guidelines¹⁵ and called on institutional investors to give greater regard to SRI principles and for companies to report on important SEE issues that affect their business. In June 2002 a Private Member's Bill¹⁶ sought to require companies to publish reports on their social, environmental and economic impacts. Although it failed, legislative intervention is probable in the near future. The recent White Paper, Modernising Company Law (Cm 5553), implies greater environmental reporting on the part of large companies, since it demands that larger companies produce an "*operating and financial review*" (OFR). The importance of all of these developments is that they begin to demand that companies

¹² Supra note 1

¹³ Internal Control: Guidance for Directors on the Combined Code, ICAEW/1999. Available at <http://www.icaew.co.uk/viewer/index.4m?AUB=TB216342&tb5=1>

¹⁴ The Occupational Pension Schemes (Investment, and Assignment, Forfeiture, Bankruptcy etc.), Amendment Regulations 1999, cl.2 (4), (S.I 1999 / 1899). These Regulations are commonly called the SRI Disclosure Regulations.

¹⁵ Disclosure Guidelines on Social Responsibility 2001. The guidelines which focus on the annual reports of companies rather than their listing particulars have been widely adopted by life insurance companies, fund managers and institutional investors.

¹⁶ The Corporate Responsibility (CORE) Bill was subsequently dropped after its first reading on June 19, 2003. Another private member bill (Performance of Companies and Government Departments (Reporting) Bill similar in contents to the CORE bill was also introduced into Parliament in January 2004. This bill sought to make provision for the production and publication of annual reports on the social, environmental and economics impacts of companies and Government departments. It was also dropped after its second reading in March 2004.

take proper account of environmental impacts by the company including historic liabilities for the sites that they occupy. The danger for banks in relation to their security interests is not merely the catastrophic single site, causing the bank to release its security and walk away, but that the realisation of the true costs of pollution affects the entire portfolio of mortgaged properties.

In addition to wider questions about how one might account for environmental liabilities, there are more particular problems which could attach to individual sites over which security is held. Problems could arise on any site in which the remediation costs of the site outstrip the value of the site once restored. This problem, often leading to 'orphan' sites is becoming more common, and it may become more so as a result of the new contaminated land regime (Part IIA, EPA 1990).¹⁷ This places a duty upon local authorities to inspect for contaminated land and to effect its remediation. It remains to be seen how proactive local authorities will be in cleaning up land, but they have produced inspection strategies highlighting priorities for site clean up. It seems sensible to assume that where the strategies or post-strategy inspections target sites for future clean-up, there will be a dramatic effect on land value. Moreover the Part IIA regime largely requires historic owners (polluters) of the land to meet the cost of remediation, the impact on business will be uneven and difficult to predict.

In the event that an appropriate person does not respond to a remediation notice by undertaking the work on the site, the authorities will have the power to enter onto the land and effect the clean-up as required by the remediation notice. In the past, this type of power in the hands of a local authority has not always been exercised partly because of inertia, but largely because of a lack of any opportunity to recover the costs expended. Here, however, there is a duty on the authority to act, but more importantly it is backed by a statutory charge which will attach to the land together with mechanisms to recover the cost over a period of up to 25 years. This raises the interesting prospect that some of the public sector led remediation may be backed by the private sector finance. More worryingly for banks, it is likely that this may rank as the first charge on the land by virtue of its status under statute – see *Westminster City Council v Haymarket Publishing* [1981] 2 All ER 555.

In addition to the contaminated land regime, regulations under the Pollution Prevention and Control Act¹⁸ introduce the requirement of site remediation under surrender of the licence. Below the paper considers some of the problems already posed by the requirement in the area of waste licensing, but for now it is sufficient to note its impact on land value. It will inevitably sharpen the focus upon problems of contamination at industrial facilities, and lenders may wish to consider the impact on reinstatement costs upon the value of land subject to a security interest. In the 1990s, a claim against Mott Macdonald in respect of the over-run costs above the original estimate for remediation at the Chatham Dockyards was settled prior to the appeal against a Court award of £18.5m.¹⁹ This illustrates the size of these problems. In fact the claimants' original estimates of quantum were much larger than this figure.

Liability risk

This raises the most worrying, though not the greatest area of risk for lenders – that they may be liable in their own right for environmental damage caused by others. This is a remote prospect both under the UK and European law. Note, however, that lenders do not have an absolute exclusion from liability under Part IIA of the EPA. Whilst it is not likely, it must remain a theoretical possibility that a bank with sufficiently wide powers under the covenants of a loan agreement could exercise a sufficient degree of control so as to engage in activity which might be said to '*cause or knowingly permit*' pollution. These trigger terms apply not merely in relation to responsibility for substances in, on or under contaminated land, but in a number of other regulatory contexts (see, for example, s33 EPA 1990 or s85 Water Resources Act 1991).²⁰

The major problems concern the lender's activity in the event of default. The power of local authorities and the Environment Agency to serve remediation notices demanding restoration of the land is an obvious matter of concern for any lender seeking to enforce security rights. The

¹⁷ Part IIA was inserted into the EPA 1990 by Section 57 of the Environmental Act and provides the regulatory regime for the identification and remediation of contaminated land.

¹⁸ Pollution Prevention and Control (England and Wales) Regulations 2000 (S.I 2000/1973)

¹⁹ See (1) Urban Regeneration Agency (A Body Corporate Known as English Partnerships) (2) English Partnerships (Medway) Ltd v. (1) Mott Macdonald Group Ltd (2) Mott Macdonald Civil Ltd (3) Mott Macdonald Structural & Industrial Ltd (4) Mott Macdonald Ltd (1999). QBD (Judge Thornton QC 5/10/99. LTL 22/2/2000 (Unreported Elsewhere))

²⁰ S.33 of the EPA 1990 deals with environmental offences relating to depositing, recovering or disposing of controlled waste without a site license or in breach of its conditions while s. 85 of the Water Resources Act 1991 creates the offence of discharging to controlled waters matters which are poisonous, noxious or polluting.

'appropriate person' to clean up the site will be the person who 'caused or knowingly permitted' the pollution 'to be in, on, or under the land'.²¹ However, where this person cannot be found, responsibility will revert to the owner of the land.²² It follows that banks will not wish to find themselves as a mortgagee in possession of land, once such a company is in insolvency – and hence cannot be 'found'. The Act defines owner as not including a mortgagee not in possession, but by implication it treats a mortgagee in possession as an owner – a position which accords with case law (see for example *Maguire v Leigh on Sea UDC* (1906) 95 LT 319).²³ The prospect of being fixed with the responsibility for the remediation of sites should cause lenders to carefully review their strategies prior to taking any steps with respect to the land that is subject to a charge. See for instance the case of Midland Bank (now HSBC). The Bank became directly liable for a clean-up of a site they had repossessed. The owner of the site had used part of it to deposit over 13,000 used tyres (many of which were contaminated with oil.). It would appear that Midland did not carry out an inspection of the site prior to repossession. Once in possession, the Bank was served with a remediation notice from the regulatory authority to remove the tyres and restore the site.²⁴

It is a widespread but mistaken assumption on the part of banks that they are exempt from liability under Part IIA of the EPA 1990. This is not the case. The exclusions written into the Guidance are not absolute. In the absence of any other Class A responsible party, the remaining party will bear liability if it has caused or knowingly permitted pollution of the land. It is unlikely that the bank will have caused pollution, but the test here is one of strict operational cause and is not fault based (see *Alphacell v Woodward* [1972] AC 824 and *Empress Cars v National Rivers Authority* [1998] 1 All ER 481). This leaves open the possibility that in a situation of financial crisis the bank assumed operational control of the enterprise and itself 'caused' the damage. Such liability has been known in the USA (see *US v Fleet Factors Corporation* (1990) 901 F 2d 1550, (1993) 821 F Supp 707). The discussion here is of the prospect of a bank being found liable as a class A liable appropriate person. There has been

²¹ Deemed as Class A appropriate persons under the Part II A regime.

²² Owners and/or occupiers of the land are considered as Class B appropriate persons who may be required to clean up the land in the absence of Class A appropriate persons.

²³ See however the Canadian case of the Attorney- General (Ontario) v. Tyre King Tyre Recycling Ltd. (1992) 8. C.E.L.R (N.S) 202

²⁴ Case referred to in 'Lender Liability: Environmental Risk Management' in Lovells, Business Restructuring and Insolvency (2000) 1 at 7 Available at <http://www.aboutremediation.com/PDFS/Environmental%20Issues%20for%20Lenders%20-%20GSL.pdf> -

much speculation concerning a bank's liability as a shadow director.²⁵ It must be said that on the basis of case law to date this seems somewhat unlikely (*Re Hydrodam (Corby) Ltd* (1992) Times 19 February and *Tridos Bank NV v. Dobbs* (2004) EWHC 845 (ch))²⁶ but the shadow director concept is not necessary under Part IIA to create a route to liability.

There are however two other potential routes to liability. One is Class B liability as owner or occupier of the site. This is considered below, but the other possibility is that the bank '*knowingly permits*' the contaminants to be in, on or under the land. It may be sufficient that a bank has available to it considerable elements of control in the covenants of a loan agreement, and is armed with the knowledge of environmental shortfalls on the part of the borrower company.²⁷ Might the failure to intervene in such a circumstance amount to knowingly permitting the pollution? In strict legal theory this might seem to be the case. The problem with this is that possible intervention by the bank, such as treating the breach as an event of default and accelerating repayment, might make matters worse rather than better.²⁸ It has also been suggested that the recent European Court of Justice case (*Van de Walle and Others*)²⁹ may have an impact on the design and application of national regimes like Part IIA "*seeking to allocate responsibility for the remediation of contaminated land.*"³⁰ A possible implication of this case is that the owner or occupier of land contaminated by substances that could be regarded as constituting waste or where the contaminated soil itself is regarded as waste may be treated as a holder of waste and could face criminal liability for keeping controlled waste or knowingly causing or permitting controlled waste to be kept in land without an appropriate waste management licence.³¹

²⁵ See Gower & Davies, *Principles of Modern Company Law*, 7 ed (2003) 197

²⁶ In the *Tridos Bank* case at 226, the court dismissed the claim that the bank had become a shadow director by reason of its having assumed management of a project development project.

²⁷ See comments on this in Richardson B, *Ethical Finance in Britain: A Neglected Prerequisite for Sustainability*, (2004) 5(2) *Enviro* 109 Lexis Nexis

²⁸ See Sheppard C et al, *The Statutory Contaminated Land Regime - Consideration for Lenders* (2000) *Financial and Credit Law* 2.9 (1) LexisNexis where this is extensively discussed.

²⁹ Case C-1/03 [2004] 7 September 2004 (not yet reported)

³⁰ See the case comment: O McIntyre, 'The All-consuming Definition of 'Waste' and the End of the 'Contaminated Land' Debate? - Van de Walle and others' (2005) 17(1) *Journal of Environmental Law* 109

³¹ *Ibid* p 123.

Insolvency

Insolvency practitioners also need to exercise caution. This is lest they find themselves fixed with a problem for which there is no immediate solution but from which the Environment Agency will not let them walk away (such as abandoning a half-completed landfill site – see the recent case of *In Re Mineral Resources* [1999] 1 All ER 746).³² This case was appealed (sub nom. This case was applied in *Wilmott Trading (No.1)* (1999) 2 BCLC 54) and followed in *Wilmott Trading (No.2)* (2000) B.C.C 321. In *Wilmott Trading (No.1)*, the Court of Appeal allowed that a waste licence can be disclaimed as onerous property under the Insolvency Act 1986. The Court did not say that this would be permitted in all cases,³³ however, and it may be that the waste licence will continue to subsist.

Beyond that, although the receiver will act as agent of the company, this does not guarantee freedom from personal liability for environmental offences which occur or continue during the receiver's time in the company. Nor is the position of the receiver, or, for that matter, the lender clear at the point at which the company goes into liquidation. However, the Insolvency Act 1986 may put a halt to proceedings against the company, and it is now clear that this may include criminal proceedings for environmental offences (see *Re Rhondda Waste Management Co* (2000) 3 WLR 1304).³⁴ Note that in relation to contaminated land, there is a statutory exclusion from personal liability available to the insolvency practitioner (s78X(3))³⁵ in relation to remediation costs, unless the requirement for remediation

“is a result of any act done or omission made by him which it was unreasonable for a person acting in that capacity to do or make”.

³² The court held that in the absence of strong factors to the contrary, the interest of the environment should take precedence over the interest in a fair and orderly winding up of companies. See the following case comments-The scope of liquidator's power to disclaim waste management licence. *Insolv.L.*1999. 5(Aug). 211-214. Who gets to clean up after insolvency? *W.M* (2004) Jun, 60 -61. Insolvency and environmental principles: a case study in a conflict of public interests. *Env. L.Rev.* (2001) 3(2), 90-112. Should insolvent companies pay?The search for environmental principles. *Env.Liability* (2001) 9(1), 11-17.

³³ See *In Re Celtic Extraction Limited (In Liquidation)* (2001) Ch.475. The Court of Appeal did not follow *In Re Mineral Resource* or its earlier decision in the *Wilmott* case. It held that termination of the Waste License was permissible by statute under s.35(11) and further added that s.178(3) of the 1986 Insolvency Act could only be excluded by express provisions.

³⁴ See case comment Waste Offences and Insolvency. *Env. L.M* (1999) 8(9), 7-9.

³⁵ Part IIA EPA 1990

This leaves open the central question of when it will be unreasonable for an insolvency practitioner to omit to take charge of a problem of contamination. But when that stage is reached (e.g. because conditions at the company may result in other environmental offences such as that under s85 of the Water Resources Act 1991) then not only might that conduct amount to 'knowingly permitting' but the immunity offered by s78X(3),(4) will be lost.

In some instances, financial provision may be required to make provision for damage caused to the environment by an enterprise, the best example in the UK being in relation to waste under the 'fit and proper person' criteria of s 74 of the EPA 1990. Banks are commonly involved in this process through the provision of guarantees or bonds. However, a recent case, Environment Agency v Hillridge Ltd, Waste Point Ltd, and City of Bradford Metropolitan Borough Council [2003] EWHC 3023,³⁶ has shown that care is needed in the construction of financial provision if funds are to be available to fund clean up in the event that the company is liquidated. In the Hillridge case, Environment Agency made an application under s112 of the Insolvency Act 1986 in relation to monies held in a trust fund, the purpose of which was to ensure the restoration and aftercare of the landfill site, following the liquidation of the waste company operating the site. Almost £400,000 was held in the account at the point when the liquidators disclaimed both the landfill site and the accompanying waste management licence. Bradford MBC determined that the site was contaminated under Part IIA of the EPA 1990, posing a risk to human health, and the Agency hoped to secure access to the funds in order to effect some site clean-up. The Court held that, in disclaiming the waste management licence, the liquidators were taken to have disclaimed any interest in the fund. This was available to meet the liabilities of Hillridge as the holder of the waste management licence, but that company had been liquidated. Court ruled that the money was not available to the Environment Agency. This was because in order to undertake work on the site the waste management licence would have to be extant, but the disclaimer had brought an end to the waste management licence. In the view of the Court, this meant any money remaining in the trust deed would have to vest in the Crown as *bona vacantia*, on the basis that there was no-one available to assert a claim to the monies in the trust fund.

³⁶ See case comments: Waste Financial Provision and Insolvency. Env.L.M (2004) Jan, 1-2, Who Gets To Clean Up After Insolvency? W.M (2004) Jun, 60-61 and Financial Provisions and Waste Companies in Liquidation. ENDS (2004) 348, 46.

Finally, it is important not to overlook the common law liabilities which may attach once a bank has taken possession of a contaminated property. Under the contaminated land regime, "owner", in relation to any land in England and Wales, means:

"a person (other than a mortgagee not in possession) who, whether in his own right or as trustee for any other person, is entitled to receive the rack rent of the land, or, where the land is not let at a rack rent, would be so entitled if it were so let".

By implication this definition accepts that once in possession the mortgagee will be taken to be the 'owner' of the facility. Thus the careless enforcement of a security interests could easily land the mortgagee with Class B liability under Part IIA. Indeed this is a scenario that becomes more likely since, if the mortgagor has gone into liquidation, then the most likely Class A party disappears from the liability picture. Taking possession of premises in this way may give rise to other potential liabilities – such as adopting a nuisance already occasioned by the property.

Project risk

This final section of the paper explores the risks caused to banks by environmental regulation in one particular context that of project finance. Environmental considerations have the capacity to impact upon the entire range of risks connected to a project, and not merely the physical risks such as land contamination or the difficulties caused by flooding. For example the technical capacity of the project may be influenced by environmental considerations such as air emission standards. The economic forecast of the entire project may also be altered by demands for re-routing away from areas of conservation, or that cleaner fuel is used. Even political risk may arise out of the pressure by NGOs on Government to change their policy towards the project or to tighten the legal framework under which the project operates.

The particular issue here is that as non-recourse financing, the funders will be especially reliant upon the success of the project. Yet we see a growing number of projects beset by problems attaching to the environmental impact of the project. Two examples would be BP's Bakū-Tbilisi-

Ceyhan oil pipeline formally opened in May 2005³⁷ and the Fortis' Chalillo dam in Belize. Clearly what matters with such projects is not the credibility of the project's sponsor but the viability of the project itself in the face of environmental opposition. In such instances, the environmental regulation in developing states will be less onerous than that in the company's home jurisdiction, but this leaves the rather more tricky problem of the environmental standard to which the borrower ought to follow, and indeed the standard that the lender might wish to demand.

This is not to say that no law will apply. Clearly the host country may have environmental regulation, however rudimentary, and along with environmental regulation world-wide, this may tighten rapidly in the lifetime of the project. Indeed if in a position to do so, the borrower might seek guarantees from the host state indemnifying against compliance costs in meeting changes in environmental law affecting the project. Similarly there may be relevant international law obligations where the activity under the project is covered by a treaty to which (say) the Host State is bound. These obligations could include mandatory requirements but may take the form of much softer legal instruments such as recommended action or incentives for particular forms of conduct. On June 4, 2003, ten international banks³⁸ adopted what has come to be known as the Equator Principles. These voluntary principles are based on the IFC Environmental and Social standards and apply globally to development projects in all industry sectors with a capital cost of \$50 million or more.³⁹ Equator Banks are required to ensure that projects are carried out in a socially and environmental responsible manner. A recent survey concludes that "the Equator Principles are a shining beacon for responsible banking and generally have had a positive effect not only on the attitude of lenders to social and environmental considerations in project financing but also in other areas of banking."⁴⁰

³⁷ Despite serious social and environmental concerns raised by local community groups, national and international NGOs and the Dutch Commission for Environmental Impact Assessment, the IFC and the EBRD approved the BTC pipeline as 'best practice.' See Paton N, Pipeline Opens New Oil Route To West, The Guardian, May 26, 2005, p 15.

³⁸ Thirty three institutions have so far adopted the principles. Further information available at <http://www.ifc.org/ifcext/equatorprinciples.nsf/Content/EquatorNews>

³⁹ M Forster et al, 'The Equator Principles- Towards Sustainable Banking? Part 1' (2005) 20(6) Buttersworths Journal of International Banking and Financial Law 217.

⁴⁰ Banking on Responsibility , Part 1 of Freshfields Bruckhaus Deringer Equator Principles Survey 2005: The Banks (July 2005) Available at <http://www.ifc.org/equatorprinciples>

Such obligations may have significant impact on the financial underpinnings of the project, or their impact may be slight owing to poor monitoring and enforcement in practice. Finally there may be other more practical legal considerations such as the requirements of institutional lenders such as the World Bank, demanding model practices or even covenants or contracts.⁴¹

Oddly enough, the lack of sophisticated environmental regulation may make the project task easier rather than harder. For example, we tend to take it for granted that the planning system provides a framework for consultation with those people likely to be affected by the project. However, where there are no such systems, what then are the responsibilities of the company? And what should the bank demand to be assured that opposition to the project will not threaten its viability? Similarly where there is a lack of clearly prescribed environmental factors, it would be idle to think that none will apply. But it will be for the lenders and borrowers to agree on what might be necessary to avoid liabilities that might threaten the future viability of the project by (e.g.) jeopardising required re-financing. In relation to such liabilities, it is worth bearing in mind the expansive approach of the English appellate courts in allowing actions to proceed where injury is occasioned by a project such as mining and where the claimant in a personal injury case would be denied effective redress in the host state jurisdiction (see *Connelly v RTZ Corporation* [1997] 4 All ER 335).

Where the project is financed or co-financed by one of the major development institutions, it is likely that not only will they set the standards⁴² and that these may be independent of those that might be imposed by environmental regulation in the Host State. This is likely to result in a thorough appraisal of the project plan, and may affect the project management in terms of the timetable, especially if there are conditions precedent, and the costs of ongoing monitoring. Commercial co-financiers need to be aware of the likely demands of institutional lenders. The presence of institutional lenders may mean that they rather than the borrower are the target of

⁴¹ Apart from setting out the amount of the loan/credit, World Bank Loan/Credit Agreements normally include undertakings of the borrower to carry out the project and to take other actions necessary to ensure that the project is implemented in accordance with requirements under Bank policies including its safeguard actions. One of such safeguard actions is the Environmental and Social Safeguard Policies. See the World Bank's Safeguard Policies Website at <http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/EXTPOLICIES/EXTSAFEPOL/0,,menuPK:584441~pagePK:64168427~piPK:64168435~theSitePK:584435,00.html>

⁴² IFC's Procedure for Environmental and Social Review of Projects (December 1998). IFC is presently conducting a review of this procedure. Further information is available at <http://www.ifc.org/enviro>

objections by NGOs.⁴³ In the absence of available legal remedies to halt the development (see the decision of the Privy Council in *Belize Alliance of Conservation Non-Governmental Organisations v (1) The Department of the Environment (2) Belize Electricity Co Ltd* Times (25 September 2003)⁴⁴ environmental NGOs may decide that pressure on (e.g.) the World Bank is the most effective route of opposition. Any such backlash may clearly impact adversely on commercial co-financiers. Having said all of this the involvement of an institutional lender may often be in the interests of the commercial lender. This is because such involvement will give the project credibility and will bring considerable experience both of project appraisal and background issues relating to the Host State.

Clearly the ambit of due diligence widens in the context of an international project. Considerable thought needs to be applied to the foreseeable impacts of the project and the subsequent effects on the project's cost base and running costs. The due diligence exercise must be conducted with sensitivity to local conditions and problems as well as wider international ramifications. It may be difficult to assess the borrower's environmental audit data given the problems of distance and the different context in which environmental risk will need to be assessed. Moreover, risk management options may be limited if traditional devices, such as indemnity or insurance cover are unavailable, and options for security are limited to the project assets. Considerable care will need to be taken in the use of conditions precedent, and to warranties and covenants in the loan documentation. However, in the case of later default of environmental covenants, it is unlikely that sensible remedies will be available to the lender. It is unlikely that the lender would wish to accelerate payment on this account, particularly in the early days of the project. Thus the benefit of good due diligence may lie in affecting the operating conditions of the project at planning stage rather than in providing for environmental protection once the project is operational.

⁴³ For instance, in January 2003, the Colavecchio Declaration was launched by over a 100 civil society organisations. It appeals to private financial institutions to acknowledge their responsibility in fostering social and environmental sustainability. Further information is available from www.banktrack.org

⁴⁴ Reported also in [2004] UKPC 6 and [2004] Env.LR. 38. The Privy Council treated this appeal as one of competing interests and took the view that in the absence of an undertaking in damages, it would be inappropriate to "halt a major project which is of real importance to the economy of Belize." See further Canworth, Lord Justice, , 'Protection of the Environment: At Home and Abroad' (2004) 16(3) Journal of Environmental Law 315

Conclusion

This provides a brief overview of the increasing number of reasons why lenders ought to take an ongoing interest in the environment. The effects of environmental regulation upon lenders may be direct or indirect. Direct liability will not prove common and can be avoided with good advice. Indirect impacts in terms of a customer's ability to service obligations or reductions in the anticipated value of security interests are more problematic. Nonetheless at all stages of a lending transaction it makes considerable sense to take steps to minimise environmental risk.

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ISBN 1 904393 65 9