ENVIRONMENTAL LAW

Liabilities of Lenders

DENIS CLIFFORD

Buddle Findlay, Solicitors, Wellington

INTRODUCTION

New Zealand's economic well-being depends, notwithstanding a manufacturing sector of increasing importance, on its pastoral, horticultural and fishing industries. The international acceptability of the products of those industries is dramatically influenced by the health and cleanliness of the environment from which they are produced. New Zealand depends on its 'clean, green' image. That image can however be a double-edged sword. Small falls from environmental grace have the potential of causing significant and long term economic harm.

A consumer of steel will not particularly mind if the steel it buys and uses is produced by a plant that pollutes and is itself located in a heavily polluted environment. The steel remains unaffected. A purchaser of products intended for human consumption however can react adversely to the smallest level of pollutants in those products or the slightest concern that the general environment may be suffering from some form of pollution. At the same time it is not unknown for high environmental, health and associated standards to be imposed on the exporters of such products as a non tariff trade barrier. The state of hygiene of a New Zealand meat processing plant, as opposed to most European slaughterhouses, bears ample evidence of this.

All this would suggest, at least in theory, that countries such as New Zealand would have had for some time a real sensitivity to environmental issues and have developed legal responses that had the potential to affect significantly financiers.

New Zealand's traditional approach to environmental law reflected historic assumptions in this area. In particular, in my view it reflected the assumption that New Zealand was indeed a clean, green environment, relatively untouched by man, and that accordingly 'pollution' was not a major problem. Relatively speaking, that was a true assumption. Correspondingly there was not a great sensitivity in New Zealand, or its laws, to human impact on the environment. This ignored the significance of even small levels of pollution for an environmentally sensitive economy such as New Zealand's. As the realisation of the true significance of these issues has increased so has the profile of environmental issues. There is now a much greater awareness that relatively small scale environmental problems have the potential to cause considerable economic harm. In the current legal environment this means that lenders are potentially exposed to a far greater degree than has been the case in the past.

In his paper Greg Pearce has highlighted two issues. The first of these is the level of uncertainty which faces Australian financiers in the absence of any clear guidelines as to how potential liabilities will actually be enforced against financiers in this context. The second issue he has highlighted is the general need for an effective administrative response from a financial institution to questions of potential environmental liability in addition to due diligence investigations and contractual covenants and

undertakings. Commenting from a New Zealand perspective, the issue of uncertainty looms large. In my commentary I hope to highlight this, and also reflect on some implications of that uncertainty for the very sensible recommendations that Greg Pearce has made.

THE LEGAL ENVIRONMENT

Recent New Zealand experience with environmental law, as in a number of other areas, has been one of radical reform. The reform has been radical in a classical sense, rather than indicating any particularly aggressive approach to fundamental environmental issues.

The legal framework for this issue is now largely found[1] in one comprehensive piece of legislation, the *Resource Management Act* 1991 (RMA). The RMA is one of New Zealand's most ambitious pieces of law reform. It was promoted by a very ambitious law reformer, the former Prime Minister and now Professor, Geoffrey Palmer. Professor Palmer was one of the guiding lights behind two other very significant pieces of New Zealand law reform, the *Accident Compensation Act* and the *Bill of Rights Act*. The *Resource Management Act* repealed 59 Statutes, amended 54 others and brought together in one comprehensive piece of legislation almost all New Zealand's laws relating to human interaction with the natural and physical environment.

Although far less threatening in terms of its apparent ability to seek monetary compensation for natural resource damages, the RMA is much broader in scope than Superfund and similar legislation, and deals with more than environmental pollution and its clean-up. It also concerns the use, development and protection of natural and physical resources, with the overriding purpose of promoting their sustainable management.[2]

Reflecting New Zealand's unitary political system the RMA establishes a top-down hierarchy of national, regional and local plans, each subordinate to the other, and subordinated to the overall national goal of the sustained management of the natural and physical environment.

The RMA contains a definition of sustainable management[3] and spells out a number of duties and restrictions which are designed to achieve that goal. In particular, and in very general terms:

(a) land may be used in any way that is not expressly prohibited;

(b) coastal areas, rivers and lakes may not be used in any way unless expressly allowed;

(c) water may not be taken, used, dammed or diverted unless an express permission, either in general or specific terms, exists; and

(d) no 'contaminants' may be discharged without express general or specific consent.[4]

A breach of any of those basic rules may give rise to both civil and criminal liability. Civil liability extends to 'owners' and 'occupiers'.[5] Such persons may also be liable for 'clean up' costs. Criminal liability also extends to agents and, in the case of bodies corporate, their directors and persons concerned in the management of the body corporate.

The RMA contains a relatively simplified enforcement approach:

(a) Sections 310 through 313 provide for 'enforcement' by declaration. A declaration may be issued to the effect that a certain course of action contravenes the RMA or a specific resource consent.

(b) Sections 314 through 321 establish the procedure for enforcement orders. Such orders can take a number of forms including cease and desist orders, remedy and mitigation orders and compensation orders. At the present time enforcement orders may only be made against a person with respect to actions done by or on behalf of that person. An amendment currently

before Parliament would remove this restriction, and place enforcement orders in this regard in the same position as abatement notices. As mentioned below, an abatement notice may be issued against a person in respect of land of which the person is the owner or occupier, irrespective of whether that person caused the condition in question. Failure to comply with such an order is itself an offence. Certain enforcement orders can be applied for by any person. Enforcement orders are made by the Planning Tribunal (New Zealand's specialist planning court). Section 319(2) clearly envisages the possibility of cease and desist orders and remedy and mitigation orders being made in respect of 'complying' activities.[6]

(c) Sections 322 through 325 provide the procedure known as abatement notices. These are, in general terms, similar to enforcement orders but differ to the extent they may be issued ex parte, as it were, by local authorities and must be complied with unless appealed against within 7 days. Abatement notices would appear to be able to be issued in respect of complying activities, but there is no equivalent to section 319(2). The position in that regard is unclear. In my view, an abatement notice could be issued in respect of adverse effects on the environment caused by permitted activities. The fact that the relevant activities were permitted could potentially be raised on appeal before the Planning Tribunal. The counter argument would be, however, that if the legislature had intended that defence to be available it would have so prescribed in the relevant sections as it did in section 319(2). It is important to note that abatement notices may be issued against an owner or occupier of land irrespective of whether that owner or occupier caused the adverse effect on the environment. Failure to comply with an abatement notice is an offence.

(d) Sections 338 through 343 contain the criminal offence provisions. Prison sentence of up to two years, fines of up to $200,000 and, for continuing offences, $10,000 per day may be imposed. Strict liability applies in certain matters.[7] Certain statutory defences are available. These recognise emergency action carried out reasonably with adverse environmental effects being mitigated and unforeseeable and uncontrollable actions again adequately mitigated or remedied.[8]

Accordingly:

(a) An owner, occupier, its agents and in the case of a body corporate, its directors and other management personnel, may be criminally liable for a breach of the RMA, any regional plan, local plan, specific consent, enforcement order or abatement notice;

(b) Owners and occupiers may be civilly liable for compensation or reimbursement for the costs associated with such breaches and for clean up costs caused by their own or inherited pollution, potentially even if the result of 'approved' activities.

POSITION OF LENDERS

Lenders are generally at risk under environmental legislation both indirectly and directly:

(a) Indirectly by reason of the adverse financial effects environmental costs have on their borrowing customers; and

(b) Directly, by becoming liable under the legislation in their own right, most probably as a result of:

  (i) security enforcement, and hence becoming the legal or de facto owner or occupier of a property, as indemnifier of a receiver, or agent; or

  (ii) management influence (for example in a work out) and hence liable as a shadow director.

All these possibilities exist under the RMA.

The position of lenders in New Zealand is therefore not dissimilar to that of lenders in other jurisdictions. In particular, the very sensitive areas are:

(a) the initial lending decision, and the need for processes and procedures to properly assess environmental risk;

(b) any course of action which might expose the lender to the 'shadow director' or 'management' risk for causing 'breaches'; and

(c) with respect to land and securities over land, the enforcement decision and in particular any decision to go into possession and hence incur possible liability as an owner or occupier.[9]

SOME COMMENTS

The difficulty for lenders in New Zealand, as elsewhere, is the lack of any accepted standards by which environmental liability may be identified and, in commercial and financial terms, assessed.[10] To some extent this is an inherently political process - involving a trade-off at a national, regional and local level between competing interests.

An example of this in New Zealand are the problems both actual and potential which have been identified in connection with ground contamination of timber treatment sites by PCP (pentachlorophenol - a toxic anti-sap stain chemical associated with the treatment of timber, particularly pinus radiata). This problem has been said to threaten the commercial viability of up to 30% of New Zealand timber companies. That analysis has been stoutly denied by the timber industry itself. On the other hand it is undoubtedly a real problem. At the same time, and as at August 1992, one commentator[11] was able to assert as follows:

> *'Also as yet unresolved by the NTG (National Task Group) are the issues of who pays for a clean-up, and how future user of contaminated sites can be protected...*
>
> *Ellis said that the MFE (Ministry of the Environment) had commissioned the Crown Law Office to examine the legislation to see what could and could not be done under the Resource Management Act.*
>
> *"We won't have that answer for several months. It's a very, very complex area which reaches to the heart of contaminated sites, not only timber treatment sites but anything that might have been contaminated by industrial use or for whatever reasons."'*

Not very comforting words for lenders trying to assess from a credit point of view the implications of such matters.

Some advice has now been received by the Ministry for the Environment from the Crown Law Office. In summarising that advice the Crown Law Office said as follows:

> *'Summarising very briefly what we say in more detail below, we conclude that there are helpful available statutory remedies, which may, in particular circumstances, be usefully supplemented by actions in tort. Questions of proof, periods of limitation, and matters of status and capacity, cannot of course be ignored, but are of no greater significance than in other situations. The greatest practical problem may be to find those responsible for the contamination and with the means to pay the costs of restoration. However, the ability in some instances to impose a charge on the land may assist in that.'* (Quoted with kind permission of the Ministry for the Environment).

That advice does not particularly clarify the situation. Accordingly, financiers in New Zealand, as it would appear is the case in most parts of Australia, face the possibility of an environmental liability which is highly uncertain both as to its incidence and scope. In his paper Greg Pearce highlighted the progress

which has been made in the United States on an administrative level in clarifying the potential applicability of environmental liability to financiers. Certainly, in New Zealand progress in that area seems quite a way off.

Greg has also suggested that important issues from a lender's perspective in environmental issues today involve questions of obtaining in a timely fashion information of environmental significance, having the expertise to assess that information and then the systems to react properly to that assessment. That is, in my view, undoubtedly the case. That expertise, and those systems, may however have associated risks. If a financial institution at the end of the day can be shown to have known more, and perhaps understood more, than its customer of the environmental significance of its customer's activities then that of itself may make the lender more open to liability. For example, in terms of section 319(2) of the *Resource Management Act*, it may be more difficult to argue that the former bank, now mortgagee in possession, should not pay for clean up costs. Furthermore, the commercial reality is that it is probably not possible for lenders to impose higher standards of environmental conduct on their borrowers than the market generally requires and accepts. Even if a lender has sophisticated identification and assessment procedures, its customer may simply not be able to afford the cost of the action which is, in terms of best environmental practice, appropriate. On the other hand, lenders cannot expect to turn a blind eye and seek protection in apparent ignorance.

What this leads to is a need for lenders to work with their customers to develop jointly environmental standards and procedures which:

(a) promote substantive compliance;

(b) enable timely recognition and allowance for environmental costs; and

(c) provide a framework within which lenders, in terms of their own interests, can both monitor and react to environmental credit risks in their lending portfolio.

Covenants and internal systems and procedures will be of limited benefit if the customer is not as environmentally aware, and responsible, as the financier.

FOOTNOTES

1. The following statutes are also of possible relevance:
   - the *Health Act* 1956;
   - the *Radiation Protection Act* 1965;
   - the *Dangerous Goods Act* 1974;
   - the *Toxic Substances Act* 1979; and
   - the *Pesticides Act* 1979;

   From a practical point of view it is considered that the comprehensive provisions of the RMA, and the increased levels of liability provided for, render this earlier legislation of little relevance for environmental purposes.

2. Section 5(1): 'The purpose of this Act is to promote the sustainable management of natural and physical resources.'

3. Section 5(2): 'In this Act, "sustainable management" means managing the use, development, and protection of natural and physical resources in a way, or at a rate, which enables people and communities to provide for their social economic, and cultural wellbeing and for their health and safety while-
   (a) Sustaining the potential of natural and physical resources (excluding minerals) to meet the reasonably foreseeable needs of future generations; and
   (b) Safeguarding the life-supporting capacity of air, water, soil, and ecosystems; and
   (c) Avoiding, remedying, or mitigating any adverse effects of activities on the environment.'

4. These rules are contained in sections 9 through 16 inclusive.

5. The terms 'owner' and 'occupier' are defined in section 2. It is uncertain as to the extent to which these terms include a lender. 'Owner' is defined as the person who is (or would be if they let the land) entitled to the rack rent of the land (being the rent of the full annual value of the tenement), and includes the owner of the land and any person who has agreed to purchase the land or any leasehold interest in it. 'Occupier' is defined to mean the inhabitant occupier of any property, or in relation to rateable property, any occupier within the *Rating Powers Act* 1988. The terms 'owner' and 'occupier' would in my view include a mortgagee in possession. A receiver is normally agent of the mortgagor, and hence a bank appointing a receiver probably would not become an owner or occupier. However the receiver as agent may be liable and hence, indirectly, the bank as the receiver's indemnifier. On liquidation or bankruptcy the receiver ceases to be agent of the mortgagor, and the position could then change. Enforcement of an assignment of rents provision could also render the assignee/mortgagee the owner.

6. Section 319(2): 'The Planning Tribunal shall not make an enforcement order... against a person who is acting in accordance with-
   (a) A rule in a plan; or
   (b) A rule in a proposed plan to which section 19 applies (changes to plans which will allow activities); or
   (c) A resource consent, -

   if the adverse effects in respect of which the order is sought were expressly recognised by person that approved the plan, or notified the proposed plan, or granted the resource consent, at the time of approval, notification, or granting **unless, having regard to the time which has elapsed and any change in circumstances since the approval of the plan, the notification of the proposed plan, or the granting of the consent, the Planning Tribunal considers that it is appropriate to do so.'** (emphasis added)

7. Breaches of sections 9, 11, 12, 13, 14 and 15.

8. Section 341(2).

9. See footnote 5.

10. I am aware that a group known as the Hundred Group of Finance Directors has prepared a Statement of Good Practice: Environmental Reporting and Annual Reports. At the time of writing, a copy of this publication which is being sent to me by Coopers & Lybrand has not yet arrived.

11. P Stevenson writing in *Terra Nova* August 1992.