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MITIGATING ECOSYSTEM RISK WITH FINANCIAL ASSURANCE

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SUMMARY

Financial assurance exhibits regulatory potential to mitigate risks to ecosystems associated with industrial activity.

But in the EU, with limited exception (e.g. Spain), political will is just not there to mandate that operators hold financial assurance for costs associated *with a pollution incident*.

Why? (1) **cost** to industry, particularly smaller companies; and (2) relatedly, the **'first mover' disadvantage**.

BACKGROUND (1): SOURCE OF PROBLEM

Environmental laws' relationship with corporate law and insolvency law is not always a happy one.

Corporate law may be used strategically (and lawfully) to avoid costs associated with environmental obligations.

Insolvency (or bankruptcy) law orders the priority of debts; regulators often join the other unsecured creditors at the 'back of the queue!

BACKGROUND (2): A SOLUTION

Regulatory intervention can improve relationship: **operator (or related party) could be required to evidence provision made for actual/potential environmental liabilities**.

e.g. environmental impairment liability insurance, a bank guarantee, a bond or a cash deposit with relevant regulator.

This is described as evidencing or making ‘financial assurance’.

COMMON ‘FA’ MEASURES

1. funds or assets may be set aside with a third-party (e.g. **escrow account, cash deposit** and **trust fund**);
2. charge over valuable asset(s), e.g. real estate;
3. risk may be transferred to a third-party, such as an insurer or bank, in return for a premium or fee (e.g. **insurance, bank guarantees** and **surety bonds**);
4. financial strength may be ‘tested’ (e.g. **self-insurance** and **parent company guarantees**);
5. membership of a fund or pool.

MITIGATING ECOSYSTEM RISK (1)

Financial responsibility for costs of redressing environmental damage may *incentivise* operators to reduce their environmental risk.

But, **deterrent effect dictated by operator's asset level**; corporate decision-makers have unilateral control over this.

Financial assurance can reduce disincentives to exercise due care; motivate risk reduction.

MITIGATING ECOSYSTEM RISK (2)

An FA measure may exhibit a preventive capacity where it attaches a **price** to the activity, e.g. premium, cash deposit.

That price and its ***responsiveness*** to (environmental) risk-reducing measures could motivate behaviour modification.

But, where price does not reflect *environmental* risk (e.g. surety bonds, bank guarantees), or there is *no price* (e.g. self-insurance) motivation to modify lessened.

MITIGATING ECOSYSTEM RISK (3)

"Member States shall take measures to ensure that ***all of the costs involved in the setting up and operation of a landfill site***, *including as far as possible the cost of the financial security or its equivalent*…, and the estimated costs of the closure and after-care of the site for a period of at least 30 years ***shall be covered by the price to be charged by the operator for the disposal of any type of waste in that site***."

EU Landfill Directive, article 10.

COMPENSATION FUNDS

European Commission has consulted on the prospect of introducing an EU-wide compensation fund.

Ability to ensure that private funds can be drawn upon to undertake clean-up measures, *even where costs very high*.

Controversial: fund members, generally, held **collectively responsible** for the environmental costs associated with a large industrial accident – **‘polluter-pays’ principle!**

FUTURE RESEARCH

1. How wedded are we to the polluter-pays principle? Are there alternative justifications upon which to build liability regimes?

2. Effect on trade of different financial assurance regimes in, for example, the provinces of Canada.

3. Developing transparent, accurate valuation tools (see e.g. the Spanish MORA risk assessment).

CONCLUSION

Certain FA measures can help mitigate ecosystem risks.

But, political appetite not present in EU/UK.

FA should: (1) ensure sufficient private funds available to undertake works; **&** (2) motivate reductions in ecosystem risk.

Compensation funds, when used in a tiered-structure, can do both but the devil is in the detail…

ANY QUESTIONS?

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