

## Opinion

### Two challenges for the ECJ when examining the Environmental Liability Directive

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#### 1. Introduction<sup>2</sup>

In this article some basic insights into the functioning of liability rules are examined and related to what the ECJ could or should do.<sup>3</sup> I will try to develop the following two themes. (1) There exists a reasonably firm policy basis for a 'double track' system of public law and civil liability. Since there is a possibility that the Directive on Environmental Liability (ELD)<sup>4</sup> might encourage the use of a regulatory compliance or permit defence, there is a potential role for the ECJ to exercise a sceptical attitude towards such state practices and thus be hostile to Member State 'one-stop-shop' solutions that crowd out civil liability and transform traditional liability principles into a rule of regulation-based negligence. (2) Strict liability works best when harm is assessed in line with welfare and economic concepts and valuation techniques. Since this idea is most imperfectly implemented in state practice, there exists a potential role for the ECJ to promote or to impose duties to acknowledge the use of welfare-economic concepts and valuation techniques in the assessment of harm.

#### 2. Regulatory compliance and permit defences

An economic analysis of liability law finds that both negligence and strict liability can lead to desirable results, which however, depend heavily upon how the liability rules

are operated by the relevant decision-makers.<sup>5</sup> It is important that a negligence rule sets the right legal standards;<sup>6</sup> if the standard set is too lax or too stringent, there might well be improper incentives for precaution. And with a rule of strict liability it is important to set the right 'price' for behaviour in light of the harm that is caused.<sup>7</sup> If the assessment of harm is too lax or too stringent, improper incentives for precaution may develop.

According to the ELD, the governing principle is strict liability. However, room is left for regulatory compliance or permit defences, which let the polluter off the liability hook if he complies with certain regulations and permits, the most important general example being regulations and permits implementing the framework pollution control rules in the IPPC Directive, see ELD Article 8, 4(a):

The Member States may allow the operator not to bear the cost of remedial actions taken pursuant to this Directive where he demonstrates that he was not at fault or negligent and that the environmental damage was caused by: (a) an emission or event expressly authorised by, and fully in accordance with the conditions of, an authorisation conferred by or given under applicable national laws and regulations which implement those legislative measures adopted by the Community specified in Annex III, as applied at the date of the emission or event; (...)

Such defences in effect transform the liability rule from one that 'prices' behaviour (ie strict liability) to one that is based on a behavioural standard (ie negligence). This may be dubious from a social welfare point of view, for two reasons.

The first reason is that the grounds on which strict liability may be said initially to be superior to a negligence rule, might suggest that there is scepticism towards regulatory compliance or permit defences. In order for the negligence rule to function properly, the court has to weigh the marginal social costs and benefits of various courses of action and then set the standard of behaviour on that basis. However, if certain aspects of the polluter's behaviour are not monitored through the application of the negligence rule, strict liability will tend to be superior. The reason is that strict liability dictates the behaviour and leaves the polluter with the choice to adjust any aspect of behaviour

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<sup>3</sup> For a discussion of eight open questions concerning the Directive, see P Wennerås 'A Progressive Interpretation of the Environmental Liability Directive' (2005) JEEPL pp 257–67. For a critical account of the harmonisation of environmental liability rules from a law and economics perspective, see K De Smedt, *Environmental Liability in a Federal System. A Law and Economics Analysis* (Intersentia Antwerp-Oxford 2007). For a comprehensive account of environmental liability and ecological damage in European Law, see M Hinteregger (ed) *Environmental Liability and Ecological Damage in European Law* (Cambridge University Press 2008).

<sup>4</sup> Directive 2004/35/EC of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage OJ L 143/56 of 30.4.2004, as amended.

<sup>5</sup> A fairly updated and accessible account is found in S Shavell *Foundations of Economic Analysis of Law* (Harvard University Press 2004) pp 175–289.

<sup>6</sup> See eg R D Cooter 'Prices and Sanctions' (1984) 84 Columbia Law Review pp 1523–560; R D Cooter 'Economic Theories of Legal Liability' (1991) 5 Journal of Economic Perspective pp 11–30.

<sup>7</sup> *ibid.*

which he controls, and about which he may have superior information.<sup>8</sup>

To elaborate, one can distinguish between two forms of precaution: care and the reduction of the level of activity. An example, in the context of noise from traffic, is the distinction between protective measures such as double walls and improvement of houses (care) and the lowering of the amount of traffic (activity level). Another example in the context of wind energy is the distinction between the improvement of windmill technology (care) and the number of hours in operation (activity level). Finally, in the context of toxic releases from ships in fjords and harbours, the distinction lies between the choice of chemicals and ship paint (care) and the number of trips (activity level). In these examples, inclusion of the activity level in the determination of negligence may be hampered for two reasons. First, such inclusion requires precise information on the use that the polluter obtains from carrying out the activity, and the court may lack such information. Secondly, such negligence-balancing requires the finding of a certain level of activity as a matter of fact, and that factual determination may be hard to make in practice. For these reasons, the element of the activity level gives rise to an advantage of strict liability over negligence in certain pollution contexts.

The second reason why it may be dubious to transform the liability rule from one that dictates behaviour (ie strict liability) to one that is based on a behavioural standard (ie negligence) is that with the regulatory compliance or permit defences to strict liability, the legal standard may, in contrast to traditional negligence, be based solely on what is laid down as prescribed behaviour in the regulation or in the permit. Under traditional negligence, the courts would not allow other government decisions to outweigh the courts' own judgments in this way. Thus, strict liability with the regulatory compliance or permit defences has even less teeth than traditional negligence.

Ideally, I think this implies that courts should challenge regulations and permits ex post when making liability decisions. There are three basic reasons for this. First, ex ante decisions, on which the defences are based, require detailed *information* on the costs of pollution that might not be available at the time of the decision. This is especially the case with the assessment of harm that pollution might cause. Optimal pollution patterns vary with time and place and depend on the preferences and other characteristics of those that are unhappy with the effects of pollution (victims). Ex ante regulation must, in order to economise on information costs, be based on average estimates of costs and benefits. In contrast, ex post liability can be based

on more precise measurement of actual harm and the costs of avoiding it.<sup>9</sup>

Secondly, there are *administrative costs* (the cost of the time and effort by government officials and private parties in producing regulations that work) to be saved if ex post liability is allowed to play a regulatory role. Ex ante decisions tend to spread administrative effort equally over all cases of pollution. Ex post decisions, in contrast, concentrate administrative effort to situations in which notable harm occurs. If there is a right to compensation, moreover, victims are given an incentive to prove the extent of harm.

Thirdly, there are so-called *public choice reasons* to doubt whether the ex ante administrative decisions taken by state officials are always in the public interest. If government officials are self-interested, the administrative costs of ex ante decisions will increase both because of the wish for prestige (bigger department) and the lack of work effort (laziness). There is a risk that government employees are recruited and allowed to work in such a way that they become 'zealots', ie governing their sector without a proper concern for overall welfare. Finally, there is a real risk that government officials lacking all the relevant information might be targets for information campaigns by firms or well organised interest groups. I would not claim that all these concerns lead to bad decisions in practice; however, the risk of government failure should count in favour of a cautionary approach, and that ex post liability might be a proper check on how the regulatory bureaucracy works.

In sum, I think there are reasonably firm policy arguments for a double track system of public law and (civil) liability. Both ex ante and ex post regulation/liability are imperfect, and it is not reasonable to assume that the situation would be better with ex ante regulation alone. Thus, the welfare basis for a regulatory compliance defence is dubious.<sup>10</sup> The question then is asked: 'Is the ECJ in a position to rule on this?' There is no wording in the current Directive, so the court will have to rely on its power and will to be creative and develop judicial techniques for reviewing defences in state legislation and other state practices. However, is the court in a position to do this? What kinds of judicial techniques are available? It is clear that

9 *ibid* p 576. See also M J White and D Wittman 'A Comparison of Taxes, Regulation, and Liability Rules under Imperfect Information' (1983) 12 *Journal of Legal Studies* pp 413–25; S Shavell 'Liability for Harm versus Restitution of Safety' (1984) 13 *Journal of Legal Studies* pp 357–74.

10 For a critique of the prior proposal from the Commission along similar lines, see P Wennerås 'Permit Defences in Environmental Liability Regimes – Subsidizing Environmental Damage in the EC?' 4 *Yearbook of European Environmental Law* (Oxford University Press 2004) pp 149–80. See also De Smedt (n 5) pp 225–31 for a summary of the debate.

8 Shavell (n 5) p 182.

the ECJ has increasingly developed a dynamic and teleological interpretation of EC law, especially with regard to the environment.<sup>11</sup> A radical approach would be to invalidate Article 8(4) on grounds of being contrary to the principles of environmental law embodied in the EC treaty.<sup>12</sup> Could it be said, in certain circumstances, that to allow polluters to escape sanctions through the liability being based on such defences would be against the polluter pays principle and the principle of sustainable development?

Another and more moderate option is to challenge the validity of the defences as legislated in national law based on an investigation into the context in which the defences have been promulgated. Might such defences be considered state aid? A modest and obvious possibility is to develop principles of interpretation that demand very clear language regarding the defences and which also reads the defences as narrowly as possible. It is my understanding of ECJ jurisprudence that in general exceptions are read narrowly, and on the basis of the above, it seems desirable to deem Article 8, 4 (a) ELD to be an exception to the main rule.

### 2.3 Valuation of harm in the conceptualisation and assessment of damages

More than a century ago, the Austrian lawyer-economist Victor Mataja set down his thoughts concerning two particular tort issues.<sup>13</sup> On the one hand, in Mataja's view, the culpa rule is sometimes insufficient and strict liability is desirable on the basis of cost-internalisation considerations. On the other hand, a broad conception of compensatable harm is required, broader than that of only including pecuniary harm. Mataja explicitly based his thoughts on economic arguments, as is evident from the title: '*Das Recht des Schadenersatzes vom Standpunkte der Nationalökonomie*'.<sup>14</sup>

11 P Wennerås 'Towards an Ever Greening Union? Competence in the Field of the Environment and Beyond' (2008) 45 *Common Market Law Review* pp 1645–685.

12 Compare P Wennerås *The Enforcement of EC Environmental Law* (Oxford University Press 2007) p 196 ff.

13 Izhak England describes the work and opinions of Austrian lawyer-economist Victor Mataja on torts law, and documents how this work was discussed among continental tort scholars at the turn of the century. According to England, Mataja's ideas neither influenced continental legal change nor continental legal-doctrinal justification of liability law: 'It remains a fact that Mataja's ideas, though widely known, did not have much impact upon the legal process in Continental Europe. Maybe the reasons for their ultimate failure to bring about a radical change in the law of liability have some relevancy for the assessment of the renewed American experience'. I England 'Victor Mataja's Liability for Damages from an Economic Viewpoint: A Centennial to an Ignored Economic Analysis of Tort' (1990) 10 *International Review of Law and Economics* pp 173–91 at p 174.

14 *The Law of Damages from an Economic Perspective* (Duncker & Humblot 1888).

The interdependence of the issues of strict liability and compensatable harm illustrated by Mataja with the help of the welfare economics of his day is confirmed by the now standard economic model of precaution, harm and liability already referred to in this article.<sup>15</sup> In this model, two types of cost are considered, the cost of precaution and the cost of harm. Precaution is said to be socially desirable when the sum of both types of cost is minimised. Without any liability rule, the potential injurer will only take into account his own cost of precaution and not the cost of harm. Thus, actual precaution will, if the potential injurer minimises his own and not the social cost, tend to be less than socially optimal.

What level of precaution will the potential injurer choose with a rule of strict liability? This depends on how strict liability affects the injurer's private costs. Since strict liability implies liability without fault, it is reasonable to assume that the injurer is liable for the victim's losses regardless of which level of precaution (x) the injurer chooses. Thus, the potential injurer faces two types of costs, namely, the cost of precaution, cx, and expected liability costs which, if full compensation is the rule, equals expected costs of harm. The private costs for the injurer thus equal total accident costs, cx + Probability (x) Harm. A potential injurer who wants to minimise his own costs will then choose a level of precaution equal to optimal precaution in the model. An important requirement, however, is that compensatable harm fully reflects actual harm, otherwise accident costs will not be fully internalised and the potential injurer will choose a level of precaution lower than the optimal.

It is likely that this overall purpose of the liability system will be stronger if environmental harm is conceptualised and measured with best practice using environmental and welfare economics. Only in this case will it be safe to assume that cost internalisation leads to a powerful enough incentive to show precaution. Thus, it would be desirable that state legislation and state court practices are based on this essential insight.

In practice, however, national legal systems are only slowly and partially moving in this direction. Is it possible that the ECJ might contribute to more desirable and faster development? It is worth noting that the economic logic outlined above is reflected in the preamble to the ELD:

The prevention and remedying of environmental damage should be implemented through the furtherance of the "polluter pays" principle, as indicated in the Treaty and in line with the principle of sustainable development. The fundamental principle of this Directive should therefore be

15 The now standard model which is accounted for in eg Shavell (n 5) is arguably derived most directly from G Calabresi *Costs of Accidents* (New Haven and London 1970).

that an operator whose activity has caused the environmental damage or the imminent threat of such damage is to be held financially liable, in order to induce operators to adopt measures and develop practices to minimize the risks of environmental damage so that their exposure to financial liabilities is reduced.

Based on this preamble, as well as on the shorter but similar statement of the purpose of the Directive in Article 1, it might be expected that the Directive included some language that defined harm and prescribed its assessment in such a way that the cost internalisation philosophy was securely implemented in state legislation and state practice. In fact, the Commission had proposed such language; see eg the proposed definition of 'value' (of environmental goods and services) in Article 2 (19) of the Commission's proposal:

'Value' means the maximum amount of goods, services or money that an individual is willing to give up to obtain a specific good or service, or the minimum amount of goods, services, or money that an individual is willing to accept to forgo a specific good or service. The total value of a habitat or species includes the value derived by individuals from their direct use of the natural resource, for example, swimming, boating, or bird watching, as well as the value attributed by individuals to the habitats and species irrespective of direct uses.

The underlying economic thinking behind this definition was followed up by rather detailed principles of valuation clearly inspired by welfare economics in a proposed Annex II to the Directive. Subsequently, however, the wording was softened significantly, probably due to industry lobbying efforts. Thus, the ECJ must again rely on its power and will to be creative.

It is not unheard of for courts to play a role in nurturing the development of damage definition and damage assessment rules along the lines suggested by welfare economics. The American Natural Resource Damage Assessment Regulations include references to welfare-economic concepts and valuation techniques, and US federal courts have played an active role in maintaining a welfare-economic perspective in the practical implementation of these rules. I would suggest the ECJ should do something similar based on the preamble cited and the precautionary principle and the principle of sustainable development. Or would that be too creative?

If this is a possible way forward, I would in particular emphasise that the welfare economic approach indicates that there is a potential role for the ECJ to acknowledge the protection of the interest against 'loss of use' including in situations where it is not possible to show diminution of market value. This would be especially valuable in protecting victims from harm that occurs before it is

possible to restore the environment through probably costly efforts. Such harm often occurs in the context of oil spills. Moreover, in the context of environmental noise, pragmatic principles of compensatable harm and damage measures would be particularly valuable. Traffic noise may lower welfare substantially even if it cannot be proven in court that counter-measures will lead to (cost-effective) protection of the market value of property. In this setting, I would suggest that the use of values of property should be protected beyond the traditional market value definition of compensatable harm. This could be done by acknowledging a right for the property-owners to transfer the responsibility, based on civil liability, for the costs of hypothetical, cost-effective countermeasures. Such a right would in my opinion improve on the legal situation in at least some European jurisdictions.

#### 4. Qualification and conclusions

I have not mentioned so far the fact that the ELD does not, strictly speaking, cover tort liability, and that such liability very often is, under the principle of subsidiarity, best regulated by individual state jurisdiction. However, there is reason to think that the development of the concept of environmental liability, based on the Directive, may well spill over into civil liability generally and inspire more general tort law developments. Moreover, the mindset of the ECJ in dealing with liability issues generally may well influence doctrinal tort law thinking in the individual state jurisdictions. Thus, based on my discussion of the two chosen themes, I will conclude that there seems to be some room for the ECJ to improve on the workings of the system of environmental liability, but that the legal techniques for this have to be elaborated.<sup>16</sup>

A final observation: in one of the seminal modern law and economics papers it was remarked that the state itself is in many instances the one causing or enabling the causation of environmental harm.<sup>17</sup> My final contention is that it is unrealistic in such cases to rely solely on the good will of the Member States' governments to perfect the system of environmental liability. In this situation, it is worthwhile to discuss whether or not some of these suggestions for an ECJ contribution are realistic, and what precise legal form such a contribution might take.

<sup>16</sup> See Wennerås (2008) (n 11) for an account of the activism of the ECJ based on an analysis of EC environmental law cases between 2003 and 2008.

<sup>17</sup> I am of course referring to Coase's paper on social cost (1960), which appears almost unabridged in R H Coase *The Firm, the Market, and the Law* (University of Chicago Press 1988) see especially pp 126–32.