ENVIRONMENTAL LAW

Liabilities of Lenders

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INTRODUCTION

On the occasion of the Earth Summit, a group of 30 International banks issued a statement committing themselves to an operational policy of pursuing environmental protection. They pledged to integrate environmental risk into the 'normal checklist of risk assessment and management' and to view the environmental practices of their customers as a 'key factor demonstrating effective corporate management'.

The Earth Summit, the United Nations' Conference on Environment and Development, in Rio de Janeiro in June 1992, was the culmination of massive international interest in the environment and development and will be a watershed event with its declarations, treaties and agenda for change. The financial community, like many industries and industry groups, recognised the political, economic and community imperatives to be involved in the Rio Summit and accordingly adopted the concepts and language of the Rio documentation. The attached advertisement by the Co-operative Bank, which appeared in a supplement to the *Financial Times* on 2 June 1992 (to mark the Earth Summit) is typical of the response. The signatories to the bank statement commit the banks to 'the best practice of environmental management' in their internal operations, to the 'integration of environmental considerations into internal operations and business decisions' and to update 'management practices, including accounting, marketing, risk assessment, public affairs, communication and training to incorporate relevant developments in environmental management'.

The positive tone of these statements reflects the shift in focus which has occurred since the last time I spoke to the Banking Law Association in 1991. At that time, the focus was on criminal liability following new legislation and on a series of cases in the United States highlighting potential direct liability for financial institutions for clean-up costs. The cases suggested liability merely where a financial institution was concerned in the management of a borrower. There was also a great deal of concern about potential personal liability for directors and the 'deep pocket' syndrome - the policy that environmental liability should be borne by an appropriately 'deep pocketed' private beneficiary of the property to which the liability attaches.

Although I was in Rio for the Earth Summit and was aware of the bank's statement I have referred to above I am afraid I do not have a copy. I am indebted to Robert G Lee, visiting Professor at Queensland University of Technology for his references to the document which I have quoted above and for a comprehensive and thoughtful article entitled 'The Obligations of Lenders to Remediate Contaminated Land - A Comparative Analysis' which has just appeared in the *Environmental and Planning Law Journal*, April 1993 at page 97. I commend Professor Lee's article to you as it canvasses the current legislation concerning contaminated land in the United States, the United Kingdom, the European Community and Australia. Professor Lee's general views are essentially the same as the views I propose to put to you, ie that banks and financial institutions have responded to environmental risk for reasons of fundamental business concerns and a sense of corporate responsibility, rather than having been coerced into responses. On the contrary, whilst the US EPA and Australian politicians have responded to the legitimate concerns of financiers (ie that financiers may be fixed with liability in such a way that lending business would be threatened) the record shows that, apart from the administrative actions on the part of the US EPA and the NSW EPA, there has not been any serious attempt to rectify the current legislative situation and indeed the legislation which has been introduced recently has continued the position.

Environmental Laws can affect financial institutions in several ways:

1. by imposing liability on the financial institutions in respect of secured property;

2. by imposing liability on borrowers which may affect the ability of the borrower to service its debts;

3. by affecting the value of property secured to financial institutions; and

4. by imposing liability on financial institutions as landowners in their own right.

This paper will discuss the liability of financial institutions in respect of secured property and current moves to clarify that liability. It will then briefly discuss the more indirect effects of environmental matters. Finally, it will outline ways in which financial institutions can minimise their exposure to environmental risk.

THE FIRST PHASE

In Australia, laws concerning environmental liability have been in place for many years.

The recent prolific phase of environmental legislation is commonly associated with the rise in awareness of the environment as a political concern coinciding with the environmental disasters, international conferences and agreements that took place from the late 1980s and into the 1990s.

In New South Wales, for example, the *Environmental Offences and Penalties Act*, 1989 consolidated existing legislation (particularly from the 1960s and 1970s) such as the *Clean Waters Act*, the *Clean Air Act* and the *State Pollution Control Act*. It also created a number of new offences to supplement existing offences. Most notable of those was the series of 'tier one' offences for intentional or negligent harm to the environment. Those offences now carry maximum fines of up to $1 million for corporations, as well as fines of $250,000 and imprisonment for individuals, including directors and managers of corporations. In addition the courts are given extensive power to make orders including the power to 'freeze' a company's assets. Similar legislation was introduced in other States and countries.

Prior to and following the introduction of that legislation, the concern for the environment became quite prominent. Corporations and their directors and managers began to focus increasingly on potential criminal liability associated with their business activities and the properties on which those activities were carried out.

Australian environmental laws generally impose liability on owners and occupiers of property (that is, those in 'control' of property) and not simply those who actually, whether by action or omission, cause environmental harm. This topic has been canvassed at length in recent years and most financial institutions are aware of the legal arguments in this regard. I do not propose to consider those arguments in detail here. However, the wide way in which the laws are currently drafted, directed significant attention towards the liability of financial institutions and speculation arose that lenders could be exposed to liability in the course of their operations.

This speculation was reinforced by case law in the United States where courts, considering statutes similar to those in Australia, found very limited degrees of control sufficient to entail direct liability in a lender.

Probably the most alarming case was **United States v Fleet Factors Corporation** (901 F 2d 1550, 17 July 1990), in which a Circuit Court of Appeals held that a secured creditor may incur liability by participating in the financial management of a facility to a degree indicating merely a 'capacity to influence' the treatment of pollutants at the facility. Fleet Factors' security included a textile facility and all of its equipment, inventory and fixtures. The allegation was that Fleet Factors, in arranging the sale of equipment and fixtures pursuant to its security, authorised the removal of drums of toxic chemicals and dislodged asbestos contaminated material. The court held that the lender had 'capacity to influence' the activities of the company and, hence, was bound to pay clean-up costs. The court also suggested that a secured creditor could be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect pollutant disposal decisions if it so chose.

In another case reported shortly thereafter, **Bergsoe Metal Corporation v East Asiatic Company** (9th Circuit, 9 August 1990) a secured creditor was found not liable in a different Appeals Court. The court held that a creditor must, as a threshold matter, exercise actual management authority before it can be held liable for action or inaction which results in the discharge of pollutants. Merely having the power to get involved in management, but failing to do so, was not enough.

When the United States Supreme Court and the Supreme Court unanimously refused to review the case (1991 111 S Court 752), this was taken to mean that the wide interpretation of lenders liability in **Fleet Factors** was good law.

In addition to these cases and a number of other United States cases, a Canadian decision in 1991 seemed to confirm the trend of making lenders potentially responsible for environmental claims against borrowers. In **Panamerica de Bienes and Servicos v Northern Badger Oil and Gas Limited** (Alberta Court of Appeal, 12 June 1991, unreported) the court held that orders by regulatory authorities on a receiver of bankruptcy in relation to prevention of environmental degradation, in effect took priority over payment to secured and unsecured creditors.

In **O'Neill v QLCRI Inc** (750 F Supp 551) the court held that where a lender is aware of environmental violations on secured property but fails to impose conditions in the loan relating to remediation of those violations, then it can be claimed that the lender has aided the borrower's violations, regardless of whether the lender has entered into possession of the property.

Clarification of liability - USA

The range of cases in the United States, the considerable lobbying on behalf of financial institutions and the concerns of regulators such as Federal Deposit Insurance Corporation and the Resolution Trust Corporation which act as conservators and receivers of failing or failed insured depository institutions led to attempts to clarify the extent of lenders liability under environmental laws.

The US Environmental Protection Agency issued a draft ruling on lender liability on 5 June 1991 and requested public comment. The final ruling which defines and specifies the EPA's position on this issue insofar as certain statutory elements (namely, the secured creditor exemption) in the *Comprehensive Environmental Response, Compensation and Liability Act* (CERCLA) were concerned, was issued in April 1992. While the rule is not statutory, it does provide some degree of certainty for United States lenders in assessing environmental risks and also provides some guidance for Australian lenders.

In formulating the rule, the US EPA sought to balance a variety of competing interests, attempting to shield financial institutions from liability where they hold indicia of ownership as protection for a security interest, but at the same time ensuring that the EPA does not inadvertently shift to the taxpayer the cost of poor loan decisions. In its explanatory preamble to the rule, the EPA made it quite clear that it did not intend to provide protection to financial institutions from the ordinary commercial risk assumed by a financial institution that a security's market value may not be sufficient to cover the borrower's debt.

Ultimately, the EPA sought to 'reconcile a holder's need to manage, oversee, or otherwise act in a manner consistent with holding ownership indicia as protection for a security interest, with the EPA's duty to clean up waste sites and recover public funds spent in remediating those sites from those responsible'.

After publishing the rule in its proposed form, the EPA received over 350 comments on it from representatives of banking, trade and industry groups, environmental groups, individual banks and lending institutions as well as individuals. The EPA considered that the 'overwhelming majority' of the comments were supportive of attempts to address the issue of lender liability administratively. It perceived a broad based consensus for the overall approach in the proposed rule.

The rule in its final form affords protection to financial institutions from potential liability arising out of environmental risk management activities. It allows the holder of a security interest a fairly broad range of activities prior to entering a transaction, during the course of the loan and in workouts and foreclosures without attracting liability, provided that the holder does not participate in the management of the facility. Given the detailed consideration of the issue by the US EPA it is useful to report some of the activities referred to in the ruling as a guide to 'management' activity by a bank.

The ruling provides that lenders will not attract liability simply as a result of:

(a) actions taken prior to or at the inception of a transaction. This is because the financial institution cannot be considered to be an owner or operator of a facility at that stage. Accordingly, a lender will not attract liability simply by requiring or undertaking pre-loan inspections, requiring the borrower to come into compliance with environmental laws prior to entering the transaction or requiring the borrower to clean up a facility as a condition precedent to a loan;

(b) policing activities during the course of a loan such as requiring a borrower to undertake a clean up during the course of the loan, requiring a borrower to comply with environmental laws during the course of a loan and requiring assurance from the borrower about such compliance; and undertaking compliance monitoring by periodic inspections throughout the course of the loan. The EPA recognised these practices as becoming customary among financial institutions in order to ensure that their loans are not secured by contaminated property;

(c) work out activities prior to foreclosure such as restructuring or renegotiating the terms of the security, payment of additional rent or interest, exercising forbearance, requiring or exercising rights pursuant to an assignment of accounts or other amounts owing to the lender, requiring or exercising rights pursuant to an escrow agreement pertaining to amounts owing to a lender, providing specific or general financial or other advice or guidance and exercising any right or remedy the holder is entitled by law or under its agreement; and

(d) foreclosing on a property and maintaining the business carried out on it, provided that certain steps are taken within twelve months following foreclosure to sell the property. Those steps include listing the facility with an agent or advertising it for sale on at least a monthly basis and not outbidding, rejecting or failing to act upon an offer for fair and reasonable consideration for the facility (unless otherwise compelled by law). The key issue is whether the financial institution was acting in a manner consistent with seeking to recoup the outstanding loan obligation by actively seeking to sell or otherwise divest itself of the property.

Essentially, the US EPA agreed that covenants which seek to ensure that a facility is operated in an environmentally sound manner merit protection insofar as they facilitate common policing activities consistent with the environmental objectives of environmental legislation, and have the effect of ensuring that the value of the security is not impaired by contamination. It warned, however, that financial institutions must not 'overstep the bounds of the rest of management participation'.

Similarly, with respect to foreclosure, the EPA accepted that financial institutions should not be required to refrain from foreclosing or to shut down ongoing businesses each time that they do foreclose. However, it stressed that foreclosure by financial institutions is a voluntary act and financial institutions are never actually required to foreclose. Ultimately, the EPA considers that the issue of whether a financial institution determines that it should foreclose because it is commercially desirable depends on the facts of each case, as does the question of whether there is a commercial need to maintain the activities on the property as a going concern.

The US EPA simply accepts that foreclosure and continuing operation of facilities do not by themselves entail liability. They are consistent with the manner in which financial institutions ordinarily operate. The aim of the rule is to protect lenders from being exposed in their normal course of business.

The rule clearly specifies, however, that a lender attracts liability if it:

(a) exercises decision-making control over the borrower's environmental compliance such that the lender has undertaken responsibility for the borrower's hazardous substance handling or disposal practices; or

(b) exercises overall and day-to-day management control of the borrower's enterprise with respect to environmental compliance of all or substantially all of the operational (as opposed to financial or administrative) aspects of the enterprise.

Most importantly, the US EPA rule stressed that the 'mere capacity to influence' standard of liability for lenders is **not** the standard adopted by the EPA in assessing whether a lender participates in the management of a facility. The rule expressly states that the mere capacity or unexercised right to control facility operations does not attract liability unless the lender **actually** participates in the management of the facility.

Although some commentators considered that the rules administratively overruled the **Fleet Factors** case in this regard, their view was not shared by the EPA. Indeed the EPA rejected the view of many commentators that the **Fleet Factors** case established a 'mere capacity to influence' test as a basis to impose liability on a lender. Instead, the EPA characterised **Fleet Factors** as adhering to the test of actual involvement in the management of the facility and as having simply raised the question of the amount or extent of involvement that would be sufficient to support any inference raised by the lenders capacity to influence operations.

(For a comprehensive consideration of the EPA rule, see generally 57 Federal Regulation 18344 on which the above discussion is based).

Clarification of liability - Australia

As in the United States, the issues facing financial institutions in Australia generally fall into two areas:

(a) environmental liability associated with existing portfolios, transactions entered into at a time when the environment was not a prominent issue; and

(b) environmental liability associated with current and future portfolios where banks are aware of environmental issues and the risks and responsibilities associated with them at the time that the banks enter into the transactions.

The *Australian Financial Review* has recently carried articles on the problems facing financial institutions arising from contaminated land provided as security at a time when business and the community were not fully aware of the problem of environmental damage. In one article, it was estimated that banks may be faced with a cost of approximately $1 billion in writing down contaminated sites (see Rosy Mobbs, 'Banks Face a $1 Billion Green Alert' *Australian Financial Review* 3 March 1993 pp 1-2).

I refer to those articles and correspondence because they emphasise that the problem has not gone away and that there is still a strong lobby pushing the deep-pocket syndrome. RL Burritt, a visiting scholar at Griffith University, wrote in a letter published in the *Financial Review* on 15 March 1993:

> *'It is most disappointing, but not unexpected, given recent banking debacles, to read about the industry holding out a begging bowl to the Federal and State Governments once again ... the banks want bailing out of the potentially high costs associated with environmental damage to sites under their control. ... Banking Industry leaders (should) reconsider their stance, and demonstrate to others their acceptance of responsibility for environmental, as well as economic, actions.'*

Much has been made of developments which have been taking place to clarify the liability of financial institutions, but, despite the lobbying of bodies such as the Australian Bankers Association, consistent environmental laws which clearly state the limits of lenders' liability do not appear to be imminent.

This can be illustrated by reference to recent developments in Queensland and New South Wales.

New South Wales

In New South Wales, the Minister for the Environment foreshadowed in August 1991 that the second phase of environmental legislation in New South Wales would include a consolidation of existing pollution control statutes and a review of the legislative framework. He stated that the government intends to address the 'question of the liability of persons who lend money to enterprises but have no operational role in the activities of that enterprise'.

He envisaged that lenders should not be subject to liability for pollution caused by an enterprise if they have done nothing more than advanced money to that enterprise by normal commercial forms in some legal fashion and have taken no role that would have led to the creation of environmental problems. However, Mr Moore also warned that the Government has no intention of excusing a lender that takes an effective management role by intervening or, for example, appointing a receiver or manager to an enterprise (see Second Reading Speech for Protection of the Environment Administration Bill No. 2 by Mr Moore, Minister for the Environment, August 1991).

Unfortunately, this second phase of legislation has not yet been drafted.

The NSW EPA, however, released draft prosecution guidelines last year stating that lenders may in limited situations be technically liable for prosecutions because they could be considered owners or occupiers of property.

The guidelines attempt to bring into a balanced focus the reasons for broad environmental liability. The guidelines state:

> *'In criminalising breaches of environmental laws a primary, though not the sole, aim of parliament is deterrence. By extending criminal liability to a wide range of people who may be involved in some way with environmental breaches, eg ... directors and managers of corporations, the legislation generates increased awareness and responsibility for environmental performance ... . Potential liability, however, does not mean automatic prosecution.'*

In its brief consideration of the issue of lender liability, the draft guidelines maintain that 'the guiding principle for the EPA is the culpability of defendants in relation to the offence. More than technical legal liability will be necessary as a pre-requisite to prosecution'.

The good news for the financial community is that the draft guidelines go on to state that:

(a) in the absence of such culpability, the EPA will not proceed against lenders in normal commercial loan transactions for tier one offences (including offences for aiding and abetting tier one offences); and

(b) the EPA will not proceed against lenders with 'management capacity' or who exercise 'actual management of the company' in a general sense. The issue is actual control or influence over the conduct of the corporation **in relation to its criminal conduct**. (See Prosecution Guidelines for the Environment Protection Authority, Draft for Comment, EPA, NSW, undated pp13-14).

The discussion above arising from the US EPA's ruling is particularly relevant given the strong statements in the NSW EPA's guidelines stressing that the crucial issue in deciding to prosecute is whether, as a question of fact, a person has actual control or influence over a corporation.

Queensland

I understand that major new legislation (the Environment Protection Bill) is being drafted in Queensland.

Present indications are that the Act will provide for the protection of the environment through:

(a) the development of environment protection policies;

(b) management of environmental contamination through licensing, management plans, audit and clean-up;

(c) enforcement through environment protection notices, injunctions, infringement notices and a system of offences and penalties similar to the three tiers of offences in New South Wales;

(d) financial assurances to ensure compliance with licence requirements and Environment Management Plans.

I do not propose to comment on that legislation in detail.

However, by way of example, I will comment briefly on the existing *Contaminated Land Act*, 1991 (Qld). While that Act may have introduced additional problems for financial institutions in relation to environmental liability, it does provide some relief mechanisms.

Generally, the Act, among other things:

(a) prohibits contamination of land;

(b) required the notification of existing contamination sites by the end of 1992;

(c) obliges owners and occupiers to notify likely contamination within 30 days of becoming aware of the problem;

(d) establishes a contaminated Site Register; and

(e) establishes mechanisms for investigations of likely contaminated lands and remediation of contaminated land.

The Act does not appear to have greatly assisted financial institutions in that the definition of owner, for example, is arguably sufficiently wide to incorporate lenders in circumstances where lenders are entitled to possession of secured property (see Robert G Lee *Environmental Planning Law Journal*, April 1993 pp 110-111).

However, the Act does provide that persons may appeal to the Planning and Environment Court against notices to assess or remediate sites under sections 19 and 20 of the Act and need not comply with such notices if the court makes an order that it is satisfied that:

(a) the person caused the contamination while acting in accordance with lawful and accepted practices at the time;

(b) the contamination was caused **before the commencement of the Act and it would not be fair and reasonable** for the person to be required to comply with the notice or pay the costs; or

(c) the person is unable to pay the costs of complying with the notice.

Costs of compliance may still be incurred, though, because the court may order the appellant to pay such part of the costs of compliance with the notice as the court determines. (If the total of the costs of compliance with a notice to assess or remediate a site cannot be recovered, those costs are borne by the local authority and the Department of Environment and Heritage.)

In addition, s21 of the Act provides that if the Chief Executive of the Department of Environment and Heritage takes action to execute against property to recover costs incurred in exercising the power conferred under the Act to remediate contaminated sites, his entitlement to recover those costs from the proceeds of sale of the property is subject to:

(a) the rights of local authorities in relation to unpaid rates and charges; and

(b) any registered mortgagee under a mortgage that was lodged for registration before particulars of the classification of the land as a contaminated site were recorded in the Contaminated Sites Register.

The point of all of this is that the legislature in Queensland did not take the opportunity to clarify the position of lenders in the legislation and, therefore, lenders are left to rely upon the sensible administration of the legislation and the due diligence undertaken by the lender and its documentation. There is potential for a lender to become liable under this legislation for clean-up costs. For the lawyers in the audience, you might be interested to pick up the article I mentioned earlier by Robert Lee, as he raises some interesting arguments relating to the statutory right to possession and the possibility that for common law title, a lender may always be liable as owner.

INDIRECT LIABILITY

Regardless of which form new legislation takes, the direct liability of lenders under environmental laws is only part of the problem as far as financial institutions are concerned.

Environmental laws can have an impact on financial institutions whether or not it is the lender itself that attracts liability. The problems facing financial institutions stem not only from liability under environmental legislation. The issue is also commercial.

Environmental liabilities may impose significant costs on a borrower which may undermine the borrowers' cash flow and capacity to service and repay a loan.

For example, borrowers may incur fines, damages, cleanup costs, legal costs in defending claims and prosecutions, not to mention increases in insurance premiums, adverse publicity, disruption owing to litigation and publicity crises and even closure or threatened closure of a facility.

Most importantly, however, as far as banks are concerned, environmentally hazardous industries that have in the past or are currently being carried out on secured property can severely affect the value of the security.

Beven Schwaiger, managing director of Environmental Management Australia Pty Limited, in an article in the *Financial Review* gave an example of an inner-Sydney four hectare industrial site which was discovered to be contaminated with coke and fly-ash as a result of infilling from nearby gas works more than 25 years earlier. The site was unsuitable for residential uses and required remedial work which could cost up to $800,000.00. He also claims that there are more than 100,000 contaminated sites in Australia based on previous industrial and agricultural activities and associated problems of poor quality landfill. No doubt, you have all been quoted examples of very expensive clean-up quotations and of contamination.

WAYS TO MINIMISE LIABILITY

Regardless of whether the issue of lender liability is clarified in legislation, there is a clear need for financial institutions to put in place environmental due diligence measures to protect the value of securities, if nothing more.

Generally, due diligence means:

(a) establishing systems to ensure compliance with laws; and

(b) supervision and verification of the system;

(c) ongoing review of the system;

(d) establishing reporting procedures.

It is probable that the majority of major financial institutions have made some steps towards addressing environmental matters.

Some may have formulated general policies on the environment. Most have formulated sets of environmental representations, warranties, covenants and indemnities to be included in loan documentation when the bank is lending on the strength of security associated with environmental liability.

But more is required in order to implement effective due diligence. It is not enough to incorporate standard clauses in loan documentation and simply leave it at that. There have been cases in New South Wales where the courts have held that it is not sufficient to rely on a contractual allocation of environmental responsibility.

[See **SPCC v Sydney Harbour Tunnel** (May 1991) - a noise pollution case where a company engaged a contractor to carry out work. The contract between them required the contractor to comply with the conditions of its licence. The contractor did not do so and the company was aware of this, but for commercial reasons allowed the contractor to continue working in breach of the licence. The company was fined the maximum penalty notwithstanding that the contractor had covenanted to the company to comply with the licence.]

Most lending officers are aware of environmental problems and very broadly, how they can affect financial instructions. But they often have little or nothing to guide them on a practical level to address those issues.

What is needed is the implementation of formal procedures by which lending officers can identify and respond to:

(a) borrowers engaged in activities which have a potential exposure to environmental liability; and

(b) property used as security which carries with it a potential exposure to environmental liability.

Without those procedures, the results can be:

(a) heavy handed approaches where borrowers are required to carry out full scale audits, provide a barrage of warranties and indemnities and undertake ongoing compliance procedures that are neither warranted nor commercial in the circumstances; or

(b) alternatively, potentially hazardous properties are left undetected and, while the lender in question may have all of the latest environmental provisions in its loan documentation, it does not utilise them properly, if at all.

Policy guidelines should clearly outline the institution's policy on the environment and, in a broad sense, the types of transactions and level of environmental risks acceptable to the institution.

Guidelines should require each lending officer to investigate **all** property proposed as security.

The levels of investigation in each case will vary - ranging from a simple, preliminary investigation through to a detailed audit.

For commercial/industrial loans, we often suggest that banks formulate a simple standard preliminary questionnaire consisting of 10-20 brief questions which identify past, current and proposed uses of any security property and surrounding property. That standard preliminary questionnaire then becomes part of the loan application.

Sometimes that information can be supplemented with information derived from other sources - such as valuation reports.

In this regard, the Institute of Valuers is in the process of preparing standards for the valuation of contaminated land in Australia to be utilised as a guide by its members.

Essentially, the Institute recommends that valuers become knowledgeable in relation to environmental laws, contamination and its effect on property values. It raises the question of whether valuers who simply value property without regard to the possibility of contamination and attempt to simply disclaim liability by expressly stating that the issue of environmental contamination has not been considered may not be providing the level of 'best practice' expected by the client or the courts.

The Institute outlines general ways in which the valuer can identify and quantify contamination and stages at which the valuer should recommend that specialist environmental consultants be consulted and also highlights the sensitivity of financial institutions to environmental issues. Finally, it outlines the ways in which contamination can affect values and valuation approaches.

(See generally Proposed Draft Standard for Valuations of Contaminated Land for Australian Institute of Valuers and Land Economists.)

That information can then be cross-referenced with one of the several lists of activities associated with environmental liability produced by various bodies locally and overseas. The 1992 Guidelines on Contaminated Sites issued by the Australian New Zealand Environment Conservation Council and National Health and Medical Research Council, for example, identify more than 30 land uses associated with contamination. The Queensland *Contaminated Land Act* prescribes land uses in similar categories. The Victoria register is also a useful starting point.

If no alarm bells ring after considering the information derived from the questionnaire and other sources, then the lending officer can proceed without need for onerous audits or 'over the top' provisions in the loan documentation.

However, if the information indicates that there could be problems then the guidelines should oblige the lending officer to proceed further - to commission such things as preliminary audits where technical consultants can advise on facts or circumstances indicating environmental risk.

If bank policy provides that the level of risk is acceptable to the bank, then appropriate environmental conditions can be incorporated in the loan documentation. Often these will need to be specifically tailored to the transaction in question.

Ideally, apart from requiring the borrower to provide warranties about the environmental condition of the property, the loan conditions should require the borrower to have systems in place to minimise environmental liability. They should also require the borrower to report to the financial institution regularly about compliance with environmental laws.

While much of the emphasis in discussions on environmental liability relates to contaminated land, its effect on security and the potential for clean-up costs being incurred, the real art is in assessing the operations of a borrower and the potential risk elements. Where the borrower is engaged in manufacturing or industrial activity, the lender will normally be focused upon that activity and give consideration to requirements that the borrower hold appropriate licenses and not engage in activities which lead to pollution of the air, water or ground. Less often, however, lenders focus on potential environmental liabilities which borrowers face in relation to commercial and residential property and other seemingly less vulnerable investments like shares in a company. In order to assess the likelihood of environmental risk, the lender needs to understand the likelihood of expense for such items as replacement of asbestos, upgrading works associated with air quality, waste disposal issues and generally to look to the entities involved to ensure that they are fully aware of their potential environmental liabilities and the expenditure that may be required to comply with environmental laws.

The institution's due diligence does not stop there. Ongoing review of facilities that carry with them potential environmental liability should be continuous. If there are covenants in loans requiring assurance about compliance with environmental laws, they should be enforced.

Finally, there should be in place a series of reporting mechanisms. A person or body within the institution should be given responsibility for environmental matters. Lending officers should be required to report to that person or body any proposal that carries with it significant potential liability.

That person or body should then be required to report to the board at regular intervals about the acceptance and refusal of any such proposals.

Similarly, notifications of non-compliance with environmental laws that are reported to the financier in accordance with loan documents, whether immediately or as part of annual reviews, should be reported to the person or body in charge of environmental matters who should, in consultation with legal and technical advice, determine steps to take in response. Again, that authority should be required to report to the board on a regular basis.

Financiers, by insisting on environmental risk assessment, environmental management plans, periodic audits, can assist clients assess cost and risk, plan and perhaps provide defences, assistance in public debate and good management.

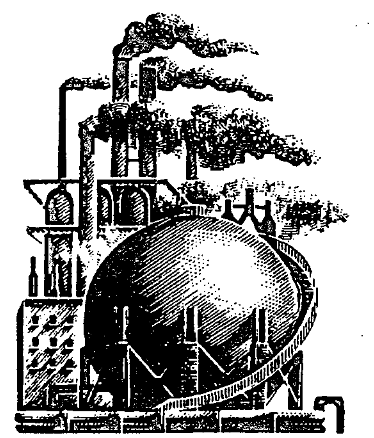
By focusing on these positive aspects of your response to potential environmental liability, I suggest the issues can be effectively understood and addressed. Unfortunately, I cannot promise that the legal position will be clarified satisfactorily.

These are the trees

The Wilkinsons planted

With interest accrued
on their savings

Which their bank
had lent



To a chemical giant

That ceaselessly spews

Toxic waste.