Comments on the White Paper on Environmental Liability[*]

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- ***Introduction***

In this first section, the White Paper (WP) declares that the main purpose of Community policy in this matter is to avoid environmental damage, and then suggests that an instrument to achieve it would be a Community directive establishing a civil liability regime with real deterrent effect[1]. The authors of these Comments subscribe the WP's basic idea, but try to improve some elements just sketched by the WP when describing the factual content and legal consequences of the suggested regulation. With special reference to aspects related to the identification of the different types of damages, the methods for its evaluation and the distinction between compensating harm and restoring the environment. Likewise, attention has been paid to the connection between the different liability standards outlined by the WP and the inherent risk of the different kinds of activities.

- ***What is environmental liability?***

This initial section of the WP does not offer any description, not even a brief one, of the essential features that are likely to characterise an environmental liability system. It seems to accept as a basic concept the obligation to compensate or restore the environmental damage.

1. The aim of environmental liability

The intention of the WP to introduce an environmental civil liability regime, understood basically, without more clarifications (see, for example, section 4.5), as a compensation or environmental restoration system, generates at first some puzzlement:

- The WP seems to assume that the new civil liability regulation would be introduced on top of public regulations on potentially polluting activities and the existing systems of administrative and criminal fines. This can produce ***overdeterrence*** of activities potentially harmful to the environment [in economic theory it is well known that overdeterrence will result when the public regulation of care levels that could be optimal in the absence of liability for damages is combined with a (new) liability system: Steven Shavell, "A Model of the Optimal Use of Liability and Safety Regulation", in *Rand Journal of Economics* (1984), p. 271; Charles Kolstad, *Environmental Economics,* Oxford (2000), p. 235].

It is necessary to undertake a detailed analysis of the administrative and criminal regulations in force in the member States before adding a Community regulation on environmental liability. An isolated consideration and design of individual instruments of environmental policy by the legal system can have unexpected and distorting consequences for the global efficiency of the environmental protection system. The performance of each instrument is not the key issue. What is important is

[1] The White Book also describes in this section the structure and background of the text, issues that will not be covered by the authors in these Comments.

that the total effect on environmental damage prevention attains the socially optimal level.

- The "Polluter pays" principle and its consequences for an environmental liability system are enounced in an ambivalent way –"the polluter must pay for the damage reparation"-. But, in the WP, "repair" entails two very different things, since it means taking on[2] the costs of:

a) ***"Restoration"*** or
b) ***"Compensation"*** of damage.

Restoring can be more or less expensive than compensating or paying damages and, at the limit, it can be infinitely expensive -i.e., impossible- or, at the other end, useless from an economic point of view. In legal terms, things are restored, but people are compensated. The distortion of deterrence, given the possibly high differences between damages to be paid and restoration costs, is potentially important.

We suggest establishing from the beginning a normative criterion to distinguish between the factual content and the legal consequences of restoration and compensation. It is also essential to precisely define who is entitled to file an environmental liability claim.

2. Types of environmental damage for which liability is suited.

In order to define the kind of damages to be included in the new liability regime, the WP establishes several indexes:

- Distinction between ***concentrated damages*** (discreet events or, if continuous, derived from easily identifiable sources, such as the pollution of a specific territory) and ***diffuse damages*** (acid rain). The distinction is a dichotomous one, thus it will work badly if it is not clearly defined, and probably even in that case: reality is not dichotomous.

> Is the Chernobyl case diffuse or concentrated damage? Certainly civil liability performs poorly in cases of diffuse damage, because, given the high number of possible victims, the individual incentive to file suit is small and the claim management costs are likely to be high.

- The idea that "there need to be one (or more) ***identifiable agents*** (polluters)", i.e., that the damage has to be attributed to a specific human action or omission. However, no effort is made at all to define the criteria for imposing liability.

- Damage valuation: (economically) non-quantifiable damages can remain outside the system, except may be through the restoration cost concept.

[2] The WP says that the polluters will "assume the risk" of taking on the related costs. But if it is assumed that polluters are to be identifiable, that the law applies for every case and that the damage can be perfectly evaluated, then the polluters will do something more than assuming a mere risk of being condemned to restore or compensate.

- The causal relationship. The WP is supposed to mean natural causation or *causation in fact*. We must foresee cases of multiple causation and of probable causation: the system must define evidence standards for both cases.

- ***The case for an EC environmental liability regime and its expected effects***

1. Implementing the polluter pays, the preventive and precautionary principles.

The WP includes the basic result of the economic theory of liability: ***if polluters need to pay for damage cost, they will cut back pollution up to the point where the marginal cost of abatement exceeds the compensation avoided***[3]. Indeed, if polluters expect to pay damages equal to the real environmental cost of their activity, they will choose a socially optimal level of pollution, equating the marginal cost of abatement with the marginal benefit of reducing the expected damage payment.

However, such proposition is based on several strong assumptions that the WP does not make explicit:

a) The damage award the polluter has to pay will equal the actual harm caused to the environment.

b) Polluters cannot escape liability: i.e., all polluters will be forced to pay the total amount of damages.

c) There are no problems of having several agents concurring in causing the environmental damage (plurality of causal agents).

Therefore, perfect environmental cost internalisation and optimal levels of prevention of environmentally harmful behaviour require several assumptions that very seldom occur in reality. However, the level of deterrence and internalisation of negative external effects that can be achieved through a system of environmental liability is quite important, and its positive effect on the development and spreading of cleaner technologies cannot be underestimated.

An excess of optimism on the deterrent effect of environmental liability –hard to measure with rigour and virtually impossible in the short term- has to be avoided. It can generate a frustrating reaction if the expectations are not soon confirmed by a noticeable improvement in the behaviour of agents potentially harmful to the environment.

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[3] The Spanish version says: "Si quienes contaminan se ven obligados a sufragar los costes relacionados con el daño causado, reducirán sus niveles de contaminación hasta el punto en que el coste marginal de la descontaminación resulte inferior al importe de la indemnización que habrían tenido que abonar". According to the French version: "Si les pollueurs doivent réparer les dommages causés en supportant les coûts correspondants, ils réduiront la pollution tant que le coût marginal de dépollution reste inférieur au montant de la compensation ainsi évitée". The German version states: "Wenn die Verschmutzer für die verursachten Schäden bezahlen müssen, werden sie die Umweltbelastung so weit verringern, daß die Grenzkosten für deren Minderung den umgangenen Schadensersatz übersteigen". The English and French versions are the most likely to be correct.

2. Ensuring decontamination and restoration of the environment

The WP intends not only to enforce the "Polluter pays" principle, but also that the amounts paid by the polluter effectively serve the recovery of the environment through the necessary operations to restore the damaged ecosystems.

Indeed, the WP says literally:

> "In order to make the polluter pays principle really operational, Member States should ensure effective decontamination and restoration or replacement of the environment in cases where there is a liable polluter, by making sure that the compensation which he has to pay will be properly and effectively used to his effect." (page 12).
>
> "Member States should be under a duty to ensure restoration of biodiversity damage and decontamination in the first place *(first tie*r), by using the compensation or damages paid by the polluter." (page 22).

In order to meet both objectives the commitment of public authorities of the Member States is crucial. Without their participation it will be difficult to make the polluters of non-appropriable natural resources pay for the damage caused. Also, such public authorities must ensure that the compensations paid will be really devoted to recovering the affected environmental elements.

A few comments have to be made hereto:

a) The deterrent effect of civil liability does not depend at all on the destination of the damage award. As long as the potential polluter anticipates having to pay for the harm caused, he will refrain from polluting, and he will be totally unconcerned as to how the money is actually spent later.

b) From a purely economic point of view, even in the event that the damage caused to the environment is perfectly quantifiable, money should be assigned to the socially most desirable purpose, which may or may not be environmental restoration. For example, restoring the damage caused to a 1,000-hectare wood can cost 10,000 monetary units, which would serve to restore a neighbouring 2,000-hectare wood, twice as vast as the other: What is preferable? Using the damage award to restore the harmed ecosystem or investing it in an activity that is socially more desirable at the time?

c) The WP tries prevent public authorities of the Member States from misusing the funds paid by polluters. But it does so by pre-determining the destination of such amounts, a discredited technique in Public Finance: economics should be applied not only in choosing the most efficient preventive measure but also in determining the destination of the resulting amounts of money. The underlying idea in the WP seems to be that the public authorities would always choose a worse solution.

d) The WP foresees the alternative assignment of the awards only in a specific case, i.e., when the restoration of the damage to biodiversity is impossible or is extremely costly (page 21). However, it seems to consider that, when restoration is possible investing the amounts obtained through the damage payments, this should be the preferred use of the monies regardless of other alternatives, ***even of environmental nature, which might be socially more desirable.*** This is obviously wrong.

e) Considering, therefore, that the suggested solution is to have potential polluters feel threatened at all times with having to pay the necessary amounts to restore the damaged environment, overdeterrence may occur: if the expected damage amounts to, say, 1000 units, optimal deterrence requires an investment no higher than 1,000 or, alternatively, making polluters pay no more than 1,000. If restoration costs 5,000, the social agent involved will invest too much in precautions.

f) Finally, all the above is based on the assumption that environmental damage is easily and exactly quantifiable. Very often this will not be the case, but historical experience seems to show that environmental damage is underestimated rather than overestimated. The WP eludes the problem, assuming that the value of a damaged natural resource is almost always equal to the cost of restoring it (including damage evaluation costs). However, restoration costs depend essentially on the level of quality of the resource we want to reach *ex post*: the WP does not discuss any standard for this purpose. The decision may be, then, substantially arbitrary and will not necessarily correlate with the initial value of the damaged resource and, therefore, to the social cost caused by the polluter.

g) As for the system's administration costs, see the part of section **7** dealing with transaction costs.

3. Boosting the implementation of EC environmental legislation.

The WP states in this section that "If liability exerts the preventive effect described ... and restoration is ensured" we will also achieve, through its admission by the Member States, an improvement in "compliance with EC environmental legislation" (page 12). The double goal pursued is to promote a wider and more efficient implementation of the EC environmental legislation and, at the same time, to complement the legislation of Member States regarding environmental protection by means of liability rules.

> Notice, again, that the WP seems to assume that damage compensation and specific reparation –*in natura* – of the environmental resource are identitical, but this will not always be the case. One thing is optimal investment in precaution to avoid environmental damage (deterrent effect: additional Euros must be invested in prevention up to the point where an extra Euro invested in higher care reduces expected environmental damages in precisely another Euro). A different one is the required investment to restore the destroyed or damaged resource (restoring effect: ex-post investments should reach a level that is sufficient to restore the damaged natural resource to its original or pre-accident state). The latter might be lower, equal to or

> higher than the economic assessment of the harm, i.e., the amount the polluter has to pay, pursuant to the rule set forth in section 2.1 of the WP).

To this respect, the WP acknowledges a notable diversity of environmental protection regimes in the legal systems of the Member States: "Whereas most Member States have introduced national laws that deal with strict liability for damage... to the environment... these laws are very different in scope and often do not cover... all damage ...for the environment" (page 12).

Therefore, there is a regulatory gap regarding certain environmental harms and, particularly, many of those not affecting "human health or property, or contaminated sites" (page 12), i. e., the usually more diffuse ones known as damages to natural resources. The examples thereto are clear: non-appropriable or collective goods (air, migratory birds, wild animals).

Consequently, the WP favours the idea of national laws covering at least some damages to natural resources, such as those protected by the Council Directive 79/409/EEC on the conservation of wild birds (D O L 103, p. 1) and 92/43/EEC of the Council, on the conservation of natural habitats and of wild fauna and flora (D O L 206, p. 7).

As for the implementation of EC environmental legislation, the effect of an environmental liability regime, such as that supported by the WP, on the application of the Directive 92/43 of natural habitats seems to be unquestionable: it would stress on national public authorities the obligation imposed by the Directive to restore the protected natural resources, and at the same time it would allow them to collect funds for this purpose through liability suits against polluters.

> Indeed, the Directive 92/43 imposes duties to the Member States, but they are imperfect duties, that is to say, they are not accompanied by a sanction in case of breach. An environmental civil liability regime would fill this gap.

We have no empirical evidence on the results of the different and heterogeneous national regulations on this matter as to be able to face the problems of environmental harm. It is therefore very difficult to judge their effectiveness in preventing damage to the environment. However, it seems undeniable that there is currently a lack of protection through liability rules regarding pure environmental damage (i. e., damage other than to health and physical integrity, property or affecting contaminated sites). It is clear that it is this area of pure environmental damage –such as damage affecting biodiversity- where the main innovative scope of the EC intervention lies, with respect to Civil Codes and special national rules on environmental liability, let it be civil, criminal or administrative. The future evaluation of the new liability system will greatly depend on the results obtained in this field –the most complex one.

4. Bringing about better integration

For the Commission, the legal policy suggested by the WP, which tends to force agents potentially harmful the environment to internalise the costs of their activities, meets the dispositions of art. 6 of the EC Treaty, according to which:

> "Environmental protection requirements must be integrated into the definition and implementation of the Community policies and activities referred to in Article 3, in particular with a view to promoting sustainable development".

This (correctly, in our view) assumes a normative interpretation of the aforementioned article according to which environmental protection requires efficient environmental cost reduction and not, for instance, a more strict –and more expensive- interpretation, such as eliminating these costs –reducing them to zero-, or a more lenient one that would not even require the internalisation of such costs. There are, of course, other possible interpretations.

5. Improving the functioning of the internal market

Member State companies compete in the intra-EU and extra-EU markets. As for the former, the WP assumes the existence of a collective action problem derived from the fact that the different Member States' environmental liability regimes do not cover damage to biodiversity (that is to say, damage other than to human health, property or affecting contaminated sites) and these might be very significant.

The idea of the Commission seems to be that, in the absence of external pressure, Member States would adopt a dominant strategy of no co-operation: no State is interested in legislating to include damage to biodiversity because in this way it can preserve the competitive advantage of its companies; no matter what the other Member States do, each one of them lacks any incentive to legislate and thus raise the costs for its companies. And this is so although all Member States are aware that legislating on biodiversity would improve their joint position or collective well-being.

The action of a higher entity, in this case the European Union, would solve the problem: EC legislation leading to the internalisation by Member States of the damage caused to biodiversity would lead to the adoption of a co-operative strategy on an equal basis: the external agent imposing the co-operative solution solves the prisoner's dilemma.

> Notice that the above discussion assumes that the model that best explains the lack of legislation on biodiversity is the prisoner's dilemma. The Commission does not consider any alternatives, which are theoretically possible: in terms of game theory, the collective action problems in the environmental arena can also be understood as games of *Chicken, Battle of the Sexes or Assurance* [Todd Sandler, *Collective Action. Theory and Applications*, Ann Arbor (1992) p. 38].

Moreover, the Commission considers the problem of the influence of new EC legislation on liability for damage to biodiversity on the competitiveness of European companies in extra-EU markets. To this respect, the WP suggests to bear in mind that the negative effects that could easily arise should be minimised. To this end, it proposes to implement a "progressive or gradual approach" (Sections 6 and 7): a framework regime containing minimum requirements would be approved and it would be developed by the Member States. The costs arising from uncertainty and adaptation to new liabilities would thus be reduced.

6. Expected effects

The WP correctly affirms that the "Polluter pays" principle creates incentives for more responsible behaviour by firms. However, a number of conditions need to be met for this effect to happen, the WP adds. For instance, potentially liable companies must be able to pay, either with their own resources or through insurance or some other financial guarantee. A serious obstacle for the implementation of the aforementioned principle lies on the insolvency or limited solvency of the potential polluters. The expected damage award against the polluting company with limited assets has, as an upper limit, its own solvency and does not cover the actual amount of damage it can cause, which may be much higher. If this is the case, it will choose sub-optimal precautions as the WP indicates. How can this problem (j*udgement-proof problem*) be mitigated?. There are several possible solutions: one of them is to hold all companies that have some degree of control over the hazardous activity joint and severally liable (even financial institutions can be held liable[4]). A different solution is to impose mandatory insurance. A third one, usually much more expensive than the others, is to require a minimum solvency level above the highest possible environmental risk created. All of them can serve to reduce the feasibility of circumventing liability by transferring hazardous activities to thinly capitalised firms.

The Commission does not favour any of these measures in particular, but just points out that “availability of financial security, such as insurance, is therefore important”, but then, in Section 4.9., explicitly rejects the solution of mandatory insurance: “the EC regime should not impose an obligation to have financial security...The provision of financial security by the insurance and banking sectors for the risks resulting from the regime should take place on a voluntary basis” (p. 23). But this can be subject to criticism since, as it is known, in the absence of an obligation to buy insurance, the insolvent or thinly solvent potential injurer will have no incentive to insure for all damages exceeding his expected liability: the firm who might cause damages hypothetically exceeding the value of its assets has no interest in voluntarily insuring against a damage award it would not be able to pay in any case. The premium it would pay would serve to buy coverage against a risk it would not have to bear, simply because it doesn't have the means to.

> For example, let us suppose that company A is solvent up to 10 units, but can cause an environmental accident with a probability 0.1. If the accident actually occurs, the damage can amount to: a) 10, with a probability 0.5, and b) 40, with the same probability. The expected damage is then 10 x 0. 1 x 0.5 + 40 x 0.1 x 0.5 = 2.5. But the expected damage award against the uninsured potential polluter is only 10 x 0.1 x 0.5 + 10 x 0.1 x 0.5 = 1. With these figures, company A will never buy liability insurance

[4] U.S. Courts have sometimes imposed liability for the damage caused by hazardous waste to financial institutions that had financed the activities of the polluting agents, even when such institutions had had no part in the agent’s operations: *United States v. Fleet Factors*, 901 F.2d 1550 (11th. Cir. 1990) and *State of New York v. Shore Realty Corporation*, 759 F.2d 1032 (2d. Cir. 1985). Such extension of liability has been subject to strong debate in the law and economics literature: Kathleen Segerson "Lender Liability for Hazardous Waste Cleanup", in Tietenberg Ed., *Innovation in Environmental Policy: Economic and Legal Aspects of Recent Developments in Environmental Enforcement and Liability*, London (1992), p. 195; James Boyd and Daniel E. Ingberman, "The Search for Deep Pockets: Is «Extended Liability» Expensive Liability?", in *Journal of Law, Economics and Organization* (1997), p. 232; and Tracy R. Lewis and David E. M. Sappington, "Using Decoupling and Deep Pockets to Mitigate Judgement-proof Problems", in *International Review of Law and Economics* (1999), p. 275.

voluntarily for a premium corresponding to maximum damage of 40, but it will only cover the less serious possible accident for a premium of 0.5.

- ***Possible features of an EC environmental liability regime***

1. No retroactivity

The WP suggests that the new regime should only cover future damages and just from the entry into force of the new liability regime. This no retroactivity solution is justified by reasons of "legal certainty" and "legitimate expectations" (page 14). We can add thereto the argument that past behaviour cannot be deterred any more and the only thing to do is to try and repair *ex post* the damage already caused, a task the WP leaves to the Member States. For clean-up tasks, moreover, a civil liability regime is administratively too costly to operate, and it would be completely useless to introduce it as a deterrent in these cases. It seems reasonable to endorse, with the WP, the idea that a locally managed administrative regime would be more efficient.

The WP points out that determining the cut-off point for future damage is very difficult in environmental issues, since this type of damage can be caused throughout very long periods of time and may show up only after an equally prolonged latency period. Likewise, we must agree with the statement at the end of this section of the WP, according to which, in cases of continuous harm starting before the entry into force of the new system, the sharp discontinuity from a regime of no liability to a liability regime for the whole damage, will induce potential plaintiffs to try to prove that all or most of the damage took place after the legal change. For similar reasons, a related bias is to be anticipated, and there is a real risk that judges, courts or authorities in charge of enforcing the law may interpret the historical regime through the lenses of the new one (*Hindsight Bias*). (For instance, Spanish courts could decide to construe the historical normative according to the social situation existing at the time when it should be applied, pursuant to art. 3.1 Spanish CC).

2. The scope of the regime

The WP considers two different dimensions to define the scope of the proposed regime: the type of damage and the activities resulting in such damage.

a. Damage to be covered

The WP distinguishes between:

a) Environmental damage, which can be divided into:
   aa) Damage to biodiversity, and
   ab) Damage in the form of contamination of sites.

b) Traditional damage, which includes damage to health and property damage.

This basic classification is quite idiosyncratic: strictly speaking, damage consisting in contamination of sites is property damage (therefore "traditional") and there would be no need to create a category *ad hoc*, but the WP wants to stress the environmental

character of the types of damage caused to certain sites and to biodiversity, as it understands that they have historically been treated in very diverse ways by the laws of the Member States (page 14) and, sometimes, they have simply been ignored (page 14).

As for traditional damage, the WP considers it has to be included, since, considering the frequency with which an accident causes both environmental and traditional damage, it is convenient to have common rules for of them: if the former were governed by the Directive and the latter by the various legislations of the Member States, "there could be unfair results, such as paying less or no compensation for damage to health" (page 15). This is true, but it creates a serious problem, that is, the unfair situation resulting from the fact that the same damage can be compensated differently depending on where it originated or how it happened. Thus, for instance, damage to health arising from an environmental accident would be dealt with in a different way than if caused by a workplace, medical or traffic accident: it doesn't seem reasonable to link the type of compensation regime to the origin of the damage.

The two classical distinctions in civil liability law are those referring to the following types of damage:

a) Personal injuries and property damage.

b) Pecuniary and non-pecuniary damage (*dommages immatériels, pecunia doloris, Schmerzensgeld, Pain & Suffering, daño moral*).

Nowadays, the most useful analytical distinction is the latter. If we try to compensate harm, the essential distinction must be made between economically quantifiable and non-quantifiable damage.

> However, the WP does not include any consideration specifically devoted to pain and suffering, i. e., damage affecting goods not replaceable by money, since it seems to understand that its legal treatment lies with the Member States' legislations (which, as it is well known, are significantly different to this respect.)
>
> The destruction of a habitat –whether by damage to biodiversity or contamination of specific sites- not only involves pecuniary damage (that can be directly translated into monetary terms), but also, or at least often, strictly non-pecuniary damage (as, for example, the psychological disutility experienced by people involved, or even by all citizens, after an environmental disaster), but this is not subject to specific consideration by the WP. It is unclear whether the omission implies or not an attempt to reject its right to compensation. Indeed, there are reasons to exclude it. In these cases, estimating damage can be infinitely expensive, the probability of inducing frivolous claims would be high and, due to lack of precedent, legal uncertainty could also be high. However, leaving them aside from any calculation implies a risk of underdeterrence.
>
> Likewise, damage to health (included in the section on traditional damage) constitutes a clear case of bodily or personal injury also involving non-pecuniary damage (pain and suffering). In this case, the exclusion might be less founded and would be in contradiction with the WP's declared intention of uniform treatment.

In view of the former, it seems desirable that the new regime includes an explicit rule on the question of non-pecuniary damage.

b. Activities to be covered

The WP tries to define the limits of the activities with environmental effects subject to the prospective regime. The identification method is as follows (p. 15-16):

a) When dealing with human health or property damage or contaminated sites, the criterion to be followed is the *acquis communautaire* on environmentally ***hazardous activities*** regulation (activities regulated in the following categories of EC legislation: legislation that contains discharge or emission limits for hazardous substances into water or air, legislation dealing with dangerous substances and preparations with a view (also) to protecting the environment; legislation with the objective to prevent and control risks of accidents and pollution, namely the IPPC Directive and the revised Seveso II Directive; legislation on the production, handling, treatment, recovery, recycling, reduction, storage, transport, trans-frontier shipment and disposal of hazardous and other waste; legislation in the field of biotechnology and legislation in the field of transport of dangerous substances). It is possible, it poonts out, that "in the further shaping of an EC initiative" "a list [is established] of all the pieces of relevant EG legislation with which the liability regime should be linked" (page 16). A list system , such as the one implemented by the IPPC Directive or the German *Umwelthaftungsgestz* would improve the foresight of potential liabilities and, therefore, their insurability. This makes the elaboration and implementation of the list, in principle, a good idea. However, it is important to mention the risk of having an under-inclusive list not covering all activities that are really dangerous for the environment. Mainly in view of the possibility of subjecting those not included in the list to a negligence rule which, unlike strict liability, does not allow a complete internalisation of activity levels, which is particularly important for inherently dangerous activities.

b) When dealing with damage to biodiversity, however, the criterion is the ***damaged natural good or resource.*** To this purpose the Directives 79/409 and 92/43 are quoted. Thus, ***any potentially harmful activity***, to anything the *acquis communautaire* considers to be biodiversity would be included.

This technique of defining the activities that will be subject to the planned Community regime does not seem to correspond to any identifiable criterion other than ensuring in any case a connection with existing EC legislation, which on the other hand is notably heterogeneous. Besides, we must bear in mind that both criteria produce different results: in the first case, the area of potential injurers is reasonably well defined and a higher detail is foreseen (list system); on the other hand, the population of potential victims is enclosed in a non defined circle whose radius is infinite. In the second case, on the contrary, potential agents are not delimited, but victims are very well defined. As the deterrent effect of liability rules depend on their effective possibility of having a real influence on the behaviour of potential polluters, it seems likely that the same rules, enforced by a finite number of enforcers, will have a higher effect on the members of a reduced group of potential injurers than on the almost infinite pool of agents that can cause damage to biodiversity.

3. The type of liability, the defences to be allowed and the burden of proof

This section of the WP starts saying that "Strict liability means that fault of the actor need not be established, only the fact that the act (or the omission) caused the damage"[5].

However, the concept of strict liability has been traditionally linked to a liability for simple causation, without fault being understood as non-compliance with a duty of care. It is not, therefore, a matter of burden of proof, as the Spanish version of the WP seems to sustain.

Much more important is the remark concerning the text that follows in the WP: "At first sight, fault-based liability may seem more economically efficient than strict liability, since incentives towards abatement costs do not exceed the benefits from reduced emissions". The statement is unclear: indeed, legal rules should induce additional decontamination measures up to the point in which marginal cost equals expected damage from pollution. The WP seems to assume that a negligence rule would push towards more careful behaviour and, consequently, it is more desirable than strict liability. But this is wrong, even at first sight: operating optimally, negligence and strict liability induce exactly the same level of care. When correctly implemented, such level of care is the socially efficient level. Differences between the rules arise concerning the level of activity –the amount of potentially harmful behaviour-, not the level of care for a given level of activity -the "quality" of behaviour-.

> Indeed, under a negligence rule, an injurer adjusting his behaviour to the due care level required by law is not liable for the damage caused: expected damage payment is zero. Instead, under strict liability, the injurer faces all damage derived from his activity, regardless of whether he meets the standard of care. In the first case, the agent lacks any incentive to reduce the level of activity carried out, which he does already with due care. In the second case, the potential injurer will try to maximise the difference between the benefit from the activity and the expected damage and will reduce the activity to the socially optimal level.

However, the WP sets forth that the strict liability rule, adopted by different legal systems of the Member States, is superior to the negligence rule in the field of environmental liability, for two reasons:

a) The higher cost for the plaintiff to prove fault .

[5] The text in French also defines strict liability with reference to the burden of proof: "On parle de responsabilité sans faute lorsqu'il n'est pas nécessaire de prouver la faute d'un auteur, mais seulement le fait (ou l'omission) qui a causé les dommages". Instead, the English version of the WP says, more concretely, "Strict liability means that fault of the actor need not be established, only the fact that the act (or the omission) caused the damage; likewise, the German version says: "Verschuldensunabhängige Haftung bedeutet, daß nicht das Fehlverhalten eines Akteurs festgestellt werden muß, sondern lediglich die Tatsache, daß der betreffende Schaden durch eine bestimmte Handlung (oder Unterlassung) verursacht wurde".

b) Normative and *a priori* preference of the polluter pays principle.

Indeed, strict liability has some advantages over negligence for activities inherently dangerous to the environment, although for different reasons than those mentioned by the WP: the more dangerous the activity, the more important it is that people reduce it to the socially optimal levels and, as we have just seen, only the strict liability rule achieves this internalisation of activity levels. On the other hand, the problem of higher or lower costs of proof for the plaintiff may be solved by shifting the burden to the defendant ("Burden of Proof and Strict Liability" in **http://www.InDret.com**). And the reasons for the normative preference of the polluter pays principle must be made explicit.

The tendency of the WP authors not to make the reasons for their normative preferences explicit is shown again when the text suggests using the negligence rule for activities carried out in compliance with the implementation measures of the Wild Birds Directive and Habitats Directive, which aim at protecting biodiversity (Directives 70/409 and 92/43), activities legally considered as not dangerous: "would not give rise", says the WP, "to liability of the person carrying out the activity other than for fault".

It is not clear what must be understood under the term fault in this case. It is not likely that duties and prohibitions contained in the above Directives can be used as significant elements of the standard of care, and only marginally as a *Negligence per se* derived from the breach of their provisions (forbidden behaviour is basically intentional). It is not obvious at all that the Directive or the Courts of the Member States that must enforce implementing legislation will be able to determine an optimal level of care for each activity that could have a negative impact on the areas that Directives 79/409 and 92/43 try to protect. Besides, it is assumed that expected damages, when meeting such standard, even optimally determined, would be zero or close to zero. In the absence of fault, the uncompensated damage, says the WP, will be covered by the State[6]: there is no internalisation at all of the activity levels, and the potential polluter can carry out all the desired activity if it adjusts to due care levels. State coverage provides no incentive for polluters behaviour.

Defences

The WP affirms that commonly accepted defences should be allowed, such as Act of God, contributory negligence, consent by the plaintiff and intervention by a third party. The reference to plaintiff's consent is a momentum-induced carry over from the general rules on civil liability to liability for environmental damages: in the latter, we cannot generally speak on any right of the plaintiff to decide upon the environmental goods, both *ex ante* and *ex post*. Maybe we should say that the State will normally be the claimant pursuing the decontamination, and it should have the power to settle the claim. If it is so, the text should be more clear.

The WP deals subsequently with the defence for development risk, but does not explicit the suitability of its admission or rejection (except when it points out that the rule should take into account insurability of risk and the impact of the regime to be

[6] As well as those produced by an unknown agent

adopted on SMEs. To this respect, it seems recommendable to consider environmental and product liability regimes jointly [Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products (D O L 210, page 29)] with the aim of unifying or, at least, increasing the degree of harmonisation of the different national laws in both matters.

> First, the rules of arts. 7 e) and 15.1 b) of Directive 374/85 were the result of a compromise among different points of view by the then Member States, and the national transposition laws of the Directive have introduced or rejected the defence in an uneven way.
>
> Second, the Directive is in the process of being reviewed. It seems reasonable to wait for the reactions of the Commission to the Green Paper on product liability. Prior to the end of the year the Commission will issue a report that can be accompanied by a proposal to amend Directive 85/374.
>
> Finally, the WP itself, in its section 4.5.4 warns about possible overlaps between the product liability and environmental liability regimes, mainly in terms of traditional damage, and suggests that product liability should prevail for a very specific type of case (defective product that does not meet the environmental standards required by EC legislation).

Notice, however, that the WP records the opinion of "some interested parties", according to which compliance with EC legal standards should be considered as a liability reducing factor (page 17), but this thesis assumes that legal standards always coincide with scientific and technological standards, an assumption whose empirical basis is, at least, arguable.

Burden of proof

For the WP, in environmental cases, "it may be more difficult for a plaintiff and easier for a defendant to establish facts concerning the casual link (or the absence of it) between an activity carried out by the defendant and the damage" (page 17). The statement (in the sense of burden of production) is not very risky, unless it is understood in the sense that the burden of proof must be attributed to the party that, given the circumstances of the case, can provide, at the lower cost, sufficient evidence to convince the judge that there is a casual link between the defendant's behaviour and the damage. However, it must be noted that the WP refers to both positive and negative proof (lack of the casual link): in this last aspect, the WP should have been precise, in line with some national legislation (paragraph 6 of the German *Umwelthaftungsgesetz*), as to whether the defendant will only have to prove the existence of an alternative source of damage, or that his behaviour did not exceed the quantitative limits set by administrative regulation, etc. That is to say, the requirements for an effective negative proof must be limited (*probatio diabolica).*

> Indeed, the cost difference is one of the factors to be considered in the assignment of the burden of proof, but is not the only factor, not even the determining one. The *ex ante* probabilities that there is or there is not a casual link are equally decisive to attribute the burden to the plaintiff or the defendant (see "Carga de la prueba y responsabilidad objetiva" *[Burden of proof and strict liability"]* in **http://www.InDret.com**).

Note that the WP does not precise the differences between proof of fault (noncompliance with due care), proof of Proximate Causation (*imputación objetiva, objektive Zurechnung*) and Causation in Fact (*prueba de la causalidad de hecho, Kausalität*). All three show structural similarities, but it is confusing to deal with them as if they were identical.

Application of equity

One of the *Leitmotiven* of the WP is the "Polluter pays" principle. This paragraph, however, says that, on fairness grounds, "it [may be] inequitable for the polluter to have to pay the full compensation for the damage caused by him" (page 18). "Some room might be granted to the Court (or any other competent body...) to decide… that part of the compensation should be borne by the permitting authority, instead of the polluter". It seems reasonable to place here the following distinction:

a) If we want to render the regulatory agency liable for the damage caused, no objection at all: it should answer for the damage just as any other co-injurer. But this solution assumes that Courts or competent authorities can determine which was the socially optimal standard in each and every case.

b) But if goal is to introduce an exception to the application of the polluter pays principle, apart from any causally relevant contribution of the regulatory agency, and at the expense of the tax payer, the suggested solution does not seem reasonable. If such proposal were accepted, the regulated firms would have an additional incentive to capture the regulatory agency: they would not only obtain a more comfortable regulation according to their private interest, but they could also transfer part of the expected compensation to the taxpayer.

4. Who should be liable?

The WP suggests three rules to determe the liable parties:

a) **Liability of the operator,** that is to say, the person or persons in control of the activity that has caused the damage. Note that the regulatory agency that supervises (authorises, inspects, etc.) the activity is excluded, in contrast to paragraph 4.3, in which the WP pointed to a different rule: liability of the regulatory agency or public contribution to repair the damage.

b) **Exoneration of the managers and employees of the corporation carrying out the activity.** "Where the activity is carried out by a company in the form of a legal person, liability will rest on the legal person and not on the managers (decision makers) or other employees who may have been involved in the activity". The suggested rules leaves to the corporations themselves the task of establishing the internal incentive mechanism to induce optimal reduction of the company's expected civil liabilities for environmental damage. Moreover, it does not preclude the criminal liabilities the individuals may have to bear.

c) **Financial institutions without operative control of the activity are exempted from liability.** This criterion seems reasonable, since the specific expertise of a

financial institution is limited to financial assessment and management and it has no comparative advantage to assess how dangerous to the environment is the activity of the financed company. However, if the costs of undertaking an environmental audit prior to the loan are lower than the reduction of the expected environmental damage, a different rule could be defended: holding the lender liable provides the right incentives to undertake the audit. The matter requires an empirical analysis. In any case, the concept of "operative control" should be defined more precisely: shareholder's majority?, control majority?, presence in the Board?

5. Criteria for different types of damage

In this section, the WP refers to four tasks:

a) Preparing liability criteria for biodiversity damage, something that did not exist up to now.

b) Combining the different existing criteria in the national liability regimes for contaminated sites.

c) Doing the same in relation to the rules on traditional damage.

d) Establishing decision rules for the cases of overlap between environmental liability and product liability legislation.

a. Biodiversity damage

The WP points out generically some elements arising from the concept of **significant damage:**

First, the damage covered by the system would be identified through a list. If it is so, it is convenient to specify whether the list can be extended by analogy or if this is not the case.

Second, it suggests a minimum threshold below which the EC system would not enter into force. For locally concentrated damages, the criterion seems reasonable, but in any case it will have to be specified whether national systems can operate below the threshold or if the rule is one of complete exoneration. According to the subsidiarity principle, the first interpretation should prevail.

Third, the WP promotes a system of physical (*in natura*) restoration, defined by standard cost/benefit analysis. A system of equivalent restoration is foreseen when the former is too expensive due to technical or economic reasons, though always guaranteeing a minimum restoration level that returns the natural resource to a state comparable to the pre-accident one. The rule of minimum restoration is consistent with a policy of environmental protection of well defined sites, but the WP should pronounce itself on the distinction between geographical equivalent and environmental equivalent: feasible restoration *in natura et in loco* can be too expensive and at the same time, an investment of equal amount can be ecologically more

beneficial in a different protected site, maybe a neighbouring place to the one irreversibly (or almost irreversibly) damaged.

Fourth, the WP assumes that the areas protected by to the Wild Bird Directive and Habitats Directive, representing 10% of the EU current territory, are already subject to a legislation that excludes the operation of companies carrying out activities inherently dangerous to the environment and, therefore, "the bulk of environmental damage to these areas may only be caused by plants operating dangerous activities in neighbouring areas... already... covered by the other pillars of the proposed regime... in the form of traditional damage and contamination of sites". Besides, it assumes that the damage they can produce will be "exceptional". This may be an optimistic forecast in view of recent events such as the Aznalcóllar disaster (**http://www.greenpeace.es**, **http://www.cma.junta-andalucia.es/**).

b. Contaminated sites

The WP uses two categories in this section:

a) **Time of occurrence,** distinguishing between **pollution already produced and risk of future pollution.** According to a general principle of no retroactivity, it is suggested that the former be subject to national regime on contamination of specific sites. The latter, instead, would be subject to the EC regime sponsored by the WP. Here we refer to what was said in section **4.1** on the no retroactivity of the suggested EC regime.

b) **Goal**, distinguishing, with respect to the function of each suggested remedy: **simple decontamination, clean-up of the contaminated site or complete restoration of the contaminated site:**

b.1) For the decision about decontamination, the WP suggests to consider exclusively damages above the significant-damage threshold. Despite the statement of the WP, according to which, such damage is determined "as in the case of biodiversity" (**4.5.1** above), in this case it is based upon a qualitative criterion: "Does contamination constitute a serious threat to man and the environment?". The WP should have been precise, at least, as to whether the minimum threshold of damage is the same for biodiversity damage (4.5.1) and for the clean-up of contaminated sites (4.5.2).

The aim of decontamination or clean-up must be to arrive at the quality levels of ground and water suitable for their current and probable future uses, says the WP. The aimed quality thresholds must be acceptable, according to the best techniques available, provided they are economically feasible. Implicitly, we go back to the cost-benefit analysis contemplated in section 4.5.1. for damage to biodiversity. Subsidiarily, the WP proposes full or partial containment of the contaminated site. It does not specify whether this would be the only or the last solution. It must be understood that, even in the event of an irreversible damage and subsequent containment of the contaminated site, the action mentioned in section 4.6 (restoration or improvement of a similar natural resource) is applicable.

c. Traditional damage

In 4.2.1 the WP defines traditional damage as damage to health and to property. In this section (4.5.3.), quite surprisingly, the concept, it says, could also include pure economic loss. In any case, the WP assumes that the scope of traditional damage is defined by each national legal system, but the legal consequence will be defined by the EC system, except for one case (special provision on access to justice, section 4.7: the standing of interest groups is rejected) and an exclusion resulting from the very nature of traditional damage (specific criteria for restoring and evaluating environmental damage: 4.5.1. and 4.5.2.). Notice that the proposed homogenisation of the different legal systems can be, indeed, a mere fiction: if, for example, for the same harmful event, a Member State includes, but another one excludes, pure economic loss from the scope of compensable damage, it is obvious that the amount of the compensation will be different in both cases (see what is set forth in **4.2.1.**).

d. The relation with the Product Liability Directive

See section **4.3**.

6. Ensuring effective decontamination and restoration of the environment

The WP emphasises in this section the prevalence of the principle of ***in natura* restoration,** with the only exception of its non feasibility or extreme unsuitability (technical or economic). In the later case, the damage award should be invested in substantially **similar projects** of restoration or improvement of the environment. In a strict sense, the application of the cost-benefit analysis means that the choice of one solution over the other depends exclusively on the fact that the benefit from *in natura* restoration exceeds its costs or not: the WP should have clarified if this is the proposed criterion (as it seems to arise from sections 4.5.1 and 4.6.).

Besides, we must remember that the general principle in the Law of Torts is that the victorious plaintiff is free to use the damage award as he sees fit. Moreover, the theory of public finance strongly discourages predetermination of public revenue.

7. Access to justice

Environmental damage is a clear example of insufficient incentives to litigate and, therefore, to ensure that the offender will pay for the damage caused. In many cases, environmental damage is diffuse in nature, affects goods that are not privately owned (sometimes not even publicly owned: migratory birds) and, finally, any rational citizen would prefer to let his neighbour enjoy the expensive honour of starting a judicial procedure or, even to report the facts (a typical *free riding* example).

Therefore, as the WP says, the first to take the burden of suing should be the State. But, it adds, the limitations on public funds suggest the convenience of expanding the standing to sue to interest groups that meet certain objective qualitative criteria. The

proposal, it continues, agrees with the Commission Communication 96(500) on Implementing Community Environmental Law and the Aarhus Convention (Denmark)[7].

To the reasons pointed out by the WP, we must add some others that reinforce the proposal of allowing interest groups to sue: it is not unusual that the damage or threat to the environment comes from a public entity, or that the regulatory agency who authorised a potentially polluting private activity lacks any incentive to sue.

However, the possible participation of the interest groups in the claims related to environmental damage does not constitute enough guarantee that the problems of insufficiency of incentives to litigate will be fully solved: possible participation does not mean effective participation (the lack of resources is not limited to public actors) and, finally, the interest groups can act in their own interest, and not necessarily try to maximise social welfare.

a. "Two tier approach": the State should be responsible in the first place

In ordinary cases, says the WP, Member States should be under a duty to ensure restoration of damage to biodiversity and decontamination in the first place (*first tier*). Subsidiarily, i. e., in the absence of proper action by the State, interest groups should get the right to ask for review of administrative decisions, to appeal against Court decisions or to sue the polluter directly (*second tier*).

Notice that the WP does not include any clue about criteria allowing to differentiate between ordinary cases and the ones qualified below as urgent or, in the first case, which behaviour of the public authorities is sufficient to trigger the proposed mechanism of subsidiary standing of interest groups. Considering the WP wording, it seems that the Judge or Court themselves should determine whether the conditions for

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[7] Convention on the Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters, implemented by the Ministery Conference "Environment for Europe", held in Aarhus, Denmark, on the 25th of June, 1998:

> Article 9. Access to justice.
>
> "3. In addition and without prejudice to the review procedures referred to in paragraphs 1 and 2 above, each Party shall ensure that, where they meet the criteria, if any, laid down in its national law, members of the public have access to administrative or judicial procedures to challenge acts and omissions by private persons and public authorities which contravene provisions of its national law relating to the environment.
>
> 4. In addition and without prejudice to paragraph 1 above, the procedures referred to in paragraphs 1, 2 and 3 above shall provide adequate and effective remedies, including injunctive relief as appropriate, and be fair, equitable, timely and not prohibitively expensive. Decisions under this article shall be given or recorded in writing. Decisions of courts, and whenever possible of other bodies, shall be publicly accessible.
>
> 5. In order to further the effectiveness of the provisions of this article, each Party shall ensure that information is provided to the public on access to administrative and judicial review procedures and shall consider the establishment of appropriate assistance mechanisms to remove or reduce financial and other barriers to access to justice".

standing are satisfied. The former seems to add some unnecessary complication and does not contribute to legal certainty.

The WP is not precise enough about the level of damages the interest groups could claim, since the understanding of what is compensable damage for them is not always obvious and, besides, there are problems related to controlling the effective destination of the awards. It is true that section 4.7.2 refers to this question, but it does not solve it completely, mainly because it only mentions interim relief and reasonable preventive costs as parts of the possible claim of such interest groups. Besides, if the scope of the damage award for interest groups is adequately defined, so that the risk of frivolous claims is reduced or avoided, it would not even be necessary to render their standing subsidiary, and it would be possible to allow those groups to go directly to Court.

b. Urgent cases (interim relief, costs of preventive actions)

In such cases, the WP proposes to reinforce the standing of interest groups, which not only becomes direct, but also comprises the possibility of asking for injunctive relief. The WP, cautiously avoids addressing the relationship between the purely compensatory action (*liability rule*) and injunctions (*property rule*). Given the great diversity of possible cases, the position of WP seems to be reasonable: it is almost impossible to determine in advance and in a centralised way when one solution is more desirable than the other (think, for instance, about the differences between a case involving emissions by automobiles and another of spills from a factory facility).

Also in this section, the WP allows compensation of reasonable preventive costs in favour of the acting interest group, a clear incentive to its active participation. The normative requirement of cost reasonableness implicitly adds a judgement of the preventive measures by interest groups in cost-benefit terms: only preventive costs that are justified in terms of reduction or mitigation of environmental damage will be reimbursable. Such requirement should therefore serve to exclude potentially frivolous and inefficient actions from interest groups.

c. Ensuring sufficient expertise and avoiding unnecessary costs

The extension of standing to sue carried out by section 4.7 of the WP does not benefit all interest groups operating in the area of environmental protection, but will be limited to those satisfying objective qualitative criteria.

Such a restriction seems reasonable: the Court system is expensive not only for litigants, but also for the tax payer. Besides, collective standing creates a higher risk of frivolous or illegitimate claims than those claims filed by individuals showing a specific harm or injury. Furthermore, in this area, the reputation of a firm is very vulnerable to threats of unreasonable lawsuits, and this danger suggests caution in expanding collective standing.

The WP does not explain which legislation will have to specifically formulate the criteria to select legitimate interest groups. In principle, due to the fact that a uniform legislation is pursued in this field of access to justice, it seems that the EC regime will be given the task by the WP. However, it is not unimaginable –and the WP does not exclude it- to leave the question to national laws. This might have some advantages,

but it implies a substantial risk of excessive variance in the *enforcement* levels of a substantive regime of liability for environmental damage, which would be essentially uniform in the different Member States.

If the EC regime has to dictate such criteria, a higher level of precision when considering them is necessary. The reference to "quality" and "objectivity" are not enough to set forth, with a minimum certainty, the scope of collective standing in this area. Numerous questions arise: is it necessary to have an administrative authorisation –European, national, regional?- in order to sue for environmental damage? Is it enough that the purpose of the interest group is the protection of the environment, or should seniority or relevant experience requirements be added? Will there be a requirement for any type of financial solvency to face eventual claims derived from frivolous or excessively impulsive lawsuits. All these questions should be addressed by the EC regime.

The remark made by the WP on alternative dispute resolution mechanisms (*ADR)* also needs further clarification. It is obvious that such mechanisms imply advantages in terms of cost savings with respect to formal Court adjudication. It is, however, unlikely that the field of environmental protection, with an important component of "public good" (in the economic sense, not in the legal one) is particularly suitable for ADR mechanisms to display their positive cost reduction effects. There is the risk that the arbiter's decision, the middleman proposal or the settlement amount do not include the element of positive externality included in the fact that the polluting agent is effectively obliged to pay for the whole environmental damage caused (what makes polluter internalise the real social cost of his activity).

The former does not imply a total exclusion of the *ADR* from this area of the Law, but it strongly suggests caution in its use. Anyway, it is unlikely that the future EC environmental damage liability regime would include measures forcing *de iure* or *de facto,* the plaintiffs to use ADR mechanisms.

8. The relation with international conventions

See section **5.1.**

9. Financial security

In this section, the WP deals with two problems and treats them as closely connected. They are, however, conceptually and practically well differentiated.

One of them refers to the incentives that an environmental liability system induces in companies of a certain size carrying out activities likely to cause this kind of damage to "externalise" potential environmental liabilities towards smaller, probably insolvent companies in the event of an environmental catastrophe. Through such manoeuvres, the deterrent effect of the liability regime disappears or, at least, is drastically reduced. The solution is not to be found in rules on financial coverage or insurance (specially if the latter is not compulsory), but in the rules determining who should be held liable: liability of the principal and not only of the agent or the contractor, liability of the waste producer and not only of the waste manager, liability of the holding company and not only of the subsidiary. The possibility to use the insurance market, contrary to

what the WP seems to think, does not reduce the incentive to escape liability: the big company, if possible, will prefer to transfer the likelihood of paying damages, to an insolvent company who is aware of the fact that it will not pay for all the damage caused -and therefore will not charge for its services the price that corresponds to its real social cost- than paying insurance premiums which, in principle, reflect the real expected social cost, plus the *overhead* of the policy administration costs –which would otherwise have to be paid to the Insurance Company. If insurance is mandatory, no doubt that the opportunity to escape liability disappears, but only in the event that big companies are considered potentially liable for the purpose of imposing compulsory financial coverage. And, even in that case, it could be advisable to avoid liability transfers to smaller companies, both because their lower solvency affects negatively the incentives for care, and because the adjustment of insurance premiums to care levels can be more easily achieved in relation to bigger companies.

The problem of insuring environmental civil liability is a different matter. Companies facing the likelihood of paying compensation (potentially very high) for environmental damage caused by them will probably demand insurance, i. e., will seek the transfer of risk to a risk neutral party (the insurance company) in exchange for a premium.

The potential offenders liability insurance is not, however, indifferent to care incentives. The insured who can affect the probability of an environmental accident, has now less reasons to invest in precaution, since the negative consequences of such accidents are insured. This moral hazard problem can be solved through *ex ante* or *ex post* control mechanisms by the Insurance Company, allowing it to link the insured's level of care with the premium, or through the use of deductibles that leave part of the damage with the insured. The feasibility of such systems in the field of environmental liability insurance seems to be, in principle, relatively high, and this partially allows us to set aside moral hazard problems.

However, the problem of insuring environmental damage in itself -or, at least, the harder to assess and quantify- cannot be omitted (see section **4.5** dealing with evaluation criteria for different types of damage). The WP expresses doubts on the feasibility, at least in the short term, of a sufficiently mature insurance market that can face such difficulties. This leads the Commission to reject the possibility of imposing within the EC regime mandatory insurance or other type of compulsory financial guarantee to cover potential liabilities.

Although this attitude reveals caution, the truth is that the WP does not state clearly enough the costs of its option against mandatory insurance. Such costs derive mainly from the limited resources of numerous potential polluters (*judgement-proof problem*). Insolvent firms have less incentives to invest in precaution, in view of their inability to pay for all the damage caused, and their incentive to insure liability is consequently reduced (in fact, below a certain level of solvency, the potential offender, even when risk-averse, has no interest in buying an insurance policy). Compulsory insurance contributes to solve this problem, at least if it is possible to reasonably link precautionary measures with premiums. In other words, the exclusion of mandatory insurance comes at the price of underdeterrence: firms lacking resources to face their expected liability have less incentives to prevent pollution (and this could be corrected by mandatory insurance under certain conditions).

It might be advisable not to reject mandatory insurance for those economic sectors that are particularly dangerous for the environment and where, given the average company size, it can be expected that the effects of the *judgement-proof problem* will be serious and cannot be properly avoided by *ex ante* regulatory measures (for example, licenses or authorisations under the condition of solvency controls, limits on activity levels or the implementation of technologies that reduce expected environmental liability to very low levels).

- ***Different options for community action***

The WP considers different normative strategies to regulate environmental damage liability and concludes that the best solution is to prepare a general EC directive on this matter.

First, it presents the possible *Community accession to the Europe Convention on civil liability for damage resulting from activities dangerous for the environment, adopted by the European Council in Lugano in 1993* (Lugano Convention). The WP does not consider this alternative feasible without an additional Community legally binding text determining the excessively vague scope of environmental damage in art. 2.7 of the Lugano Convention, and the criteria through which the restoration or compensation should be carried out. Due to the former, the WP concludes that the Lugano Convention would not be sufficient to guarantee a minimum homogeneity in the environmental liability regime. The accession to the Convention alone, thus, would not solve the problems that Community action is intended to address.

Another alternative consists in limiting the EC liability regime to cross-border damages. This solution presents important disadvantages that make it hardly advisable: the existing gap in national laws on damage to biodiversity would not be covered, the EC action would be restricted to a type of damage of quantitatively minor importance and, finally, it could imply unjustified differences between identical polluters, based on where the damage took place. Location does not seem to be a proper decisive criterion to determine the applicable legal regime.

The third alternative would be the adoption of a non-binding text, that is, a recommendation. This does not seem to be a positive solution. Though it could imply lower costs for the economic agents in terms of certainty, there would be a gap concerning cross-border damage, and would imply a significantly lower level of environmental protection. Since environmental protection at a European level has positive effects on all the EU Member States, the individual incentive for each State to establish a more rigorous environmental legislation for its own companies is very low: it will always be more advantageous to profit from the general environmental improvement provided by the neighbouring State's legislation.

Finally, and correctly, the WP considers the preparation of an EC Directive on environmental liability as the most desirable option in terms of legal certainty. This future directive would allow a more precise definition for the scope of Community action, a better regulation of damage to biodiversity in relation with the existing Community rules on this matter and a stronger guarantee of effective results when

restoring the environment. However, it is important to indicate that this future Directive should be more concrete and precise than it is foreseen by the WP regarding, among others, the types of damage included, the applicable liability rule and the standing to sue.

The WP further balances the advantages and disadvantages of basing the future Directive on a sum of regulations in specific sectors (such as biotechnology), or elaborating instead a horizontal regulation for all activities that are potentially dangerous to the environment. The second approach seems to be preferable, because it avoids differential treatment for sectors showing comparable degrees of risk to the environment.

- ***Subsidiarity and proportionality***

The WP points out that the principles of environmental and health protection established by art. 174.1 of the CE Treaty have not reached and optimal level of application in the Member States due to three types of reasons:

a) ***Protection gaps*** in the different national legal regimes, particularly in terms of damage to biodiversity.

b) ***Cross-border nature*** of an important part ***of the damage*** to be redressed.

c) ***Heterogeneity of the legal, judicial and administrative mechanisms in the field of environmental liability:*** some Member States mainly rely on public Law techniques, whereas others prefer private law instruments, though all of them combine both types in different proportions.

Given this situation, the best option for the WP is a ***gradual Directive-based approach.*** The Directive would determine the basic elements of the liability regime, but would leave a wide margin to the Member States, always –it concludes- under *ex post* control by the Commission and the ECJ.

Although the WP's double option can be shared, it might have been suitable to explain its compatibility with the principles of subsidiarity and proportionality.

- ***The overall economic impact of environmental liability at ec level***

The caution shown in this section by the WP, explicitly acknowledging that the Commission has not enough empirical information to advance a global judgement on the overall economic impact of the new regime, clearly suggests that, before setting up the process for the elaboration of the Directive, more empirical surveys must be undertaken. To this end, the WP points at the following aspects to be assessed:

a) The lessons from the American experience, particularly the one related to the ***CERCLA*** (***Superfund Legislation***).

b) The impact of the new legislation on different sectors, among which we must point out ***SME***s ***(PME, PYME, Mittelstand***), financial and insurance industries, and finally, the impact on the overall employment rate.

c) The ***costs of elaborating and enforcing the Directive*** (transaction costs, particularly those directly related with the litigation generated by the new legislation).

Although the opening of WP to the analysis of extra-EU experiences that are already well contrasted is praiseworthy, the impression given by the WP maybe over-optimistic: according to empirical studies on this matter [Lloyd S. Dixon "The Transaction Costs Generated by Superfund's Liability Approach" in Revesz and Stewart, *Analyzing Superfund*, Washington (1995)], transaction costs –not directly destined to the clean-up of contaminated sites- consumed 36% of the private sector's total expenditure under the *Superfund* system and, in the case of Insurance Companies, the rate amounted to 88% of their expenditures.

This notwithstanding, it is arguable that the high transaction costs of the *Superfund* system are mostly attributable to factors inherent to the legal system and the market for legal services in the USA, rather than to a scheme of compensation Fund for environmental catastrophes combined with reimbursement actions against identifiable liable parties. In fact, the WP should possibly take more specifically into account the option of compensation Funds, paid through taxes levied on the industries that could affect the environment more directly. The deterrent effect of the system could be kept with the help of reimbursement liability claims against the firms that caused the environmental damage. The positive effect of such a system on effective environmental restoration is, of course, obvious.

The reference to SMEs creates some puzzlement: on one side it is pointed out that these economic agents "often cause more environmental damage than their size would predict, possibly due to a lack of resources" –clear reference to the *judgement proof problem*: when a potential polluter lacks enough resources to face the maximum damage that can be caused by his action, incentives for care are reduced-, but the WP adds subsequently that "undesirable side effects could be mitigated by more targeted use of national or EC support mechanisms aimed at facilitating adoption by SMEs of cleaner processes", i.e., by public subsidies, national or EC. It seems clear that the more polluting sectors will be the ones to suffer the highest impact of the new regime, but this does not imply *per se* a positive judgement on the convenience of public subsidies in this case. The declared deterrence goal of the WP leads precisely to the result that those who pollute more should pay more. Thus, resource redistribution in favour of polluting SMEs has no explicit justification in the WP, all the more so when it acknowledges that the net effects of applying the new regime on employment could be positive.

As for the impact on the financial industry, in the absence of a more precise empirical assessment, it does not seem important, since the *lender liability* would not be included in the new liability regime.

The effects on the Insurance industry are more complex. Since the WP has expressly rejected imposing mandatory liability insurance for the liabilities resulting from the

proposed EC regime, it is almost automatic to conclude that the insurance sector can only benefit: the new –and increased- liabilities will generate a raise in the demand for civil liability insurance but, at the same time, Insurance Companies would be able to screen the insurance applicants so as to accept only those policies that, on average, can be expected not to cause a negative imbalance of their profit function, that is to say, they can reject "bad risks" or include in their policies clauses permitting to optimally define the risks under coverage.

However, this favourable effect for Insurance Companies requires certainty and predictability in the interpretation by national Courts and, eventually, the ECJ, of the norms of the EC regime for environmental liability and the norms ruling the insurance contract between Insurance company and insured. If, for example, Courts award damages exceeding the level foreseen by the Companies when determining their premiums, or declare some contract clauses delimiting the coverage as void (in this respect, it is important to remember the Spanish experience –and that of other States- with *claims made* clauses: the Spanish Supreme Court considered them incompatible with the essential concept of civil liability insurance and, therefore, void, and the legislator had to intervene in order to restore their use by the Companies), Insurance Companies can be negatively affected. Even though insurance will be voluntary, the EC liability regime on environmental damage cannot disregard what happens in the insurance market, and it should endeavour to offer the most predictable framework so that the Insurance Companies can safely cover the risks of environmental liability.

The WP's concern about the economic impact of the future EC legislation also includes the transaction costs generated by the system. The relatively optimistic view of the WP relies on two types of evidence: the American experience, that seems not to have meant an increase in the (already very high) level of transaction costs of the civil liability system in USA; and the EC experience regarding the up to now most important area of damages subject to European legislation: product liability, in which the empirical studies already completed do not show an increase in the litigation rate as a consequence of the implementation of the European product liability regime.

This might not be the most appropriate comparison, however. The empirical studies that need to be undertaken before the preparation of the EC Directive must try to check the expected transaction costs in the European environmental liability regime, with respect to the ones foreseeable under other alternative environmental damage prevention systems for Europe.

- ***Conclusion***

1. In some of its sections, the WP seems to identify the damage caused to the environment with the cost of its restoration. The former, from a strictly analytical point of view, would be wrong both in law and economics: the *in natura* restoration of a wood of centenary holm oaks is almost infinitely expensive on any time scale other than centuries. There can be, however, several reasonable approaches to estimate and compensate the damage caused. The authors of these Comments recommend developing the analysis sketched by the WP with regard to a rigorous distinction between damage compensation and environmental restoration.

2. The WP also seems to assume that it is possible to analyse the influence of a civil liability regime on environmentally relevant behaviour regardless of the effects of other environmental protection instruments, mainly public regulation and administrative and criminal fines. And this is so despite the fact that the WP recognises that the Member States' legal regimes also include these measures. The authors of these Comments point out that the optimal prevention levels in environmental matters depend on the joint use of all these instruments and it is therefore necessary to incorporate a global analysis of their interaction. If damages are correctly assessed and all offenders are sentenced to pay damages, but there is also a high probability that they will suffer the negative consequences of other measures for environmental protection, there is a clear risk of overdeterrence. On the other side, considering the use of restoration Funds, supplemented by reimbursement actions against identifiable polluters, could be an interesting alternative.

3. The WP seems to assume the principle according to which the amount of the compensation should be devoted, virtually in any case, to restore the damaged environment. If the analysis is carried further, the most likely result would be that in many cases, such a use of scarce resources may not be the most efficient one (for instance, if a neighbouring extension twice as vast as the damaged could be restored at the same cost).

4. As for damages covered by the future EC legislation, it is noticeable that no attention has been paid to non-pecuniary damages, a matter regulated in very different ways by the Member States's national legislations.

5. It would be convenient to further develop the WP's analysis on everything related to the plurality of offenders. In particular, criteria should be established in terms of assessing the multiple causal links, assignment of the burden of proof and the distribution of the damage award among the liable parties. It is important to notice that the joint and several liability rule is not the optimal one in every case.

6. The proposal envisaged by the WP concerning the partial exoneration of polluters who have adjusted their historical behaviour to the required administrative standards, combined with the idea that this partial exemption should be compensated with public Funds, implies a transfer onto the taxpayers of the effects of an excessively lenient, and therefore faulty, legislation. This liability sharing mechanism does not appear to be the best system to create incentives for the most desirable public regulatory standards.

7. The WP's option of defining the factual content of liability for traditional damage and to specific sites based on the hazardous nature of the activity, and then, for damage to biodiversity, relying on the inclusion of the damaged natural resource in the current EC environmental legislation, does not seem coherent. The solution sponsored by the WP seems to show an excessive *path dependence* and the authors of these Comments suggest the generalisation of the first criterion.

8. The criteria just sketched by the WP concerning access to justice of interest groups, specially with respect to the distinction between urgent and ordinary cases, need a

more detailed regulation: in urgent cases injunctive release is available, whereas in non peremptory cases only *ex post* compensation is at hand.

9. It would be advisable that the future Directive does not follow the WP with regard to mandatory liability insurance for certain industries. Those activities particularly dangerous to the environment should be subject to a compulsory insurance scheme. In order to improve the operation of the insurance market, at least in the short term, the introduction of damage schedules or caps could be considered.

10. The solution suggested by the WP of preparing a horizontal EC Directive is shared by the authors of these Comments. It seems a better solution than a sector-specific regulation. It is, however, important to emphasise the convenience that the prospective regime would be more precise than the WP itself implies.