

Environmental Concerns in The Transaction

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Increasing negotiations must consider environmental implications; proactive stance may benefit

All businesses have been subject to environmental protection provisions for many years. In most States of Australia legislation controlling emissions to both air and water have been in existence for some time and businesses have learned to adjust and deal with these requirements.

During the 1980s, environmental issues came strongly into prominence and business have had to deal with environmental issues in a much more intricate and formal way than previously.

Increased concern about the environment arose due to the growth in influence of the environmental movement both nationally and internationally and the change in community attitudes. This in turn prompted significant new environmental protection legislation to be introduced or proposed.

All the indications are that the environment will remain very much a "cutting-edge" issue even if there is a backlash against some of the more extreme demands that have been made by activists.

ENVIRONMENTAL LEGISLATION

The States of Australia and the Commonwealth are all moving in various ways to imposing stricter environmental requirements on all manufacturers and distributors of products. At the stage Australia does not have a coordinated national approach to environmental protection. This of itself gives rise to problems for companies doing business in more than one state. As a result of our Federal system, businesses have to deal with not only state legislation, which varies from state to state, but

also Commonwealth legislation that may not be consistent with state laws.

To illustrate the proliferation of legislation, a list of some of the legislation already passed is shown in Figure 1. This is by no means a complete or up-to-date list, but is provided to indicate the complexity and scope of the legislation being introduced.

LIST OF RELEVANT LEGISLATION

A. NEW LEGISLATION

1. The Environmental Offences and Penalties Act 1988.
2. Environmental Planning and Assessment Act 1979.
3. State Pollution Control Commission Act 1973.
4. Noise Control Act 1982.
5. Public Health Act 1982 (Part VIII).
6. Land Conservation Act 1979.
7. Prevention of Oil Pollution of Navigable Waters Act 1981.
8. Clean Air Act 1982.
9. Energy Usage and Efficiency Act 1982.
10. Rivers Act 1988.
11. Clean Water Act 1988.
12. Waste (Reposal) Act 1988.
13. Noise Control Act 1982.
14. Toxic Chemicals Research Act 1982.
15. Dangerous Goods Act 1982.
16. Petroleum and Allied Chemicals Act 1978.
17. Occupational Health and Safety Act 1985.
18. Fisheries Act 1988.
19. Environmental Protection Chemicals Act 1982.
20. The Marine Pollution Act 1980.
21. The Fisheries Management Act 1982.
22. The Pollution Control Act 1980.
23. The Environmental Protection and Rehabilitation Trust Act 1982.
24. The Environmental Education Trust Act 1982.
25. The Environmental Research Trust Act 1982.
26. The Ocean Protection Act 1982.

B. COMMONWEALTH LEGISLATION

1. Protection of the Sea (Civil Liability) Act 1982.
2. Environmental Protection (Sea Dumping) Act 1982.
3. Protection of the Sea (Offshore of Territories) Act 1982.
4. Protection of the Sea (Prevention of Pollution from Ships) Act 1982.
5. Agricultural and Veterinary Chemicals Act 1988.
6. Biological, Chemical, Pharmaceutical and Assessment Act 1982.
7. The Hazardous Waste (Regulation of Imports and Exports) Act 1988.
8. The Ozone Protection Act 1988.
9. The Industrial Chemicals Notification and Assessment Act 1988.

Figure 1

Environmental issues can no longer be ignored. Every aspect of business is potentially affected. Every activity and proposed activity of a business should be scrutinized to ensure there is no breach of any environmental legislation.

CATEGORIES OF ENVIRONMENTAL LEGISLATION

Environmental legislation can take several forms and is more conveniently considered in the context of the following categories.

1. Prevention of pollution, e.g. control of oil spills, control of emissions.
2. Clean up of contaminated sites.

3. Liability for causing contamination.

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4. Planning approval, allowable use.

Not all of these categories will be applicable to any particular project or product. However, it is useful to consider the different aspects in relation to a particular project or product.

This can best be illustrated by way of example.

An Australian company wishes to take on the licensed manufacturing and sale of an industrial product. It enters into negotiations with the licensee as to the royalties payable, as part of its preparation for the negotiations, it carries out market research on the product's attractiveness to the marketplace and the likely selling price. It also considers the cost of manufacturing. It works out the cost of setting up a manufacturing facility and the direct cost of manufacturing the product.

All categories of environmental legislation can potentially apply and must be considered before the licensing negotiations can commence.

In looking at the cost and suitability of potential sites for manufacture, the licensee must consider the question of whether the site is contaminated. The manufacturing process should be reviewed closely to see whether it gives rise to any pollution or emission problems. Are there any byproducts, wastes or materials used in the process that may cause contamination problems? Occupational health and safety issues may also arise, which in turn can lead to industrial relations problems.

Finally, is the manufacturing activity prepared allowed by the planning laws and, if so, under what conditions.

All of these issues must be addressed. At least preliminary answers must be obtained before serious negotiations can commence with the licensee.

MANAGER LIABILITY

Even though the legislation may differ from state to state, a common theme is emerging. This is the new position of automatic strict and personal liability for breaches of the legislation on directors and man-

agers. Thus, not only the company but also the individual directors and managers of that company can be held liable for breaches of environmental requirements, and the penalties can be imposed directly on them. These penalties are significant and in some cases are criminal offences. The New South Wales Environmental Offences and Penalties Act imposes a maximum penalty on individuals of \$250,000 and/or seven-year imprisonment for what are defined as "Tier One" offences. These offences relate to the "wilful or negligent disposal of waste, or leakage, escape or emission of pollutants." The Victorian Environment Protection Act has similar penalties.

More offences impose either absolute or strict liability. This means that the prosecution does not have to prove intent on the part of the polluter, merely that the pollution occurred.

Under strict liability, it is a defence to show that a person acted under an honest and reasonable mistake or that they had used due care and diligence. Under absolute liability this defence is not available.

Under both the New South Wales and Victorian legislation, where a corporation commits an offence, "each person who is a director of the corporation or who is concerned in the management of the corporation is to be taken to have committed the same provision."

Corporate Veil

Directors and managers can no longer hide behind the corporate veil. The onus of proof has been shifted and guilt is automatic unless the directors or managers can prove they come within one of three defences:

1. They had no actual, imputed or constructive knowledge of the contravention.
2. They were not in a position to influence the conduct of the corporation.
3. If they were in a position of influence, they used all due diligence to prevent the contravention.

Thus, there are not only sound business reasons but also very good personal reasons for managers to

ensure their companies comply with the requirements. As a result, managers have to change the way they approach environmental issues. Strategies and systems have to be put into place specifically to deal with these issues.

Business is therefore faced with two pressing reasons to address environmental issues. One is the stick of criminal penalties and sanctions. The other is the "carrot" of doing the best possible deal for your company.

How then should you go about protecting both your own and your company's interests?

Due Diligence

A common theme of defences to a prosecution under much of the environmental legislation is that a person "used all due diligence" to prevent the contravention. The concept of due diligence is not defined in the legislation but its meaning can be derived from a consideration of its use elsewhere. Due diligence had its origins in concepts developed in the United States, which were adopted in Australia in relation to the Trade Practices Act and the Corporations Law.

Under section 80 of the Trade Practices Act, it is a defence if:

- (a) the contravention in respect to which the proceeding was instituted was due to the act or default of another person, or an accident or other cause (beyond the defendant's control); and
- (b) the defendant took reasonable precautions and exercised due diligence to avoid the contravention.

The case law in this area has given rise to the following general principles:

1. Due diligence is more than just a one off attempt to ensure compliance. It is necessary to establish a complete system for ensuring compliance with the relevant requirements.
2. It is not sufficient merely to install a system. It is necessary to ensure that it is properly controlled and supervised and updated regularly.
3. The system must encompass all relevant areas.
4. The system must be proactive.

14. designed to identify potential breaches and the action that is to be taken to ensure that the breaches do not occur. It is not sufficient merely to state a problem to arise and then act to remedy it.

5. Merely adopting procedures that are accepted as standard in the industry will not necessarily be sufficient if it can be shown that a greater standard might have been applicable.

Drawing an analogy with the Trade Practices law suggests that such business should set up its own systems and procedures to monitor the company's activities, identify the actual risk and then take steps to ensure that there are no breaches of the relevant legislation.

COMPLIANCE PROGRAMS AND ENVIRONMENTAL AUDITS

As part of the due diligence program and system it is becoming more and more common for an environmental audit and compliance program to be carried out. The first step in establishing a due diligence program is to carry out an audit that reviews all legislation in the context of the company's operations and determines what requirements must be met.

The environmental audit is a starting point. It is designed to tell management where the company is in relation to the requirements of the legislation and whether there are existing or potential breaches of the legislation. As part of the due diligence program an environmental audit should be carried out regularly in any event to assist changes in the legislation and changes in the methods and operations of the business.

The carrying out of an environmental audit will not of itself protect directors or managers from prosecution. However, it will be evidence of a significant commitment to a due diligence program. The lack of such an audit is an indication that due diligence has not been properly carried out.

Having carried out an environmental audit the results of the audit should be assessed and any required changes should be implemented immediately. The company is ac-

tually in a worse position in terms of potential liability if it has carried out an audit and identified areas of risk or problems and that has not acted on them. In that instance it is impossible to argue that the company was not aware of the problem. The longer it is left unaddressed the more significant the company appears.

Having carried out an audit and implemented whatever changes are necessary a continuing compliance program should then be put into place. It is not sufficient to merely carry out an audit every 10 years or so. It is necessary to continuously monitor and review the company's operations to ensure ongoing compliance. Not only do the legislative requirements change frequently the company's activities also change. What was previously a complying company can very quickly become non-complying.

LEASING, NEGOTIATING AND ENTERING INTO LICENSING ARRANGEMENTS

I have emphasized general principles of compliance that apply to all businesses and all types of activities. I now wish to concentrate on environmental issues as they more specifically relate to leasing.

There are many issues other than environmental to be addressed by both lessee and lessor when negotiating and entering into leasing arrangements. The commercial issues that have been described above are merely one of many issues that need to be addressed. I am not suggesting that the environmental issues are the most important nor should they drive the commercial decisions made in relation to leasing, to the exclusion of any other factors.

Obviously, the commercial issues of whether the proposed leasing arrangement will be profitable and beneficial to both parties and the commercial terms on which any licenses are to be granted are fundamental imperatives. However, environmental issues can dramatically affect these commercial factors. Ignoring environmental issues could mean that the commercial viability of the product and the

lease arrangement is adversely affected. What may seem an attractive leasing arrangement may prove to be unattractive because the product carries with it environmental side effects that result in liability or cost to the licensee.

As discussed briefly in my earlier example, environmental issues will arise not only in relation to the product itself but also in relation to the manufacture and distribution of the product.

I maintain that an ongoing compliance program should be established to cover the existing activities of the business. Before entering into a new leasing arrangement a similar process should be carried out.

The due diligence concept has also been adopted in relation to the Corporations Law with its new pre-emptive provisions. Under the Corporations Law the person issuing a prospectus has a general obligation to provide all relevant material information in a prospectus and ensure that there are no material omissions. It defines in a preamble to that section to be that the person issuing the prospectus took all reasonable precautions and exercised due diligence to ensure that all statements were true and not misleading and that there were no material omissions from the prospectus.

■ Issues ■

Similarly, before purchasing a business or acquiring assets many companies now as a matter of regular practice carry out a full due diligence program. The assets and liabilities of the businesses are reviewed by the proposed purchaser, and everything is checked to ensure that the company's accounts and other records are correct and accurate. In a similar way, I suggest that before entering into any leasing agreements a due diligence program should be initiated and carried out in relation to the product being licensed. In particular the following issues should be addressed:

1. Does the product itself give rise to any environmental issues, i.e. is it hazardous, can it contain-

2. Do the facilities required to manufacture or distribute the product give rise to any liability issues?

3. Has the licensee obtained any appropriate licenses, etc. required under the environmental legislation, whether locally or overseas?

4. Are there any proposed legislation or regulations that are likely to impact on the manufacture and distribution of the licensed product?

5. What information has been provided in relation to environmental requirements and the product's compliance with them, particularly where the product has been developed overseas?

6. What is the cost of addressing these environmental issues?

To the extent that these issues can be addressed in the licensing agreement, they should be. The licensee should seek warranties or undertakings from the licensor as to the compliance of the product with en-

vironmental requirements. Indemnities can be sought to protect the licensee in the event that there are subsequent claims against the licensee under the environmental legislation.

From the licensee's point of view, environmental problems will decrease the value of the product. There are various things that the licensee can do to improve the product's attractiveness. These include:

1. Its own environmental compliance program, which can show that the product does comply with environmental requirements.

2. The provision of information in relation to the history and experience of the product in any environmental aspects.

3. Research on environmental requirements to be carried out by the licensor prior to offering the product to the licensee.

4. Where the product is to be li-

icensed in several countries it would be preferable if the licensee could show that the product meets the strictest of all the environmental requirements, particularly given the increased international interest in environmental issues.

5. Taking out of appropriate insurance cover to cover any liability for infringement of environmental requirements.

Rather than seeing environmental legislation as a burden, it can be turned into a positive asset. A product that is presented as complying with all environmental concerns will be more attractive to a licensee and gain a better acceptance in the market.

While we might at first think it easier to ignore these issues, those companies that take a positive, proactive approach to compliance will reap benefits over and above those of avoiding fines and imprisonment.