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European Environmental Regulation

*Brian Hartnett**

INTRODUCTION

Environmental protection is becoming increasingly arduous for industry in the European Community ("EC"). For most industries, the cost of environmental protection is certainly being felt and is frequently beginning to hurt. To determine the reasons for this trend, it is necessary to look briefly at the evolution of environmental regulation in the EC.

Environmental protection was nowhere mentioned in the Treaty of Rome, which created the EC. The Single European Act of 1986 ("SEA"), which amended the Treaty of Rome, explicitly introduced EC environmental policy objectives and principles. The constitutional base for EC environmental legislation provided by the SEA specifies that:

- EC action relating to the environment should be based on preventative action;
- environmental damage should be rectified at the source;
- the polluter should pay; and
- environmental protection requirements shall be a component of other EC policies.

The existence of a specific legal base for environmental legislation, combined with the amendment of the EC treaty to streamline decision-making on environmental measures, have led to a marked growth in EC environmental legislation. Increasingly "green" public opinion has also led to adoption of green policies by mainly political parties, which in turn have supported the formulation of a strong environmental policy at the EC level.

The new regulatory policy, introduced by the SEA, has not only led to a proliferation of EC environmental legislation, but has also influenced the nature of the environmental measures which the Community is using to implement this policy. One of the most marked trends since the SEA and the introduction of the "polluter pays" principle is the Community's use of economic and fiscal instruments.

ECONOMIC AND FISCAL INSTRUMENTS

The shift toward the use of economic and fiscal incentives to en-

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courage industry to behave in an environmentally friendly way was agreed upon by EC environment ministers in late 1990. Economic instruments are "instruments that affect costs and benefits of alternative actions open to economic agents, with the effect of influencing behavior in a way which is favorable to the environment." In other words, they are instruments affecting the costs of a firm in such a way as to *promote* the use of processes and products which are less damaging to the environment.

The Directive presently being drafted by the Commission on CO₂ Taxes is a typical example of a measure which uses a financial instrument to induce compliance. The purpose of the Draft CO₂ Tax Directive is to stabilize EC carbon dioxide emissions at 1990 levels by the year 2000. As presently drafted, the Directive would require that energy taxes be raised in equal (50/50) proportions from two sources: as a levy on all energy sources except renewables and as a charge on the carbon content of energy. The tax basis is to be a ten dollar surcharge per barrel of oil, applied in stages. Taxation of other energy sources is to be based on their energy equivalency to one barrel of oil. Temporary exemptions from the carbon dioxide tax would exist for energy-intensive sectors such as steel, chemicals, cement and packaging.

The CO₂ Tax Proposal has competitive implications for companies in Canada and the U.S. If the U.S. fails to sign the Treaty on Global Warming, U.S. companies will be at a competitive advantage over their EC counterparts. At present, the chances of the U.S. signing such a Treaty or enacting an energy tax seem very remote. Therefore, the effect of the EC tax would be to unilaterally raise the cost of EC exports, and thereby blunt the competitiveness of Community companies in world markets.

On the other hand, some non-EC countries have also complained that an EC energy tax would create a kind of invisible trade barrier, by adding to the entry costs for non-EC businesses seeking to set up production plants within the EC. However, this barrier is likely to be less of a barrier to U.S. companies than it would be to Third World and other countries that have not adjusted their technologies to the rigors of a highly taxed market.

There are many conflicting pressures being brought to bear on the content of the EC CO₂ tax, such that prospects for it are far from clear. However, what is clear is that it is an indication of the Commission's willingness to use ambitious fiscal measures in the EC to influence environmental behavior. It is a clear indication of the Community's resolve to make the polluter pay.

Another slightly less contentious, but nonetheless controversial measure which provides for the use of financial incentives is the draft EC directive on packaging. This Draft Packaging Directive is about to be submitted by the EC Commission as a proposal to the EC Member States.

The aim of the Draft Packaging Directive is to bring into line different national schemes for combatting the EC's ever-growing mountains of discarded packaging. The Draft Packaging Directive would require Member States to implement measures which would mandate that ninety percent of packaging waste should be "recovered" (i.e., reused, recycled into new products, burned to produce energy or turned into compost) within ten years of the Directive's entry into force. At least sixty percent would have to be reused or recycled within the same time frame. Packaging for which return and subsequent reuse or recovery channels are not established would be banned no later than five years after the Directive's entry into force; this is likely to be around the year 2000. "Packaging" is described very widely in the Draft as "all material of any nature so processed as to be used for the containment, the handling and the delivery of any product, from raw materials to processed goods, from the producer to the user or the consumer." The Draft requires the Member States to enact "economic instruments" to promote the prevention of packaging waste, including the establishment of funds necessary to run recycling centers.

This Directive will clearly have cost implications for virtually every industry seeking to place its products on EC markets. For the packaging industry, the Directive has obvious economic consequences, as it will result in a minimization of packaging and a requirement that the packaging industry modify its processes so as to produce more recyclable/recoverable packaging.

For U.S. companies established within the EC, the cost implications of this Directive will be no different than the cost implications for industries in the EC of European parentage. However, U.S. exporters sending packed goods to the EC will have to adapt their packaging to EC standards to assure trouble-free circulation with the EC.

The EC Directive was partly inspired by a similar national packaging law introduced in Germany. The experience of the U.S. computer company Hewlett-Packard provides an example of the effects of that law. In order to comply with the German packaging law, Hewlett-Packard redesigned its packaging *worldwide* to make it easier to recycle in Germany. Similarly, so as to satisfy the requirements of the Directive once it is in place, many exporters of goods to the EC believe that they will be obliged to incur the cost of having their products packaged by EC contractors.

INFLUENCING BEHAVIOR AND PRODUCT STRATEGY

The purpose of the use of economic and fiscal measures in EC environmental legislation is to influence the motives and behavior of producers and consumers so as to discourage processes and products that cause waste and pollution. The EC Commission recently proposed many measures which do not contain express fiscal incentives, but which none-

theless seek to encourage companies to produce "green" products and employ "green" processes. These non-fiscal measures contain elements which sensitize company behavior to environmental pressures and make manufacturers responsible for the environmental impact of their products.

An example of such non-fiscal measures is a directive which the European Commission is said to be drafting concerning electronic goods. This measure would require makers and sellers of electronic equipment to take back their products and similar products made by other manufacturers for the purpose of recycling them. Such a measure would require manufacturers to evaluate the environmental effects of a product right from the design stage of that product.

Further evidence of environmental legislation reaching into the realm of product design is found in a recently proposed EC regulation on eco-labelling. The aim of the proposed Eco-Labelling Regulation is to promote the design, production, marketing and use of products having a minimum impact on the environment for their entire life-cycle and to inform consumers of the existence of such products.

In order for their products to bear the eco-label, manufacturers or importers would have to apply to the competent authority designated by the Member State in which the product is either manufactured, first put on the market or imported. The award of the eco-label will be decided after assessment of the ecological performance of the products, judged by general principles set down in the proposed Regulation and by the specific criteria designed for categories of products.

The eco-label scheme would be an entirely *voluntary* scheme. It is anticipated that market forces will be sufficient to promote it. The costs of the scheme to industry will not just be the payment of fees for the ongoing use of the eco-label, but will also reflect the need for research and development, retooling, retraining, finding new sources of supply and promoting products with eco-labels. Indications are that companies are keen to be in a position to use the eco-label; a recent survey of EC management attitudes to environmental issues revealed, for example, that seventy-five percent of German companies and ninety percent of Danish companies stated that they had altered or planned to alter their products to meet consumer demands for environmental friendliness. While the "green" buying policies fostered by the eco-labelling scheme will involve costs for many companies, the fact is that for those who can supply goods and services that are environmentally sound, important new opportunities are also being created.

A further example of legislation by which the EC is seeking to "cash-in" on the existing market pressure on companies to comply with environmental demands is the proposed EC Regulation on Environmental Auditing. The objective of the environmental auditing scheme would be to promote the use of environmental auditing as a tool for systematic and periodic evaluation of environmental performance of industrial ac-

tivities. Like the eco-labelling scheme, participation would be voluntary. The EC Commission hopes that the scheme will be attractive to companies in that it will improve their status and environmental credibility in the eyes of the public, shareholders and authorities.

The costs of the environmental auditing scheme to companies would be those of carrying out the initial audit itself and having that initial audit verified by an external, independent auditor. Costs will be less significant for companies which are already carrying out environmental audits on a voluntary basis.

Participation in voluntary measures such as eco-labelling and eco-auditing is likely to increase. The readiness of many companies to absorb the associated costs seems to be motivated by the belief that their entire commercial success is tied largely to a sound environmental control policy.

INTEGRATION OF ENVIRONMENTAL DIMENSION INTO OTHER COMMUNITY POLICIES

The SEA provided that environmental requirements should be a component of other EC policies. There is growing evidence of the EC Commission's response to this provision by attempting to integrate an environmental dimension into other Community policies. The EC Commission, for example, has recently announced that in the future it intends to pay close attention to the environment when granting EC economic development funds to the EC's poorer regions, and the EC Commission has claimed that generally it intends to adopt policies which put environmental consensus on equal footing with economic aims.

A further example was a recent Commission Decision on state-aid. The EC Treaty prohibits the granting of state-aids by Member States if their effect is to distort competition by favoring certain undertakings or goods. In a review of proposed aid by the Belgian Government (consisting of a capital grant of US \$3.8 million and a three year property tax exemption) to a large Belgian chemical company, the EC Commission said that the aid had a valid environmental purpose which outweighed any adverse effects on competition. This Decision is particularly significant, as it comes at a time when the EC Commission is generally taking a very dim and stringent view on state-aids.

The integration of Community environment policy with other sectoral policies of the Community is a growing trend and will require industry to make adaptations with inevitable cost implications.

THE "POLLUTER PAYS" PRINCIPLE AND EC WASTE POLICY

Even clearer espousal of the EC's "polluter pays" policy is found in recent EC legislation concerning waste. Waste policy is one of the environmental areas in which the EC has been most active. Rapidly dwindling — and, in some areas, totally insufficient — waste disposal capacity

on the crowded European continent has caused something of a crisis atmosphere in the EC. In 1990, the Community agreed on a strategy for waste management. This waste management strategy was based on the principles of prevention, recycling and reuse, restoration of contaminated sites, EC self-sufficiency in waste management and the proximity principle. New legislative measures relating to waste reflect the principles contained in the 1990 Waste Management Strategy. Taken together, these initiatives will substantially increase the costs of waste management in the EC. Three direct legislative initiatives in the context of waste management are examined below.

Framework Legislation on Waste

The Community has recently amended its basic legislation on waste. The recently adopted EC Directive 91/156 provides for a harmonized EC definition of "waste". Prior to the adoption of Directive 91/156, waste was basically defined in accordance with the provisions of national law. The absence of a harmonized EC definition of waste led, in the EC Commission's view, to the distortion of competition between producers and disposers of waste and to trade barriers in the EC.

Directive 91/156 amends the existing EC legislation on wastes and defines waste with reference to a list of categories of waste set out in an Annex to the Directive. The EC Commission is presently preparing a list of specific wastes belonging to these categories before the Directive enters into force. The Directive reinforces certain priorities: the prevention or reduction of waste, recovery by recycling, reuse or reclamation, and use as an energy source. Under the Directive, the disposal of waste will be highly controlled; uncontrolled disposal is prohibited, and disposal operations will be subject to permits. Recycling operations will have to be permitted. The Directive also lays the ground for the application of the "proximity principle" by providing for the establishment of an integrated network of waste disposal installations in order to make EC Member States self-sufficient in waste disposal.

In addition to Directive 91/156, the Community has also recently amended its legislation on hazardous waste (Directive 91/689). The Hazardous Waste Directive provides for a very broad definition of "hazardous waste" by means of reference to three Annexes. The EC Commission is also drafting lists of the specific types of hazardous wastes which belong to the various Annex categories.

Basically, the Hazardous Waste Directive broadens the definition of "hazardous waste" tremendously. For example, the new definition will cover listed wastes and wastes that contain specified substances unless it can be proven that the wastes are not explosive, oxidizing, highly flammable, flammable, irritating, harmful, toxic, carcinogenic, corrosive, infectious, teratogenic, mutagenic, able to release toxic gases, leachable or exotoxic. Any waste which exhibits any of those properties is to be clas-

sified as a hazardous waste. Given the difficulty of providing that any waste may not, for example, be “flammable”, an extremely wide range of wastes would appear to qualify as hazardous wastes under this new definition.

The Hazardous Waste Directive bans the uncontrolled disposal of hazardous waste as well as the mixing of wastes unless such mixing is necessary for recycling. It further requires Member States to inspect waste producing facilities on a regular basis. Finally, in accordance with the “polluter pays” principle, the Hazardous Waste Directive places the cost of disposal of hazardous waste on the waste producer and any other holders that consign the waste for disposal.

The cost implications of these new Waste Directives are evident. While adoption of harmonized definitions of “waste” removes some uncertainties associated with often-conflicting national definitions, the definitions contained in the new Directives are far from crystal-clear. In many cases, the definitions are very broad; their breadth and complexity is likely to increase compliance costs for industry.

Proposed Directive on Civil Liability for Damage Caused by Waste

Implementation of the “polluter pays” principle is further evidenced in a proposed EC Directive on Civil Liability for Damage Caused by Waste. This proposal would introduce *strict* liability for two kinds of damage:

- damage to the environment resulting from death or physical injury, or damage to property; and
- “impairment” of the environment, which means any significant physical, chemical or biological deterioration of the environment insofar as this is not considered to be damage to property.

The principal target of the Directive is the “producer” of waste (i.e., the person who, in the course of a commercial or industrial activity, produces waste and/or who, by preprocessing, mixing or other means, changes the nature or composition of waste). Apart from the original producer, three other types of persons may be “deemed” to be producers: the person importing the waste into the EC; the person who had “actual control” of the waste when the incident giving rise to damage occurred; and the person responsible for the establishment to which the waste was lawfully transferred.

Under this Directive, fault on the part of the producer does not have to be proved; in other words, the Directive imposes a system of strict liability. Liability is both joint and several. The Directive does not apply to damage from an “incident” occurring before the date on which the Directive comes into force. However, “incident” is not defined in the Directive, and there is some legal uncertainty as to whether gradual pollution could constitute an “incident” (e.g., the case of post-directive leaching from a pre-directive deposit).

The remedies available to plaintiffs are to be determined by national laws. They must, however, include an injunction prohibiting the act causing damage and an injunction ordering the reinstatement of the environment and/or ordering the execution of preventative measures and the reimbursement of costs lawfully incurred in reinstating the environment.

The introduction of strict civil liability by this Directive is clearly intended to provide all polluters with additional incentives to carry out their activities with a greater degree of care. This has serious financial implications for industry.

The cost implications for industry are also heightened by the fact that the proposal provides that liability under the Directive *must* be covered by either insurance or other financial security. Given the unclarity of the nature and scope of the liability to be imposed by the Directive, as well as the fact that the proposal does not provide for a ceiling on the producer's liability, it is questionable whether insurance will even be available from commercial insurance companies to cover such liability. The proposal does not address this question. Even if such insurance is available, it is likely to be very expensive and, therefore, is likely to impose a severe financial burden on industry, which small industries may in particular find very burdensome.

Further costs may be incurred by industry as a result of the definition of "producer" under the Directive. The fact that the producer may be deemed to be the person who had "actual" control of the waste when the damage occurred may have implications for banks. Although it is unclear whether a lending bank could be claimed to have "actual" control of the waste and, therefore, count as a "producer", the strictness of the proposed liability has sent tremors through bankers' ranks. Their fear is triggered by a notorious court case two years ago in the U.S. involving a company called Fleet Factors, which set a broad precedent for bank liability for clean-up costs. The court ruled that banks must pay if they participate "in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes." The court also ruled that a bank did not have to exercise that capacity to be liable.

It is unclear if and in what way the EC Commission will address the issue of liability so as to define precise borders for liability under this Directive and more generally under EC law. The EC Commission is presently at the early stages of preparing a Green Paper on liability for environmental damage. What is clear is that if the proposed Civil Liability Directive is adopted in its present form, banks will closely scrutinize all sensitive projects before making any loans. Most major banks have indicated that they are likely to introduce procedures to check customers' environmental records before advancing loans and are likely to remain vigilant until loans are repaid. Many banks also have a related fear in this context that the existence of a far-reaching system of strict civil

liability may result in their customers being caught up in expensive environmental law suits, which may impair their ability to repay loans.

All of these fears will result in higher costs for industry. Industry will have to spend money providing banks with evidence of its green credentials, and its loans are likely to become more costly because of uncertainty as to environmental liability. Similarly, satisfying financiers' worries is likely to lead to lawyers' fees and delays in completing transactions, both of which will add noticeably to costs.

Proposal for a Regulation on Transfrontier Shipment of Waste

The proposed Regulation on Transfrontier Shipment of Waste, once adopted, would strictly regulate the shipment of all wastes within the EC, and indeed between regions within the individual Member States. This proposed Regulation is, in part, inspired by the EC's need to implement the 1989 Basel Convention (a Convention to which the U.S. is also a party); it would, therefore, implement the 1989 Basel Convention with respect to wastes exported *from* or *into* the EC as well as waste movements within the EC. The proposed Regulation centers on the "proximity principle" and seeks to limit the long-distance transport of wastes and encourage national self-sufficiency in waste management capacity. This proposal will pervasively affect industrial operations within the EC that generate, ship, recycle, reuse and reclaim, store, treat and ultimately dispose of wastes.

The proximity principle would be implemented through a relatively complex notification and consent regime. Each person planning to ship any waste from one jurisdiction within the EC to another — including shipments between regions within Member States where each region has competence regarding regulation of waste — must notify the "competent authority" of destination and send copies of this notification to the competent authorities for the jurisdiction of dispatch and the competent authorities of any regions or countries through which the waste will move while in transit. This notification must furnish detailed information with regard to the waste.

The notification procedure is likely to incur considerable costs for industry; the Regulation provides that the costs of implementing the notification and supervision procedures are to be charged to notifiers by the Member States concerned. In any given case, three Member States may be involved (i.e., states of dispatch, transit and destination), and each may separately request costs. The proposed Regulation does not contain any criteria of reasonableness or other limitation on the costs that may be levied. Moreover, the notification system, in practice, is likely to be cumbersome and is likely to require extensive commitment of resources by industrial companies.

The second cost aspect of the proposed Regulation is that notifiers are required to provide "security" and/or "surety" with respect to each

waste shipment. This surety will be required even when the shipment is already covered by adequate insurance. Finally, the requirement that waste be disposed of as near as possible to the place of creation will not just mean that industry will no longer be able to shop around for the cheapest and least regulated dump, but will also mean that large companies with their own disposal facilities may no longer be able to internalize their waste disposal.

Overall Cost Implications of Emerging EC Waste Legislation

This sample of emerging EC waste legislation leads to one incontrovertible conclusion: in the future, there will be extreme pressure on EC waste disposal facilities with an inevitable cost factor for those using EC waste disposal facilities. In this respect, the Community is gradually harmonizing standards for waste disposal facilities (e.g., proposed directives on standards for landfills and hazardous waste incinerators). These directives take as their standard a *high* degree of environmental protection. Therefore, waste disposal will not just be costly for industry in the EC because of the inadequacy of existing facilities, but also because of the high standards which those facilities, but also because of the high standards which those facilities will have to meet.

IMPACT OF OVERALL TRENDS ON INDUSTRY

In Europe, environmental pressure on industry and attendant costs are clearly growing. As indicated, EC environmental legislation is increasingly characterized by high environmental standards — the use of economic and fiscal incentives to induce compliance and create “peer group” pressure to comply with schemes which are theoretically voluntary. Accordingly, I see the main consequences for industry as follows:

- Industry will need to be increasingly vigilant about forthcoming legislation and will seek to influence legislators (in particular the EC Commission) at the earliest stages of the development of EC legislation. This process does not need to be negative or confrontational; the European Commission is frequently grateful to industry for scientific and technical input which will help it to formulate realistic and sound standards to be incorporated into legislation.
- Many companies are being required to change their organizational structure to cope with increasing environmental demands. For example, some companies are setting up panels (often composed of outsiders) to assess their environmental performance; other companies are linking the pay of managers to performance in meeting environmental targets, and some are going so far as to appoint boardroom directors with special responsibility for the environment.
- The broader interpretation of environmental liability emerging in

the EC is causing investing institutions and insurance companies to take even closer interest in companies' environmental records. This scrutiny from financiers is generally making acquisitions and disposals more difficult.

The trends identified in EC environmental legislation are likely, in certain ways, to have a positive impact for U.S. companies. For example, the fact that the EC is approximately five years behind the U.S. in environmental implementation means that U.S. companies have generally invested in creating structures to induce environmental compliance, while EC companies are having to invest *now* and during recession. It should also be of some consolation to U.S. industry to know that public and private spending on environmental protection in the EC has not risen in line with economic growth, with the exception of Germany and the Netherlands.

Furthermore, the fact that a growing number of companies, both European and U.S., are showing commitment to environment protection is positive. The fact is that most companies are willing and able to absorb the costs of environmental compliance so long as their competitors also bear them.

Finally, one of the most important aspects in this context for companies to remember is that while there are considerable costs involved in environmental compliance, all companies, and particularly companies in sensitive sectors, can gain long-term advantages by showing environmental responsibility. By having environmentally sound products and manufacturing processes, such companies will be able to maintain social acceptability, which is a crucial factor for their long-term survival.

