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THE LIABILITY OF LENDERS FOR REMEDIATION OF CONTAMINATED SITES UNDER THE RESOURCE MANAGEMENT ACT 1991

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CONTENTS

ABSTRACT

Environmental protection has not traditionally represented an area of concern for banks and other lending institutions. However, several provisions of the Resource Management Act 1991, namely sections 314(1)(da) and 322(1)(b)(ii), have the potential to impose liability on certain parties to clean up contamination of the environment, irrespective of whether the party was responsible for causing the contamination. Liability attracts under these sections simply on the basis that a person constitutes an "owner" or "occupier" of land. In certain circumstances, lenders may qualify as owners or occupiers of land, thereby exposing themselves to liability under the Act. Environmental issues are therefore acquiring a great deal of importance for lending institutions in this country.

This paper examines exactly how the potential for lender liability arises under the Resource Management Act. The paper then analyses, from a Law and Economics perspective, whether such liability can be justified as a matter of principle or policy. The paper argues that lender liability is largely incapable of achieving the goals of environmental law (namely, the efficient allocation of resources, and a fair distribution of loss) and that therefore, its continued existence cannot be justified.

Word Length

The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 15,193 words.

I INTRODUCTION

Contamination of land, air and water is an increasing problem in New Zealand, as it is around the world. Remediation of contaminated sites can be a costly and protracted exercise. If states decide to remediate or clean up contaminated sites, it becomes necessary for them to determine who should pay for the costs of remediation. The issue of financial liability is particularly contentious where the responsible party cannot be identified or is insolvent.

The Resource Management Act 1991 ('RMA' or 'the Act') provides the legal framework for addressing that issue in New Zealand. Through the mechanisms of enforcement orders and abatement notices, the RMA imposes liability on certain parties for the costs of cleaning up contaminated sites. Enforcement orders and abatement notices are normally directed against the person responsible for creating the adverse environmental effect. However, in certain circumstances they can be used to impose liability for clean-up costs on third parties who are not responsible for causing the pollution.

This paper is concerned with the liability of one of these groups: lenders. Under the RMA, lending institutions such as banks and finance companies, or secured creditors generally, are exposed to open-ended environmental liability if they take steps to enforce their security or are too closely involved in the management of their borrower's business. In this way, lenders can effectively be held liable for the environmentally unsound activities of their borrowers.

Debate on the topic of lender liability in New Zealand has so far been sparse. The little that has been written is often unstructured and emotive. This paper attempts to examine the concept of lender liability in a systematic way in order to ascertain whether this form of liability can be justified. Part II of the paper will briefly discuss the nature and scope of the environmental problem in New Zealand, while Part III provides an overview of the relevant enforcement provisions of the RMA. Part IV will explore exactly how the potential for lender liability arises under the RMA provisions, both directly and indirectly. This will entail a comparison with lender liability provisions of foreign jurisdictions. Having demonstrated that lenders *could* be held liable under the RMA, the paper will then examine whether the courts are likely to impose liability on lenders in practice.

The paper will then analyse whether, in principle, courts *should* impose liability on lenders for the actions of their borrowers. The paper attempts to answer this question

using what is essentially a Law and Economics approach. This paper is premised on the assumption that economic theory can assist in analysing the merits of particular legal rules such as lender liability. Such an approach is especially useful in analysing environmental issues given that, at its core, pollution is an economic problem. Using an economic approach, the paper will explore whether lender liability is successful in achieving the goals of environmental law (namely, the efficient allocation of resources, and a fair distribution of risk or loss). This involves examining what incentives are created when pollution costs are placed on lenders as opposed to other groups in society. What are the distributional effects of allocating risk to lenders ? The analysis will show that in many respects, lender liability has inefficient and unfair effects, and that it is therefore incapable of properly satisfying the goals of environmental law. This conclusion suggests that parliament should revisit the policy framework it has adopted in the RMA.

II THE NATURE OF THE ENVIRONMENTAL PROBLEM

A What is Site Contamination ?

Soil and ground water contamination historically results from the manufacture, storage and disposal of non-naturally occurring hazardous substances such as polychlorinated biphenyls, pesticides, cyanides, metals and asbestos.[1] Industries typically associated with site contamination include agriculture, airports, railway yards, service stations, paint and pharmaceutical manufacture, dry cleaning establishments, iron and steel works, and oil production.[2] A site is usually considered contaminated when hazardous substances occur in concentrations above background levels. The main concern with such contamination is that it can pose an immediate or long term threat to human health and the environment.[3]

B Site Contamination Overseas

Contamination of land and ground water has been a recognised problem for many years in Europe and North America. For example, an estimated 2.2 billion metric tons of waste is produced annually in Europe. Because of the limited availability of land, there is a critical waste disposal capacity which in turn has led to illegal dumping and an

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[1] See Ministry for the Environment *Potentially Contaminated Sites in New Zealand: A Broad Scale Assessment* (Ministry for the Environment, Wellington, 1992), 2.1 - 2.2.

[2] See above n 1, 2.2.

[3] See above n 1, 2.1. Section 344 of the Resource Management Act defines "hazardous substances" as substances which may impair human, plant, or animal health.

increased need to export waste.[4] In the Netherlands alone, over 100,000 sites have been identified as being potentially contaminated with an estimated clean up cost of $68 billion.[5] In 1980, the United States Environmental Protection Agency ('EPA') estimated that the United States produced 57 million metric tons of hazardous waste per year and that 90 percent of this waste was being disposed of in environmentally unsound ways. By 1992, 1183 sites had been placed on the US National Priority List, a list of the most dangerous sites in the country.[6]

C *The Problem of Site Contamination in New Zealand*

The problem has been recognised in New Zealand only recently. In 1991 the Ministry for the Environment commissioned a broad scale assessment of the probable nature, extent and severity of the problem of contaminated sites in New Zealand. The resulting report[7] estimated that New Zealand has approximately 7800 potentially contaminated locations[8] of which approximately 1580 pose a high risk. The cost of cleaning up the high risk sites alone is estimated to be around $620 million, with an additional $1 billion needed to remediate moderate risk sites.[9]

These figures are particularly significant in light of the fact that New Zealand has an 'environmentally sensitive economy'. New Zealand's economic well-being largely depends on its agricultural, horticultural, fishing and forestry industries. The international acceptability and marketability of the products of these industries is dramatically influenced by the cleanliness of the environment in which they are produced.[10] In other words, even small levels of pollution could tarnish the 'clean, green' image that New Zealand currently enjoys in overseas markets. New Zealand has therefore been forced to become more environmentally sensitive.

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[4] H J Alderman "The Ghost of Progress Past: A Comparison of Approaches to Hazardous Waste Liability in the European Community and the United States" (1993) 16 Houston JIL 311, 314.

[5] Above n 1, 2.1.

[6] L J Oswald "Strict Liability of Individuals under CERCLA: A Normative Analysis" (1993) 20 BC Envitl Aff L Rev 579, 585-587.

[7] Above n 1.

[8] This figure includes timber treatment sites. See above n 1, 8.1

[9] See above n 1, 8.1. The figures do not include allowance for contamination from orchardists and growers, private and farm landfills and sewage treatment plant sludges. The order of accuracy of the figures is +/- 50 percent.

[10] See D Clifford in Banking Law Association, Banking Law and Practice 10th Annual Conference, 13-14 May 1993, Queensland, Australia, 53.

III AN OVERVIEW OF THE RELEVANT PROVISIONS OF THE RESOURCE MANAGEMENT ACT 1991

Awareness of the importance of environmental issues has led to radical legal reform in the shape of the RMA. The Act's overriding purpose is the promotion of sustainable management of natural and physical resources.[11] A subsidiary goal, and one which is of concern to this paper, is the prevention and remediation of site contamination. The RMA contains a number of provisions which are designed to achieve these goals. These provisions operate on two levels.

A Regulation

At the first level, Part III of the Act sets out a number of duties and restrictions which regulate the use of land and water, and the discharge of contaminants into land or water.[12] In very general terms, section 9 prevents a person using land in a manner that contravenes a district or regional plan. Section 11 prevents the subdivision of land unless it is expressly allowed. Sections 12 and 13 restrict the use of coastal marine areas, lakes and rivers. Pursuant to section 14, water may not be taken, used, dammed or diverted unless it is expressly allowed. No contaminants may be discharged into land, air or water without express consent under section 15. Section 17 states that every person has a duty to avoid, remedy, or mitigate any adverse effect on the environment arising from an activity carried on by that person.

B Enforcement

At the second level, the Act provides for the enforcement of these duties and restrictions. The enforcement regime of the RMA is contained in Part XII. Two of the main enforcement mechanisms in the Act, namely enforcement orders and abatement notices, also constitute the primary means of allocating responsibility for remediation of contaminated sites.

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[11] Section 5 defines "sustainable management" as "managing the use, development, and protection of natural and physical resources in a way, or at a rate, which enables people and communities to provide for their social, economic, and cultural well being and for their health and safety while -

(a) Sustaining the potential of natural and physical resources (excluding minerals) to meet the reasonably foreseeable needs of future generations ; and

(b) Safeguarding the life-supporting capacity of air, water, soil, and ecosystems ; and

(c) Avoiding, remedying, or mitigating any adverse effects of activities on the environment".

As is evident from section 5, the Act encourages the maintenance of a "biophysical bottom line" and "hard environmental standards". See John Milligan "The Resource Management Act - 9 Months On" [1992] NZLJ 351.

[12] More detailed rules and duties can be found in Regional and District Plans.

Through these two mechanisms, the Act imposes both civil and criminal liability. An enforcement order or abatement notice may make a party civilly liable for the costs of remedying environmental damage. Failure to comply with such an order or notice is an offence that attracts criminal liability under sections 338 and 339. The following sections of the paper traverse in greater detail the nature and effect of enforcement orders and abatement notices, and the liability attaching to them.

1 Enforcement orders and abatement notices

(a) Procedure

Abatement notices represent a convenient and inexpensive first resort in formal enforcement. Abatement notices are meant to be issued like parking offence notices, warning a person that he or she is contravening the provisions of the Act.[13] They may be served on any person by a duly appointed enforcement officer who has reasonable grounds for believing certain circumstances exist.[14]

The abatement notice procedure is generally thought to be less onerous but also less effective than enforcement orders. For example, the effectiveness of abatement notices is reduced by the strict requirements as to form and content of the notice contained in section 324.[15] More importantly, abatement notices are ineffective if appealed, as lodgment of a notice of appeal acts as a stay of the notice, pending the Planning Tribunal's decision.[16]

While only local authorities can issue abatement notices, *any person* can apply to the Planning Tribunal for an enforcement order.[17] Enforcement orders represent more serious enforcement action than abatement notices, and often follow where abatement notices are appealed or not complied with.[18] It is also possible to apply for an interim enforcement order, which may be made ex parte, and without holding a hearing.[19] Such orders remain in force until they are cancelled, or until an application for an enforcement order proper is

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13 Judge Kenderdine, John Gallen and Royden Somerville, *Applications under the Resource Management Act 1991* New Zealand Law Society October-November 1993, 92.

14 Section 322(4) of the RMA.

15 See P Milne in Brooker's *Resource Management* (Brooker's, Wellington, 1991), 3.01.

16 See above n 15, 3.01; section 325(3) of the RMA.

17 Section 316(1) of the RMA. However, pursuant to section 316(2) RMA, only a local authority or consent authority can apply for an enforcement order of the kind specified in section 314(1)(da) or (e).

18 Above n 15, ER3.01; above n 13, 92.

19 Section 320(1) and (2) of the RMA.

determined.[20] Interim enforcement orders are therefore very effective enforcement tools where urgent action is required.[21]

(b) Scope

Abatement notices and enforcement orders can prohibit, or require cessation, of an activity, or they can require positive action. For example, under sections 314(1)(a) and 322(1)(a), a person can be required to *cease doing something* that contravenes the Act or is noxious, dangerous or offensive to such an extent that it has an adverse effect on the environment. Conversely, under sections 314(1)(b) and (c) and 322(1)(b)(i), an order or notice can be served requiring a person to *do something* that is necessary to ensure compliance with the Act or to avoid, remedy or mitigate any adverse effect on the environment caused by or on behalf of that person. Clearly, these sections provide an important means of combating environmental pollution. Section 314(4) also provides a powerful weapon for dealing with contaminated sites. Under this section an order may require the restoration of any natural and physical resource to the state it was in before the adverse effect occurred.

It is interesting to note that an "effect" is defined in section 3 as including "any positive or adverse effect", and "any past, present, or future effect". Past effects are not particularly relevant in the area of site contamination. Unless the effect is still continuing, there is no point issuing an enforcement order or abatement notice. However, it is possible that a person can be held liable to remedy a presently occurring adverse effect where the original contamination was caused *prior* to the passing of the RMA. The definition of "environment" in section 2 is also of note. It is sufficiently wide that abatement notices or enforcement orders could be used to address such diverse matters as adverse effects on amenity or property values, and the personal well-being of adjoining occupiers.[22] The broad scope of these definitions mean the RMA's enforcement mechanisms have a potentially pervasive effect.

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[20] Section 320(5) of the RMA.

[21] Above n 15, ER7; above n 13, 89.

[22] "Environment" is defined as including "(a) ecosystems and their constituent parts, including people and communities ; and (b) all natural and physical resources ; and (c) amenity values ; and (d) the social, economic, aesthetic, and cultural conditions which affect the matters stated in paragraphs (a) to (c) of this definition or which are affected by those matters". See above n 15, 3.04 ; *Montreal* v *Whangarei District Council* A83/92..

2 Compliance and civil liability

Where an enforcement order or abatement notice is served on a person, that person is required, under sections 315 and 323 respectively, to comply with the order or notice and pay all the costs and expenses of complying with the order or notice. This requirement is complemented by the power in section 314(1)(d): where any person fails to comply with an enforcement order or abatement notice, the Planning Tribunal can require that person to reimburse other parties for the costs and expenses incurred in avoiding, remedying, or mitigating any adverse effects on the environment.[23] Furthermore, section 315(2) provides that parties who comply with an enforcement order on behalf of the person failing to comply with the order, have powers to enter the land, sell or dispose of salvaged materials, and recover any costs as a debt due from that person. It is therefore virtually impossible to avoid incurring the costs of remediation when an enforcement order or abatement notice has been properly served.

3 Failure to comply and criminal liability

In addition, contravention of sections 9 to 15, or failure to comply with an enforcement order or abatement notice, is an offence under section 338(1). Section 339(1) provides for penalties of imprisonment for a term not exceeding two years or a fine not exceeding $200,000, and a further fine of $10,000 per day for continuing offences. There is also provision for a sentence of community service[24] and for the Court to make any of the orders under section 314,[25] which could include the payment of clean-up costs.

The High Court judgment of *Machinery Movers Ltd* v *Auckland Regional Council* [26] sets out the appropriate sentencing principles under the Act. The Court held that the penalties imposed by the former Water and Soil Conservation Act 1967 have no relevance to the RMA. According to Barker and Williams JJ: [27]

> The RMA is informed by a wholly different environmental philosophy which places far greater emphasis on environmental protection and introduces a much more stringent regime of penalties and punishment than did the 1967 Act.

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[23] In *Auckland City* v *Sulenta* 26 August 1994, A 66/94, the Planning Tribunal held that although it could not be drawn from the language of para (d), it was implicit that the adverse effects would have to be caused by or on behalf of the defendant.

[24] Section 339(4) of the RMA.

[25] Section 339(5) of the RMA.

[26] (1993) 2 NZRMA 661.

[27] Above n 26, 666, 668 (emphasis added).

> *... these changes constitute a clear legislative direction to the Courts to ensure that higher penalties are imposed which will have a significant deterrent quality.*

Hence, defendants can expect more severe penalties under the RMA than previous legislation.

Significantly, the RMA criminal liability provisions adopt what is essentially a strict liability regime. Section 341 provides that in any prosecution for a breach of sections 9 to 15, it is not necessary to prove that the defendant intended to commit the offence. The defendant can avoid liability only by proving that the conduct was necessary and reasonable in the circumstances or that the event was beyond the control of the defendant and was not reasonably foreseeable, and in either case the effects were adequately mitigated or remedied by the defendant.[28]

IV POTENTIAL FOR LENDER LIABILITY UNDER THE RMA

Most of the enforcement provisions of the RMA impose liability on the person who causes adverse effects on the environment. To this extent the RMA embraces the "polluter pays" principle, which holds that those who generate pollution should bear the costs of alleviating or containing that pollution.[29] However, the Act also provides for the power to impose direct liability on, and cause indirect loss or detriment to, third parties such as lenders, who have no or little connection, in any causative sense, to the offending activity.

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[28] Section 341(2)(a) and (b) of the RMA. The subsection reads:

> "(2) ... it is a defence ... if the defendant proves-
>
> (a) That -
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> (i) The action or event to which the prosecution relates was necessary for the purposes of saving or protecting life or health, or preventing serious damage to property or avoiding an actual or likely adverse effect on the environment; and
>
> (ii) The conduct of the defendant was reasonable in the circumstances; and
>
> (iii) The effects of the action or event were adequately mitigated or remedied by the defendant after it occurred; or
>
> (b) That the action or event to which the prosecution relates was due to an event beyond the control of the defendant, including natural disaster, meachanical failure, or sabotage, and in each case -
>
> (i) The action or event could not reasonably have been foreseen or been provided against by the defendant; and
>
> (ii) The effects of the action or event were adequately mitigated or remedied by the defendant after it occurred."

Section 341 represents the adoption and codification of the principles contained in *Civil Aviation Department* v *MacKenzie* [1983] NZLR 78.

[29] Australian and New Zealand Environment and Conservation Council (ANZECC) *Financial Liability for Contaminated Site Remediation* (Canberra, 1993), 14.

A *Indirect Loss*

Traditionally, it has been the indirect costs of environmental pollution that have represented a concern to lenders. Environmental laws impact indirectly on lending institutions in two ways.

1 *Decreased value of the security*

The value of the lender's security interest can be affected where environmentally hazardous industries are carried out on the property, or where land has already been polluted.[30] Even the perception of environmental risk can decrease the value of the security.[31] The *Banking Law and Practice Conference* quotes an example of an inner-Sydney industrial site which was found to be contaminated with coke and fly-ash as a result of infilling from nearby gas works. The site was unsuitable for residential use and required remedial work costing up to $800,000.[32] Not only will land such as this drop in value, but few parties will be willing to purchase such land and thereby expose themselves to liability for its clean-up. The bank may therefore be forced to write off its loan or abandon the land.

2 *Effect of environmental liabilities on borrowers*

Further, the impact of the RMA on borrowers' businesses can also indirectly affect lenders. Unforeseen environmental costs and liabilities can undermine borrowers' cash flow and consequently, their ability to service and repay their loan debts. For example, a borrower may be forced to cease profitable but environmentally unsound practices; borrowers may be innocent purchasers of contaminated land; borrowers may incur fines, clean-up costs, legal costs, not to mention increases in insurance premiums, adverse publicity, and closure of facilities.[33] All of these factors will undermine the strength of the borrower's business and so undermine a lender's security and return on its lending.[34]

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30 See G Pearce and P Delemarre in above n 10, 48; S McArley "Resource Management Act - Focus on the Bankers" (1993) 6 New Zealand Banker 29; C Maher "Lender Liability under the Resource Management Act 1991: The Case for the Banks" LLB (Hons) Seminar, Victoria University of Wellington, 1994, 6.

31 C M Ward "Environmental Risk Assessment" (1993) 110BLJ 204, 206.

32 G Pearce and P Delemarre, above n 10, 49.

33 See above n 29, 48; Maher, above n 30, 6.

34 McArley, above n 30, 29.

Such indirect liability will affect lenders regardless of whether they face direct liability under the RMA. In most cases, indirect liability will be more common and possibly more damaging than direct liability. However, indirect liability is not of immediate concern to this paper. The remainder will concentrate on the effect and desirability of *direct* lender liability.

B Direct Liability as an Owner of Occupier

1 Section 314(1)(da) and Section 322(1)(b)(ii)

Enforcement orders and abatement notices may impose liability to clean up contamination of the environment simply on the basis of a person's status as an 'owner' or 'occupier' of land. Under section 314(1)(da), the Planning Tribunal may make an enforcement order requiring:

> "a person to do something that, in the opinion of the Tribunal, is necessary in order to avoid, remedy, or mitigate any actual or likely adverse effect on the environment relating to any land of which the person is the *owner or occupier*."

Section 322(1)(b)(ii) states that:

> "An abatement notice may be served on any person by an enforcement officer requiring that person to do something that, in the opinion of the enforcement officer, is necessary to ensure compliance by or on behalf of that person with this Act, any regulations, a rule in a plan or a proposed plan, or a resource consent, and also necessary to avoid, remedy, or mitigate any actual or likely adverse effect on the environment ... relating to any land of which the person is the *owner or occupier*."

Section 314(1)(da) was inserted as from 7 July 1993 by the Resource Management Amendment Act 1993. It was not part of the original Act. Prior to this amendment, it had not been possible to use an enforcement order to place duties on owners and occupiers. In contrast, abatement notices had always placed obligations on owners or occupiers to avoid, remedy or mitigate adverse environmental effects.[35]

Select Committee submissions and contemporary Ministry for the Environment documents regarding the Resource Management Amendment Bill reveal that subsection 314(1)(da) was primarily inserted to ensure consistency between enforcement orders

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[35] See the original section 322(1)(b) of the RMA.

and abatement notices. It was felt by the Ministry for the Environment that the issue of contaminated sites had become more important by 1993, and that abatement notices could not deal with the problem as effectively as enforcement orders.[36] By inserting the new subsection into section 314, it was hoped enforcement orders would take on a new strength.[37] However, business groups responded negatively to the proposed amendment, pointing out that the provision had the potential to subject innocent parties to enforcement orders.[38]

Both section 314(1)(da) and section 322(1)(b)(ii) are of a type requiring positive action on the part of the person served by the notice or order. However, there are differences between the subsections. For an abatement notice to be issued under section 322(1)(b)(ii), action must be required to ensure compliance with the Act, regulations, plan or consent. A breach of the restrictions in Part III of the Act (sections 9-15) or a breach of the general duty in section 17[39] would be sufficient to constitute non-compliance with the Act and thereby satisfy section 322(1)(b)(ii).[40] In contrast, an

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36 Bronwyn Arthur, an official at the Ministry for the Environment, stated in an interview with the writer on 30 June 1995 that, at the time of drafting the RMA, it was envisaged that abatement notices and enforcement orders would be used to remove objectionable or offensive elements such as car wrecks. Contaminated sites were not at this point a priority.

37 See for example, the Select Committee submission from New Zealand Chemical Industry Council Inc which stated: "It is understood that the main purpose of Clause 129 [which amended section 314] is to bring the law concerning enforcement orders into line with that set out in the Act for abatement notices". See also Ministry for the Environment Departmental Report on the Resource Management Amendment Bll April 1993 which states, in reference to the phrase "owner or occupier" that, "This should be covered by enforcement orders as well as abatement notices because abatement notices take at least 7 days before they have effect and if appealed do not have effect until appeals are decided. Enforcement orders can have an interim effect, similar to an injunction, if necessary. It is appropriate to be able to take the stronger action of enforcement orders".

38 See for example, the submissions of Tasman Forestry Ltd, Winstone Aggregates Ltd, Natural Resource Users Group and Waste Management New Zealand Ltd (although the latter accepted "that it is in the public interest for the liability for environmental problems to be shared amongst the widest possible range of organisations and individuals".)
It is interesting to note that over 15 submissions were received protesting against the ability of any person to apply for an enforcement order against an owner or occupier. Groups such as Carter Holt Harvey Ltd, Lion Nathan Ltd, Coal Corp and the Employers Federation expressed concern that disgruntled neighbours and business competitors would abuse the 'open standing' nature of participation. The Ministry and Select Committee bowed to this argument and consequently amended section 316(2) to ensure only local authorities could apply for such enforcement orders. See Ministry for the Environment Departmental Report on the Resource Management Amendment Bll April 1993, 139-140. However, these fears were probably unfounded. As Jennifer Caldwell points out, of the enforcement orders sought to October 1993 where anyone could apply, only four were public interest groups ; business competitors have made seven applications ; eight were sought by private individuals. The balance were sought by local authorities. See J Caldwell "Emerging Enforcement Trends under the Resource Management Act" (1994) 1 Butterworths Resource Management Bulletin 2, 3.

39 Section 17 of the RMA provides that:

> "(1) Every person has a duty to avoid, remedy, or mitigate any adverse effect on the environment arising from an activity carried on by or on behalf of that person, whether or not the activity is in accordance with a rule in a plan, a resource consent, section 10, section 10A or section 20."

40 Milne in above n 15, 3.04, 6.04; *Waikato* v *Blissett* Unreported, 21 Jan 1994, Planning Tribunal, C 6/94.

order under section 314(1)(da) can be made irrespective of whether there is non-compliance. Such enforcement orders can be served simply where necessary to avoid, remedy or mitigate an adverse environmental effect.

2 *Defining an 'owner' and 'occupier'*

These provisions affect the current owner or occupier of the land. The definitions of owner and occupier therefore become crucial in determining the classes of persons affected by the legislation. Section 2 defines 'owner' in relation to any land, as:

> "the person who is for the time being entitled to the rack rent of the land or who would be so entitled if the land were let to a tenant at a rack rent ...".

'Occupier' means the inhabitant occupier of any property and:

> "in relation to any rateable property within the meaning of the Rating Powers Act 1988, includes any occupier of the property within the meaning of that Act".

The Rating Powers Act 1988 defines 'occupier' in relation to any land as, inter alia, "the owner thereof ...". That Act defines 'owner' in substantially the same way as the RMA. Hence, an occupier includes a person entitled to the rack rent[41] of land. In summary, a person who is entitled to the rack rent of the land will qualify as both an owner and an occupier under the RMA.[42]

3 *Innocent purchasers*

In many cases, the current owner or occupier of the land will be the party responsible for causing an adverse environmental effect: their liability under sections 314(1)(da) and 322(1)(b)(ii) is not a contentious issue. However, because no requirement other than ownership or occupation is needed to attract liability under these subsections, other less culpable parties will find themselves liable for the clean-up costs of contamination. For example, an innocent purchaser of contaminated land would qualify as an 'owner' or 'occupier' thereby attracting liability, notwithstanding that it was their predecessor in title who caused the contamination.

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41 The rack rent represents the full annual value of the land. C Maher, above n 30, 3.

42 Obviously, the definitions of owner and occupier in the RMA are wide enough to allow persons other than the holder of the legal title or the fee simple to qualify as an owner or occupier of land. Thus it may be possible for one party to be an 'owner' for the purposes of the RMA while at the same time there exists another owner in the true sense of the word.

The plight of innocent purchasers is an important issue that needs to be addressed by policy makers, but it is an issue beyond the scope of this paper. Instead, this paper focuses on lenders, for in certain situations, they too qualify as owners and occupiers and so attract liability under the Act, as the following sections show.

4 Lenders as owners or occupiers

Arguably, a lending institution (or a receiver appointed by the lending institution) will constitute an owner and/or occupier when it takes steps to realise its security either by entering into possession of the secured property or selling the property.

(a) Entering into possession

(i) A mortgagee in possession

In New Zealand, a mortgage does not operate as a transfer of the legal estate: the mortgagor remains the legal owner of the land, while the mortgagee obtains a charge over that land.[43] The rights and powers of a mortgagee, including the mortgagee's right to possession, are therefore determined by contract (in the form of the mortgage instrument) and by statute (the Land Transfer Act 1952 and the Property Law Act 1952).[44] Mortgage instruments often expressly confer a right or entitlement, upon default by the mortgagor, to enter into possession of the property.[45] In the absence of an express conferment, section 106 of the Land Transfer Act 1952 ('LTA') must be relied on. The section provides that:

> "The mortgagee, upon default in payment of the principal sum, interest, annuity, or rentcharge secured by any mortgage, or of any part thereof, *may enter into possession of the mortgaged land by receiving the rents and profits thereof*, or may bring an action for possession of the said land ...".

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43 See section 100 of the Land Transfer Act 1952 which provides: "A mortgage under this Act shall have effect as security, but shall not operate as a transfer of the estate or interest charged".

44 See *Southpac Custodians Ltd* v *Bank of New Zealand* [1993] 1 NZLR 663 (CA). See also *The Housing Corporation of New Zealand* v *St John* [1989] DCR 152, 165: "The rights and liabilities of the mortgagor and mortgagee are defined by the contract entered into between them in the form of the mortgage document" per Judge CJ Rushton.

45 An example of such an express conferment in a mortgage document can be found in *The Housing Corporation of New Zealand* v *St John* above n 44, 155-156.

The value of section 106 lies in the fact that it gives a mortgagee an unqualified statutory right to enter into possession without the need to rely on a Court order or contractual powers.[46]

The right to enter into possession does not arise until three requirements are satisfied: first, that the mortgagor is in default; second, that the mortgagee has served on the mortgagor a notice pursuant to section 92 of the Property Law Act 1952 ('PLA') requiring the mortgagor to remedy the default; and finally that the mortgagor fails to comply with that notice.[47]

According to the New Zealand Court of Appeal, the right to possession carries with it the right to receive the rents.[48] This is also confirmed by section 91(11) and (15) of the PLA. Section 91(15) provides that a mortgagee "shall be deemed to be *in possession* of the land if he is *entitled* to enter into possession thereof ..." while section 91(11) states that a mortgagee in possession of land is *entitled*, inter alia, *to the rents*. In other words, once a mortgagee is entitled to enter into possession, he or she is deemed to be in possession, which in turn implies an entitlement to rent. Hence, upon serving a section 92 notice, a mortgagee is not only entitled to enter into possession, but is entitled to receive the rack rent of the land. If a mortgagee chooses not to exercise its rights directly but instead to seek a court order for possession under section 106 of the LTA, then there is authority that the right to receive the rents arises when proceedings are filed.[49]

As soon as the entitlement to receipt of the rents arises, the mortgagee/bank would constitute an 'owner' and an 'occupier' under the RMA. Therefore, if a bank takes steps to enforce its security over

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46 *Southpac* above n 44, 667.

47 See *Southpac Custodians Ltd* v *Bank of New Zealand* (1992) 2 NZ ConvC 191,120, 191,129 (HC); *St John* above n 44, 161; *Lockwood Buildings Ltd* v *Trust Bank Canterbury Ltd* (1994) 2 NZ ConvC 191,957, 191,966; S Dukeson & B Stewart *Mortgagee Sales* New Zealand Law Society Seminar June-July 1991, 41; *CCH New Zealand Conveyancing Law and Practice* (CCH NZ Limited, Auckland, 1994), 58,303.

48 See *Southpac* above n 44, 668 per Hardie Boys J.
As a point of interest, while entitlement to rent is dependent on the existence of a right to possession, the receipt of rents does not of itself mean a mortgagee is deemed to have taken possession. To amount to an entry into possession, the mortgagee must take the control and management of the business out of the mortgagor's hands. This is achieved when a mortgagee gives notice to the mortgagor's tenants to pay their rent to the mortgagee or its agent. See*Southpac* above n 47, 191,131 per Master Williams; CCH, above n 47, 58,305; HMS p434.

49 *Southpac* above n 44, 668; CCH, above n 47, 58,304.

assets affected by environmental problems, it risks incurring direct liability under sections 314(1)(da) and 322(1)(b)(ii), by virtue of its possession or control of the property.[50]

(ii) Receivers in possession

A court-appointed receiver is an officer of the court, and neither an agent of the debtor company nor the debenture holder.[51] The receiver therefore acts as principal and a lender would incur no liability. Where however, a lender in the position of a debenture holder or mortgagee appoints a receiver, the receiver may be deemed to be an owner or occupier for the purposes of the RMA. The receiver's liability may indirectly affect lenders, as the following paragraphs demonstrate.

Receivers are usually appointed by debenture holders as a result of a debtor company defaulting under a debenture, or where the security is in jeopardy.[52] A receiver's primary responsibility is to manage and realise the assets of the company charged with the security ,with a view to liquidating the debt due to the debenture holder.[53]

The rights, powers and status of a receiver are determined primarily by the terms of the debenture document, subject to the provisions of the Receiverships Act 1993.[54] Receivers are typically empowered to take possession of the company's assets in order to protect or supervise the company's business.[55] More importantly, receivers are empowered to exercise all rights, powers and remedies as the company would exercise

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50 This is also the opinion of the Ministry for the Environment *Investment Certainty under the Resource Management Act 1991* (Ministry for the Environment, Wellington, 1994), 30; S McArley above n 30; Brooker's *Land Law* (Brooker's, Wellington, 1995) and other commentators.

51 J H Farrar, M W Russell & L F Hampton *Company Law and Securities Regulation in New Zealand* (Butterworths, Wellington, 1985), 420.

52 Above n 51, 420.

53 James O'Donovan *Company Receivers and Managers* (Law Book Company Ltd, Sydney, 1981), 112.

54 Section 14(1) of the Receiverships Act 1993 provides: "A receiver has the powers and authorities expressly or impliedly conferred by the deed or agreement of the order of the Court by or under which the appointment was made".

55 P Blanchard & M Gedye *The Law of Company Receiverships in New Zealand and Australia* (Butterworths, Wellington, 1994), 54-56. It is important to note that when the receiver takes control of company property, he or she does so on behalf of the company. The company retains legal ownership, and usually possession of the property as well. In rare situations, the receiver may dispossess the company and take possession in an independent capacity as principal. See *Meigh* v *Wickenden* [1942] 2 KB 160; *Ratford* v *Northavon District Council* [1987] 1 QB 357.

in relation to its property, which includes the right to receive rents and income.[56] Therefore, for the purposes of the RMA, receivers are owners or occupiers who are exposed to liability under that Act.

Out of court receivers are usually expressed to be agents of the mortgagor/company,[57] and so the debenture holder/bank will not attract liability as a principal. Nevertheless, it is customary for receivers to insist upon an indemnity from the debenture holder for liabilities incurred in the course of their role as receiver.[58] Therefore, personal liability incurred by the receiver will directly impact upon the debenture holder.

In certain situations, an out of court receiver can constitute an agent of the debenture holder.[59] For example, the debenture may provide expressly for such a relationship. Second, a receiver may be deemed the agent of the debenture holder where the latter treats the receiver as such by directing or interfering with the receiver's activities.[60] Finally, a court may hold that since an agent can have two principals, the receiver may be the agent of the company for some purposes and the agent of the debenture holder for others.[61] In such situations, the receiver will take possession of the company's assets and operate the

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56 Section 14(2)(a) of the Receiverships Act 1993 provides: "Subject to the deed or agreement or the order of the Court by or under which the appointment was made, a receiver may demand and recover, by action or otherwise, income of the property in receivership". See also the Auckland District Law Society standard form debenture, clause 6 which states the receiver has the power, inter alia, "exercise and enforce all such powers, rights, remedies and authorities as the Company itself might exercise over or in relation to its property ...".

57 At common law, where the debenture omitted to provide that a receiver was the agent of the company, the receiver would be deeemed to be the agent of the debenture holder. In New Zealand, the common law presumption is reversed by section 6(3) of the Receiverships Act 1993 which states that a receiver appointed privately pursuant to a deed or agreement is the agent of the grantor company unless the deed or instrument of appointment provides otherwise. See also Blanchard, above n 55, 51; *American Express International Banking Corp* v *Hurley* [1985] 3 All ER 564, 568.

58 See S McArley, above n 30, 29-30. A receiver's right to an indemnity from the debenture holder is founded on an express term in his or her appointment or in the debenture itself. See O'Donovan, above n 53, 169.

59 Note that the Receiverships Act 1993 does not apply to the situation where the receiver is expressly appointed as agent of the debenture holder. This is achieved through the statutory definition of receiver in section 2 of the Receiverships Act which excludes a mortgagee who goes into possession and the agent of any such mortgagee.

60 For example, *American Express* v *Hurley* [1985] 3 All ER 564. See also above n 55, 52.

61 For example, *Peat Marwick Ltd* v *Consumers' Gas Co* (1980) 113 DLR (3d) 754, 762 per Houlden JA. In this case, the Ontario Court of Appeal recognised that a receiver has a schizophrenic status and in reality serves two masters: the company and the debenture holders who appointed him or her. It therefore held that in carrying on the business, the receiver acts as agent of the company while in realising the security, he or she is the agent of the debenture holder. See also above n 55, 51-52.

business on behalf of the debenture holder, whose position will be that of a mortgagee in possession. As principal, the debenture holder will incur liability for the receiver's acts and omissions under section 340(1) of the RMA.[62]

Although relatively rare, a receiver can also be appointed by a mortgagee. There is no statutory power for a mortgagee to appoint a receiver in New Zealand, unlike Australia and the United Kingdom.[63] However, a mortgagee could appoint a receiver of rents where such a power is provided for in the mortgage document. Such a receiver would also constitute an owner and occupier by virtue of its receipt of rents and income from the property.[64] As in the company context, a receiver will normally be an agent of the mortgagor but may also be indemnified by the mortgagee/bank.[65]

(b) Mortgagee exercises power of sale

(i) Mortgagee purchases property

Lenders need not enter into possession in order to constitute an owner or occupier; it will be sufficient for lenders to exercise their power of sale. The mortgagee's power of sale may be contractual or it may be implied by virtue of section 78 of the PLA.[66] A mortgagee may sell the mortgaged property by one of two methods: private sale or sale by the Registrar of the High Court.[67] Sale by the latter method gives the

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62 Section 340(1) provides that:

> "Where an offence is committed against this Act by any person acting as the agent or employee of another person, that other person shall, without prejudice to the liability of the first-mentioned person, be liable under this Act in the same manner and to the same extent as if he, she, or it had personally committed the offence".

63 See for example section 101 of the Law of Property Act 1925 (UK).

64 Above n 47, 58.

65 See CCH above n 47, 58,302; above n 47, 58.

66 See CCH above n 47, 58,003. Section 78 of the PLA provides that:

> "In every mortgage of land made after the commencement of this Act there shall be implied the covenants by the mortgagor and the powers and conditions set forth in the Fourth Schedule to this Act, except in so far as the same are varied or negatived in the mortgage or deed ...".

Clause 8 of Schedule 4 provides that the mortgagee may sell the mortgaged property where the mortgagor has defaulted provided that the requirements of that clause have been met. The provisions of clause 8 are generally modified in most mortgages and so the power of sale is usually a mixture of the implied power and contractual power. See CCH above n 47, 58,003.

67 Section 99 of the PLA 1952.

mortgagee the right to buy in the property itself.[68] Clearly, if a mortgagee purchases contaminated land, it will be an owner of land and therefore exposed to liability under the RMA.

(ii) Sale to a third party

Even if a mortgagee arranges for the property to be sold to a third party, it may constitute an 'owner' or 'occupier' for the purposes of the RMA. A mortgagee cannot proceed to sell the secured property until the notice requirements of section 92 of the PLA have been complied with and there is a consequent failure of the mortgagor to remedy the default.[69] Since the right to possession (which entails the right to receipt of the rents) also arises on fulfilment of these conditions, then compliance with section 92 will have the added effect of entitling the mortgagee to the rents from the land, irrespective of whether the mortgagee intends to recover those rents.

The analysis above suggests that sections 314(1)(da) and 322(1)(b)(ii) have the potential to impose liability on lenders as owners or occupiers, if they take steps to enforce their security. The paper now turns to consider whether or not similar provisions in other New Zealand statutes, and in Canadian and Australian environmental legislation have been interpreted in a similar way.

5 *Comparable provisions in other New Zealand statutes*

An examination of current and previous New Zealand environmental regimes reveals that the concept of placing liability on owners and occupiers for the acts of others is not new to New Zealand.

(a) Health Act 1956

Under the Health Act 1956, environmental health officers may enter onto premises to abate nuisances, and recover the expenses incurred in abatement from the owner or the occupier of the premises.[70] Section 41 provides that if

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68 Section 101 of the PLA 1952.

69 See section 92 of the PLA 1952 and CCH above n 47, 57,904.

70 See section 34 of the Health Act 1956. The definition of "owner" is the same as that in the RMA. In section 29, a "nuisance" is deemed to be created, for example, where any "accumulation or deposit is

any local authority is of the opinion that cleansing of any premises is necessary for preventing danger to health or for rendering the premises fit for occupation, it may serve an order on the owner or occupier of the premises requiring him to cleanse the premises. It is an offence under sections 30 and 41(3) to allow a nuisance to continue or to fail to comply with a cleansing order.

The unreported High Court case of *Garden City Developments Ltd* v *Christchurch City Council* [71] concerned the issue of whether a landlord could be convicted under section 30(1) of the Health Act 1956, in view of the fact that the tenants were responsible for creating the nuisance. The Court held that the landlord was liable as an owner who had suffered a nuisance to continue. Hardie Boys J held that "section 30(1) plainly contemplates liability accruing to an owner who is not the occupier".[72] Arguably, the same reasoning could apply to make a mortgagee liable under the section.[73] However, the case turned on the particular meaning of the word "sufferance" and the obligations of landlords and tenants. Therefore, while it provides evidence of the courts' readiness to impose liability on innocent owners and occupiers, if offers little guidance as to whether the courts would impose such liability on lenders.

(b) Toxic Substances Act 1979

The Toxic Substances Act 1979 provides in section 48 that an officer, including a police officer, may secure land or premises if he has reason to suspect it has been contaminated by a toxic substance. The officer must take all reasonable steps to have the land or premises decontaminated. The reasonable costs and expenses incurred in the decontamination are recoverable from the *owner* of the land or premises as a debt due to the Crown.[74]

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in such a state or is so situated as to be offensive or likely to be injurious to health" or where "the burning of any waste material, rubbish, or refuse in connection with any trade, business, manufacture, or other undertaking produces smoke in such quantity, or of such nature, or in such manner, as to be offensive or likely to be injurious to health".

71 Unreported, 25 March 1986, High Court, Christchurch Registry, AP 25/86.

72 Above n 71, 2.

73 Hardie Boys J alluded to the possiblity of lender liability but avoided deciding the point. He stated at page 2 that the appellant "sought to compare the position of a mortgagee but I see little point in pursuing that line of enquiry for that must await decision on the particular circumstances of the case if at any time proceedings are brought against a mortgagee." See above n 71.

74 Section 48 of the Toxic Substances Act 1979. The Act also provides that the owner can apply for an order from the Court for compensation for loss or damage as a result of the decontamination, or for relief from liability for the costs of the decontamination (section 49). A "toxic substance" is defined to include poison, insecticide or pesticide, or any other substance that by reason of its chemical or biochemical properties may adversely affect the environment (section 2).

(c) Water and Soil Conservation Act 1967

The now repealed Water and Soil Conservation Act 1967 made it an offence under section 34(1)(f) for "the occupier of any land" to cause or permit "any waste, emanating as a result of natural processes from matter previously placed on or discharged on to the land or into the ground, to enter natural water." Under section 34B, Regional Water Boards or local authorities were given power to seek from a District Court an order that a person do certain work to prevent a further contravention of or non-compliance with any provision (such as s34(1)(f)) in the Act. Whether or not a person was convicted of an offence under section 34, section 34C provided that an occupier who caused or permitted waste to enter natural water could be charged with the costs of disposing of or neutralising the effects of the discharge.

(d) Town and Country Planning Act 1977

Under section 77(4) and (6) of the repealed Town and Country Planning Act 1977, the Council for the district could serve notice on the person using the land or the owner of land to cease, remove or reduce a "use of any land or building giving rise to any objectionable element".

The definitions of 'owner' and 'occupier' in these four Acts are essentially the same as those in the RMA. As with the comparable RMA provisions, there is nothing in the above provisions to suggest the owner or occupier had to be responsible for creating the nuisance or contaminating the ground or water in the first place. Hence, under these Acts, lenders in the position of an owner or occupier could conceivably be held liable to remedy the environmentally unsound activities of others.

However, the powers that existed under these Acts to impose liability on innocent owners and occupiers have not been utilised against lenders.[75] According to the Ministry for the Environment, "[t]o some extent, the judgment of regional and district councils could be relied upon in the past to see that such claims were not made against innocent land owners."[76] Therefore, little assistance in interpreting the comparable RMA provisions can be derived from these other statutes as no body of case law has developed around them.

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[75] Ministry for the Environment, above n 50, 31.
[76] Ibid.

6 *Comparable provisions in Canadian and Australian statutes*

However, we can obtain a great deal of assistance in interpreting sections 314(1)(da) and 322(1)(b)(ii) of the RMA by examining comparable environmental legislation from foreign jurisdictions. Like New Zealand, most industrialised countries are faced with the intractable problem of determining who should pay for the remediation of contaminated sites. Canada and Australia, among others,[77] have passed legislation that would enable lenders to be held liable as owners and occupiers for the costs of cleaning up pollution caused by others.

(a) Canada

The response of Canadian legislatures and courts to environmental problems has been dramatic. Clearly emerging is a judicial and legislative trend which favours the clean-up of the environment over the interests of lenders. For example, Ontario's principle environmental statute, the Environmental Protection Act, RSO 1980 c.141 contains a comprehensive and powerful regulatory scheme for environmental conservation. That Act authorises the issuance of several types of orders either by the Minister of the Environment or by a Director appointed by the Minister. The orders include control orders to reduce the amount of emissions,[78] stop orders to terminate discharges,[79] orders for the removal of waste,[80] and orders to undertake a wide range of actions to control a possible future discharge.[81] It is an offence, punishable by a fine of up to $1 million, to fail to comply with an order.[82]

Of special significance is the range of parties against whom the Director may issue orders. In particular, the Director may issue orders to: [83]

(a) an owner or previous owner of the source of contaminant;

(b) a person who is or was in occupation of the source of contaminant; or

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77 The United Kingdom Parliament has recently introduced a new Environment Bill which also places liability for clean-up of pollution on owners and occupiers, where the polluter cannot be found. See Mark Stallworthy "The United Kingdom's New Approach to Liability for Contaminated Land" (1995) 7 JIBL 255, 256.

78 Section 6 of the Environmental Protection Act RSO 1980 c.141.

79 Section 7 of the Environmental Protection Act RSO 1980 c.141.

80 Section 41 of the Environmental Protection Act RSO 1980 c.141.

81 Section 17(1) of the Environmental Protection Act RSO 1980 c.141.

82 Section 147(1) of the Environmental Protection Act RSO 1980 c.141.

83 See sections 6(1), 7(1), 17(1), 41(1), 42 of the Environmental Protection Act RSO 1980 c.141.

(c) a person who has or had the charge, management or control of the source of contaminant.

These parties are the same parties that can incur liability under sections 314(1)(da) and 322(1)(b)(ii) of the RMA. However, the Canadian statute goes even further by imposing liability on *previous* owners, occupiers and persons in control of contaminants.[84] In other words, banks could be required to remediate contamination of property over which they no longer possess security interests. To compound matters, the Canadian Act can prohibit any person with an interest in the property from disposing of the property without giving a copy of the order to the party acquiring it; failure to do so makes the transaction voidable.[85] Such a provision ensures that lenders will have great difficulty ridding themselves of polluted property. The lender liability provisions in the Canadian statute are therefore even more stringent than those in the RMA.

Bankruptcy and insolvency law have also been affected by judicial environmental activism. Canadian courts have held that environmental clean-up orders by regulatory agencies take priority over secured and unsecured creditors, with the result that creditors bear the costs of remediation.[86] For example, in the cases of *Canada Trust* v *Bulora Corp Ltd*,[87] *Panamericana De Bienes y Servicios SA* v *Northern Badger Oil & Gas Co* [88] and *Lamford Forest Products Ltd*,[89] the respective courts held that receivers are under a legal duty to comply with clean-up orders, in priority to the claims of creditors, even if compliance would exhaust funds otherwise intended for creditors.

(b) Australia

The environmental regimes of Australian states are considerably less stringent than their Canadian counterparts, although lender liability remains a possibility. For example, in both New South Wales and Victoria, the relevant state authority has the power to serve remediation notices on the occupier of premises, directing the occupier to "take such prescribed remedial action as is reasonable

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84 See Derrick C Tay "The Emerging Priority of Environmental Orders in Canadian Insolvency Situations" (1992) 5 JIBL 202.

85 Section 150(1) and (4) of the Environmental Protection Act RSO 1980 c.141.

86 Above n 84.

87 (1980) 34 CBR (NS) 145, aff'd 39 CBR (NS) 152 (Ontario Court of Appeal).

88 (1991) 5 WWR 577.

89 (1991) BCJ No 3681 (unreported).

in the circumstances and as may be specified in the notice".[90] As in the RMA, the New South Wales legislation enables the Authority to clean up the premises itself and recoup costs and expenses as a debt from "an appropriate defendant", who is defined to include both the polluter and the person on whom a clean-up notice is served (such as the occupier).[91]

While these provisions could technically entail lender liability, the New South Wales and Victorian environmental authorities have indicated that they will not proceed against lenders unless they possess control or influence over the site or the criminal conduct of the borrower.[92] This represents a policy decision that "the guiding principle for the [Authority] is the culpability of defendants in relation to the offence. More than technical legal liability will be necessary as a pre-requisite to prosecution".[93]

On the other hand, the recent report by the Australia New Zealand Environment Conservation Council[94] (ANZECC) setting out their policy position on financial liability for contaminated site remediation, suggests a change in direction. This report states that where lenders act solely as holders of a security interest in a contaminated site and take no steps to enforce the security, they should not be liable for the costs of remediation. However, where the lenders have either caused the pollution or have assumed the position of owner or occupier, they should be liable in the same way as any other party.[95]

Therefore, if the New Zealand courts are prepared to impose liability on lenders as owners or occupiers of contaminated land under the RMA, it is submitted that overseas precedents exist for them to draw on as authority for such an approach.

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90 Section 35 of the Environmentally Hazardous Chemicals Act 1985 (NSW); section 62A of the Environment Protection Act 1970 (Vic). If the contamination results in pollution of waters, the NSW Authority may also require the occupier of the land causing pollution to remove the pollution pursuant to section 27A of the Clean Waters Act 1970 (NSW). "Occupier" is defined in both states as "the person in occupation or control of the premises". See section 3 of the Environmentally Hazardous Chemicals Act 1985; section 4 of the Environment Protection Act 1970.

91 See section 36 of the Environmentally Hazardous Chemicals Act 1985; also ANZECC, above n 29, 50-51.

92 Above n 29, 56; above n 10, 46-47.

93 New South Wales Environment Protection Authority Draft Guidelines, 1992 quoted in above n 10, 46.

94 *Financial Liability for Contaminated Site Remediation: A Position Paper*, April 1994.

95 C Schulz "National Pollutant Inventory and Financial Liability for Contaminated Sites : Reports Released" (1994) 22 Aust Bus L Rev 441, 443.

C *Direct Liability for Involvement in Management*

Liability can extend to a lender under the RMA even if it does not constitute an owner or occupier, if it can be established that the lender has exercised some control over, or has become involved in, the management of its borrower's business.

1 *Section 340(3)*

Lenders are sometimes involved with their debtors' financial management, especially in the context of work-outs and other corporate rescue projects where financiers have considerable expertise. For example, lenders may be required to develop a scheme to enable a borrower to work through its financial difficulties in order to prevent the borrower defaulting on its loan. Such actions may place lenders in a decision-making role where they have significant control over the operations and management of the borrower's business. However, lenders risk incurring criminal liability under section 340(3) of the RMA if this occurs.[96] The section provides:

> "Where any body corporate is convicted of an offence against this Act, every director and every person *concerned in the management of the body corporate* shall be guilty of the like offence if it is proved -
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> (a) That the act that constituted the offence took place with his or her authority, permission or consent; and
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> (b) That he or she knew or could reasonably be expected to have known that the offence was to be or was being committed and failed to take all reasonable steps to prevent or stop it".

2 *Meaning of the phrase "concerned in the management"*

(a) *New Zealand authority*

No New Zealand resource management cases have focused directly on the meaning of the phrase "concerned in the management". In a case concerning section 188(1) of the Companies Act 1955, Quilliam J stated that a person would be "concerned in the management" where that person "took a hand in the real business affairs of the company".[97] This interpretation would incorporate

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96 Brooker's *Land Law*, above n 50, para 8.6.03.

97 *R* v *Newth* [1974] 2 NZLR 760, 761. Section 188(1) of the Companies Act 1955 provides that: "If any person being an undischarged bankrupt acts as director of, or directly or indirectly takes part in or is concerned in the management of, any company except with the leave of the Court, he shall be liable on conviction on indictment to imprisonment for a term not exceeding 2 years ...".

a far wider range of parties than merely directors or shareholders of a company: among others, it could incorporate lenders.

(b) Australian authority

A provision similar to section 188 of the Companies Act 1955 exists in the Companies (Victoria) Code.[98] A comprehensive discussion on the scope of this provision was considered by the Supreme Court of Victoria in the case of *Commissioner for Corporate Affairs* v *Bracht*.[99] Ormiston J interpreted the phrase "concerned in the management" to mean an involvement in the company's decision-making process such that the person has either a measure of responsibility, an area of discretion, or some influence based on his or her advice or opinion. According to the New Zealand Law Society, this interpretation covers not only trustees, receivers, consultants, influential shareholders and directors, but also lenders.[100]

(c) United States authority - CERCLA

Like the RMA, the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (known as CERCLA) imposes liability on persons who are too closely involved in the management of a polluting business.

CERCLA was passed as a response to the Love Canal disaster of the 1970s[101] and other discoveries of hazardous waste dumps around the country. CERCLA[102] imposes retrospective, joint and several, strict liability for clean-up of contaminated sites on a wide range of potentially responsible parties, including the current "owner and operator of a vessel or facility" releasing

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98 Section 227(1) of the Companies (Victoria) Code. Section 227(1) provides:
"A person who is insolvent under administration shall not be a director or promoter of, or be in any way (whether directly or indirectly) concerned in or take part in the management of, a corporation without the leave of the Court".

99 [1989] VR 821; (1988) 14 ACLR 728.

100 J Allin, R Fisher and T Randerson *Resource Management Act 1991*, New Zealand Law Society Seminar, September - October 1991, 88.

101 In 1978 it was discovered that citizens of Love Canal, New York were living on top of an abandoned waste dump containing approximately 352 million pounds of chemical waste, including dioxin, one of the deadliest substances in existence. See Alderman, above n 4, 312.

102 CERCLA created a 'Superfund' to cover the costs of governmental remediation of polluted sites. In order to preserve the Superfund's resources, the government is empowered to collect the clean-up costs from appropriate parties. G W Boston and M S Madden *Law of Environment and Toxic Torts: Cases, Materials and Problems* (American Casebook Series, West Publishing Co, St Paul, Minn., 1994) 476.

hazardous substances.[103] Under the 'security interest exemption', CERCLA excludes from the definition of owner/operator a person who "holds indicia of ownership primarily to protect his security interest in the vessel or facility" provided the person does not "*participat[e] in the management*" of the property.

The extent of participation or control required for liability to attach to the lender has been a controversial question in the American courts. *United States* v *Mirabile* [104] held that a secured creditor incurs liability when it asserts control over and actually participates in the production or operational aspects of the debtor's business. A creditor may safely participate in the debtor's financial affairs if that involvement is necessary to protect a security interest. *Guidice* v *BFG Electroplating and Manufacturing Co* [105]and *In re Bergsoe Metal Corp* [106] adopted a similar control standard, requiring "some actual management of the facility before a secured creditor will fall outside the exception".[107] However, in *United States* v *Fleet Factors Corp*,[108] decided several months after *Bergsoe*, the United States Court of Appeals for the Eleventh Circuit expressly rejected the *Mirabile* standard.[109] The court held that a secured creditor will incur liability: [110]

> by participating in the financial management of a facility to a degree indicating a *capacity to influence the corporation's treatment of hazardous wastes.* It is not necessary for the secured creditor to actually involve itself in the day-to-day operations of the facility in order to be liable ... Rather, a secured creditor will be liable if its involvement with the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions *if it so chose.*

In other words, a lender could be held liable without *actually* participating in the operations of the company.

In response to an outcry by the lending community, the Environmental Protection Agency (EPA) in 1992 promulgated a final rule clarifying the security interest exemption, designed to broaden the lender's exemption from liability.[111] It rejected the *Fleet Factors* "ability to control" test and stated that a

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103 Section 107(a)(1) CERCLA.
104 15 Envtl L Rep 20,992 (ED Pa 1985).
105 732 F Supp 556 (WD Pa 1989).
106 910 F 2d 668 (9th Cir 1990).
107 Above n 106, 672.
108 901 F. 2d 1550, (11th Cir. 1990).
109 Above n 108, 1558.
110 Above n 108, 1557-1558.
111 See Alderman above n 4, 332; Boston and Madden above n 102, 495.

lender participates in management when it exercises actual control over a facility's day to day operations. The EPA also set out a list of permissible lender activities such as requiring environmental audits and evidence of compliance with environmental laws, undertaking workout activities, and recovering the value of the security interest.[112] However, further uncertainty as to the scope of the exemption has arisen in light of the decision of *Kelley* v *US EPA*[113] in which the Court of Appeals for the District of Colombia vacated the EPA's rule and held that the EPA lacked authority to define the scope of lender liability.[114]

Despite the complexities of CERCLA case law, the above discussion indicates that the American legislation is capable of imposing liability on lenders and secured creditors who are closely involved in the management of debtors' businesses. New Zealand courts, drawing on such an approach, could therefore impose liability on New Zealand lenders who play a similar management role.

It is important to bear in mind that although a lender has the potential to incur liability under section 340(3) by virtue of its involvement in a debtor's company, it will only be guilty of the offence if it is proved that the act which constituted the offence took place with the lender's authority, permission or consent, and knowing that the offence would be committed, the lender failed to prevent it. In other words, a lender will only be held liable under section 340(3) where it has expressly or impliedly authorised or instructed its customer to undertake environmentally unsound activities. In this scenario, there is an obvious justification for imposing liability on lenders: they have clearly acted culpably or with reckless disregard for the environment. In contrast, it is much more difficult to justify the imposition of liability on lenders under sections 314(1)(da) and 322(1)(b)(ii). For this reason, the paper will concentrate on analysing the latter form of lender liability.

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112 Above n 29, 71.

113 15 F.3d 1100 (DC Cir. 1994).

114 The Court's rationale was that Congress could not have intended that the EPA, which invariably acts as plaintiff in CERCLA proceedings, could have the power to interpret CERCLA provisions. Rather, it was for the courts to adjudicate upon private rights of action arising under CERCLA. See above n 113, 1104. As Johnston stated: "to provide EPA with the interpretive authority would be akin to proving criminal prosecutors (as opposed to the courts) with the ultimate authority to interpret the enforcement provisions they implement". See C N Johnston "Superfund Reauthorization: Who Decides Who's Liable under CERCLA : EPS Slips a Bombshell into the CERCLA Reauthorization Process" (1994) 24 Envtl L 1045, 1047.

D Is Lender Liability a Genuine Threat ?

Having established that the RMA has the potential to impose direct liability on lenders for the costs of remediating polluted sites, it is pertinent to query whether lending institutions should have cause for concern. In other words, will such liability place an excessively onerous burden on lenders, and is the likelihood of facing direct liability high ?

1 Severity of liability

As far as the burden on lenders is concerned, lender liability is not limited to or in any way related to the money lent to the borrower under the mortgage or security. Clean up costs can range into the millions of dollars, and failure to comply with enforcement orders or abatement notices carries the additional penalty of up to $200,000. In other words, the cost of environmental remediation could easily exceed the amount of the loan or the value of the property. For this reason, as a worst case scenario (and in the absence of insurance), lender liability could pose a considerable threat to the economic viability of lending institutions, especially smaller institutions.

2 Likelihood of liability

Despite the theoretical possibility of liability, the chances of liability actually being imposed on lenders have historically been relatively small. As this paper has shown, lenders have not been prosecuted under other environmental statutes in New Zealand. To date, no New Zealand cases have addressed the issue of lender liability under the RMA. The lack of case law is due in part to the remarkable reluctance of local authorities to use the RMA's enforcement provisions to their full potential. The overwhelming majority of enforcement orders have been used to order the cessation or prohibition of unlawful activities, or the removal of nuisance-type objects from sites.[115] Few orders have been issued requiring positive action under sections 314(1)(b), (c), (da) or 322(1)(b).

Why have local authorities been reluctant to prosecute lenders ? In the first place, local authorities probably aim to place liability on the person responsible for causing the pollution. This preference is evident from a number of cases in which innocent owners of land have been excused from liability. For example, in *Foodstuffs (Auckland) Ltd* v

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[115] See Caldwell, above n 38.

Rattrays Wholesale Ltd [116] the owner of the land was cited as a respondent in the interim application, but was excluded from the final order because it was not responsible for the breach. In *Waitakere City Council* v *Gordon* [117] the Planning Tribunal named the owner of the land and the person responsible for the breaches in order to effect the charge, but only the latter was held liable for costs. It is only when the polluter cannot be found or is insolvent that authorities will seek another party to bear the costs of remediation.

Second, having identified a lending institution as a possible source of funds, the local authority would then need to establish as a question of law that the lender acted in a way that rendered it an owner, occupier or concerned in the management of a body corporate.

Finally, Ministry for the Environment officials, Craig Mallett and Bronwyn Arthur, have suggested in interviews with the writer that inaction by local authorities may be due to several other factors: the fear on the part of local authorities of potentially crippling litigation battles with lenders; lack of appreciation by local authorities of the severity of the environmental problem; or possibly even a lack of awareness that such parties could be held liable under the RMA.[118] However, they also suggested that as the problem of contaminated sites becomes more urgent, as it must, cases of lender liability could become more common.

It is submitted that if a New Zealand court is faced with such a case in the future, it would have to hold that lenders are caught by the RMA provisions. Not only does statutory interpretation point the courts to this conclusion, but overseas jurisdictions have held lenders liable under legislative provisions almost identical to those in the RMA. There is no reason why New Zealand courts will not follow suit. Hence, lenders run a real risk of incurring liability under the RMA, notwithstanding the current reluctance of local authorities to pursue the full potential of their statutory powers.

V ANALYSIS OF THE CONCEPT OF LENDER LIABILITY

The previous sections have demonstrated that the RMA has the capacity to impose liability on lenders, and that courts may be willing to enforce such liability in appropriate cases.

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116 Unreported, 25 June 1993, Planning Tribunal, W11/93.

117 Unreported, 25 April 1993, Planning Tribunal, A13/93.

118 Interview 30 June 1995.

The following sections of the paper are concerned with the more important question of whether the imposition of liability on lenders in this situation can be justified.

In order to undertake this analysis, it is necessary to take several preliminary steps. It is first necessary to understand exactly how lender liability under the RMA differs from other types of liability. To this end, the paper will identify and explain the unusual features of lender liability. Second, no analysis of this type can be valuable unless the purpose of such an analysis is clear. It seems to the writer that the purpose of this inquiry is to ascertain whether the concept of lender liability is consistent with the goals of environmental law, and whether it accomplishes these goals in practice. If the answer to these questions is no, then the conclusion must be that lender liability cannot be justified as a matter of principle. To this end, the paper will determine what we want a system of environmental law to accomplish, before going on to measure the success or failure of lender liability in achieving these goals.

A The Unusual Nature of Lender Liability

At first glance, it may seem unnecessary to justify the existence of a concept like lender liability. This would be true if lender liability fitted the accepted and uncontroversial patterns of liability found elsewhere in the law. However, lender liability possesses several unusual features that do not seem to fit easily with these patterns.

1 Lack of a fault requirement

Many areas of the law require proof of fault or wrongdoing on the part of the defendant before imposing liability on that party. This can be seen, for example, in the field of negligence, and in criminal law where offences typically include mens rea requirements. In contrast, lender liability under the RMA does not require a lender to be in any way at fault with regard to the discharge of contamination on a site.

2 Lack of a causation requirement

What is more unusual is that the RMA provisions do not require a lender to have *caused* pollution in order to be liable for the costs of its clean-up. It is almost axiomatic in tort law and criminal law that *at the very least*, the party bearing the costs of an activity will have *caused* the activity or created the offending state of affairs. This is evident in absolute or strict liability criminal offences: it is not necessary to show fault or knowledge, but it is

crucial to satisfy actus reus requirements. In tort law the causation requirement is "elementary policy": [119]

> With but a few recently developed and very limited exceptions, ... the rule has been: no matter how tortious the defendant's conduct may have been and no matter how long or how strongly a given loss has been considered compensable, unless the plaintiff is able to persuade the fact finder by a preponderance of the evidence that the defendant's activity was at least *one* of the infinite 'but for' causes of his losses, the plaintiff cannot recover.

3 *Quasi-vicarious liability*

Arguably the imposition of liability on lenders for the activities of their customers involves an application of the common law doctrine of vicarious liability. Again however, lender liability does not fit the pattern. Vicarious liability is often applied in regulatory quasi-criminal offences such as those in the RMA, but only to parties *who authorise others to do the offending act.*[120] While lenders are effectively being held vicariously liable for the actions of customers, it is not necessarily due to the fact that they *authorised* customers to undertake environmentally unsound practices.

4 *Status as an owner or occupier*

Instead, the wording of sections 314(1)(da) and 322(1)(b)(ii) of the RMA means that a party is exposed to financial liability simply by virtue of its status as an owner or occupier. One need only prove that a lender occupied a certain *role*, not that it engaged in particular behaviour.

5 *What is the significance of this ?*

The fact that lender liability departs from tort law and criminal law principles does not, of itself, invalidate the concept. However, it means that there should be strong reasons to justify the continuance of such an errant form of liability, because in departing from traditional forms of liability, one also departs from the protections they provide.

Any new legal doctrine of uncertain scope is an inherently dangerous beast. Usually the legal system responds to such unruly doctrines by circumscribing their scope and carefully

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119 H C Klemme "The Enterprise Liability Theory of Torts" (1976) 47 U Colo Law Rev 153, 163. The Committee Report accompanying the CERCLA Bill through Congress also confirmed this view : "[F]or liability to attach ..., the plaintiff must demonstrate a causal or contributory nexus between the acts of the defendant and the conditions which necessitated response action". In Oswald, above n 6, 600.

120 J B Robertson*Adams on Criminal Law* vol 2 (Brooker & Friend Ltd, Wellington, 1992), 4.1.02.

defining the doctrine's relationship with other legal doctrines. That process has not yet occurred with the relatively recent concept of lender liability. This provides all the more reason for analysing why the legislature has seen fit to place the costs of pollution on lenders in some circumstances, and whether this decision can be justified.

B Law and Economics

This paper will draw on the Law and Economics literature to analyse whether lender liability is appropriate in the environmental context. As the Law and Economics movement[121] has shown, economics can be a powerful tool for analysing, and providing insights into, many aspects of the law. By way of background, the following paragraphs explain some central concerns and basic principles of economics, and the means by which such an approach can assist in analysing the merits of lender liability.

The central task of economics is to explore how humans behave under conditions of scarcity. According to Richard Posner, "economics is the science of rational choice in a world ... in which resources are limited in relation to human wants".[122] Given scarcity, economists assume that individuals will attempt to maximise their desired ends. The concept of humans as rational maximisers of their self-interest implies that they *respond to incentives*; that if people's surroundings change in such a way that they could increase their satisfactions by altering their behaviour, then they will do so.[123]

Obviously, the legal system structures and controls the choices available to individuals. It therefore creates incentives to act in certain ways and disincentives to act in others. Positive economic analysis of law is concerned with examining the incentive effects and

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121 The modern law and economics movement emerged in the 1960s with pioneering articles by Guido Calabresi on tort law and Ronald Coase on property rights. See M Trebilcock, "Law and Economics" (1993) 16 Dalhousie Law Journal 360, 360-361. Much United States law and economics scholarship has focused on applying economic analysis to the field of tort law and accident law. The debate has largely centred on what form a tort regime should take to promote efficiency objectives, and in particular whether strict liability or the traditional negligence standard provides the most efficient liability regime. For example, Calabresi and Shavell favour strict liability over fault liability, while Posner, Landes and others defend the negligence standard. See G Calabresi *The Costs of Accidents : A Legal and Economic Analysis* (New Haven, Yale University Press, 1970); R A Posner "Strict Liability: A Comment" (1973) 2 J Legal Studies 205; S Shavell "Strict Liability versus Negligence" (1980) 9 J Legal Studies 1. Although highly influential, the movement has attracted a great deal of criticism and controversy. Critics of the movement argue that law and economics ignores justice, manifests a conservative political bias and fails to provide an ethical or moral guide to improving the legal system. See M Trebilcock "Law and Economics" (1993) 16 Dalhousie Law Journal 360, 365; R A Posner *Economic Analysis of Law* (4 ed, Little, Brown & Co, Boston, 1992), 25-27.

122 Posner, above n 121, 3.

123 Posner, above n 121, 4; Trebilcock, above n 121, 362.

distributional consequences of particular legal regimes or systems of liability.[124] In other words, economists ask the following kind of question: if this legal policy is implemented, how will people respond, and what will be the likely economic impact ? Understanding the incentive effects of various legal regimes enables us to judge whether that regime provides the most efficient means of attaining the regime's goals.

The concept of efficiency is central to economics. Efficiency is a measure of the degree to which particular allocations of resources maximise their value.[125] The Law and Economics movement argues that economic efficiency is one of the primary goals of the legal system. In other words, economists claim that many of the doctrines and institutions of the legal system are best understood and explained as efforts to promote the efficient allocation of resources, and thereby maximise society's wealth.[126] The task of this paper is to examine how the search for efficiency shapes the goals of environmental law, and whether those goals are best accomplished by placing pollution costs on lenders.

C The Goals of Environmental Law

This paper argues that the two principal goals of environmental law are first, to achieve an efficient allocation of resources (which entails reduction of the sum of pollution costs and pollution avoidance costs); and second, to achieve a fair and just distribution of the social costs resulting from pollution.

1 Efficient allocation of resources

If the efficient allocation of resources is one of the primary goals of the legal system as a whole, then it is certainly true of environmental law. To the economist, the environmental problem is one of the leading instances of resource misallocation.[127] Achieving an efficient allocation of resources is therefore seen as a crucial step in protecting the environment. Lawmakers in New Zealand have explicitly recognised the importance of economic efficiency to environmental law. Section 7 of the RMA provides in part that:

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124 K S Abraham *Distributing Risk: Insurance, Legal Theory, and Public Policy* (Yale University Press, New Haven, 1986), 10; Trebilcock, above n 121, 362.

125 Abraham, above n 124, 10; Posner, above n 121, 13. Efficiency or economic performance can be measured in several ways by economists. For example, *Pareto efficiency* aims to improve a person's welfare without diminishing someone else's. *Kaldor-Hicks efficiency*, on the other hand, is achieved when beneficiaries of a transaction have made sufficient gains that they could hypothetically compensate third parties for any harm suffered by them, and still have gains left over for themselves. See Trebilcock, above n 121, 364; Posner, above n 121, 13-14.

126 Posner, above n 121, 22-23.

127 R Dorfman and N S Dorfman (eds) *Economics and the Environment: Selected Readings* (3 ed, W W Norton & Co, New York, 1993), 75.

> In achieving the purpose of this Act, all persons exercising functions and powers under it, in relation to managing the use, development, and protection of natural and physical resources, shall have particular regard to - ...
>
> (b) The *efficient* use and development of natural and physical resources.

The High Court in *Machinery Movers* further emphasised the role of efficiency in designing environmental laws.[128]

In the context of environmental law, the general goal of efficient resource allocation entails reduction of the sum of the costs of pollution and the costs of avoiding pollution.[129] This formula is premised on the idea that resources are allocated inefficiently if the costs of pollution[130] exceed the costs of avoiding pollution, yet a person chooses to pollute. It is more efficient to spend money on pollution prevention if the pollution could have been avoided at a cost lower than the expected pollution cost. In other words, in the context of a legal regime which imposes liability on polluters, individuals should undertake a cost-benefit analysis in determining whether to take one of two paths: polluting and risking liability for clean-up costs, or avoiding pollution in the first place.

For example, suppose that a factory dumps waste into a river as part of its manufacturing process. Assume that the annual cost to society of the pollution is $100,000, and that the existing legal regime would impose liability on the polluter for the full amount of the social cost. Pollution reduction devices can be installed in the factory at a cost of $60,000. By investing $60,000 in the device, the factory owners can save $100,000 on liability costs, for a net saving of $40,000. Under these conditions, the factory owners have a strong incentive to invest in pollution prevention. In this way, the sum of pollution costs and pollution avoidance costs to society is reduced.

Of course, if conditions are such that pollution avoidance costs exceed the costs to the polluter of polluting, then incentives will change. It will be more efficient under these circumstances for the factory owners to continue to pollute. Hence, if society values a

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128 Above n 26, 670.

129 This formula is used in economic analysis of many areas of the law. For example, economists such as Calabresi, Posner and Trebilcock accept that the search for efficiency in accident law requires minimising the sum of accident costs and accident avoidance costs. See Calabresi, above n 121, 26; Trebilcock, above n 121, 370; Posner, above n 121, 24. Abraham argues that insurance law promotes efficiency whenever it reduces the sum of insurance costs and loss prevention costs. See above n 124, 11.

130 Measurement of the costs of pollution is extremely difficult. Many of the costs of pollution are intangible: extinction of species, lost recreation opportunities, pollution-related health problems and so on. The lack of accurate information can affect whether individuals are capable of allocating resources efficiently. See L Ruff "The Economic Common Sense of Pollution" in Dorfman, above n 127, 24-25. Also see below Part VIII A 3.

clean environment, it becomes crucial for the legal system to create conditions in which polluters are encouraged to invest in deterrence.

However, it is important to note that our society is not committed to preserving the environment or avoiding pollution at all costs. Pollution costs are not infinite, just as the value of a pristine environment is not infinite. Pollution is a necessary by-product of most of the activities that sustain human life on this planet, or at least make that life more tolerable. In other words, a certain level of pollution yields benefits to society. Therefore, as one economist has stated, "the choice facing a rational society is *not* between clean air and dirty air, or between clear water and polluted water, but rather between various *levels* of dirt and pollution".[131] If society adopts a policy of pollution abatement, the aim must be to find an 'optimal' level of pollution abatement where the benefits of abatement exceed or equal the costs. Society should no longer abate pollution where further abatement would cost more than it is worth.[132]

2 *Obstacles to economic efficiency*

A variety of factors may impede the ability of persons to make an efficient decision as to whether to invest in pollution avoidance or risk liability for clean-up costs.

(a) Transactions costs

In the world of economic theory, transactions that promote efficiency occur without cost. In the real world, efficient allocations may be prevented because the costs of transactions may exceed the benefits that could otherwise have been gained by entering into them.[133] For example, individuals who lack perfect information or knowledge about the risks they face, will not be able to accurately estimate the costs of pollution in advance. As a result, they may make inefficient decisions. In addition, the process of negotiation itself may bar an efficient outcome. To

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131 Ruff in above n 127, 22.

132 These statements implicitly rely on the economic concept of marginalism. According to this theory:

> "The standard economic problem [is] that of finding a level of operation of some activity which would maximise the net gain from that activity, where the net gain is the difference between the benefits and the costs of the activity. As the level of activity increases, both benefits and costs will increase; but because of diminishing returns, costs will increase faster than benefits. When a certain level of the activity is reached, any further expansion increases costs more than benefits. At this 'optimal' level, 'marginal cost' - or the cost of expanding the activity - equals 'marginal benefit', or the benefit from expanding the activity. Further expansion would cost more than it is worth, and reduction in the activity would reduce benefits more than it would save costs. The net gain is said to be maximised at this point."

See Ruff in above n 127, 22.

133 Above n 124, 14.

illustrate, it is unfeasible for all downstream users of the river to unite together and negotiate with the factory owner to restrain its pollution. Alternatively, it is just as difficult for the factory owner to locate and compensate all homeowners for any damage in exchange for permission to continue dumping waste into the river.

(b) Externalities

(i) The effect of externalities

An externality is a side effect of an individual's actions that is borne, not by the individual, but by others. It is a social cost, rather than a private cost.[134] To the economist, externalities, or the divergence between private and social costs, are the fundamental cause of pollution.[135] For example, factories will dump waste into rivers if water is a free resource. In this scenario, the cost of dumping waste is not included in the factories' costs of production; it is externalized to society. Because the factories can avoid paying the full cost of the resource they consume, they have an incentive to consume excessive amounts of it. In turn, the price of goods produced by factories will not accurately reflect their true cost to society. Hence, consumer demand for the product will rise, and too many goods will be produced. This results in an inefficient allocation of resources and over-utilisation of the environment. Each individual's incentives induce him or her to abuse environmental resources and invest less in protecting them than is socially desirable.[136]

(ii) How to cure externalities

The Coase Theorem demonstrates why, in the absence of transactions costs, externalities can be cured without legal intervention by the state. According to Coase, an efficient allocation of resources can be achieved by private bargaining between the parties.[137] In particular, assuming there are no

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134 See above n 127, 82; Ruff in above n 127, 23.

135 Above n 127, 75; Ruff in above n 127, 23.

136 See above n 127, 85; Trebilcock, above n 121, 367. Part of the environmental problem stems from the fact that environmental resources cannot be privately owned: they lack the property of 'excludability'. The market, while able to secure the efficient use of things that are owned, cannot provide incentives for using public goods or common-property resources efficiently. The problem of public goods is classically illustrated by Garrett Hardin's example of the commons. See G Hardin "The Trgedy of the Commons" in above n 127.

137 R H Coase "The Problem of Social Cost" (1960) 3 J Law & Econ 1. See also B White "Coase and the Courts: Economics for the Common Man" (1987) 72 Iowa Law Rev 577; R D Cooter "Coase

transactions costs, the party imposing and the party suffering from the externality will negotiate to determine who should bear the costs and how the resource should ultimately be used.

To illustrate, let us return to the example of the polluting factory. If downstream users of the river would benefit more from having a clean river than the polluter benefits from polluting, the users would pay the polluter to refrain from polluting. If having a clean river is not worth its cost, no payment would be made and the pollution would continue. In either case, economists believe the resources have been allocated efficiently. Similarly, even an inefficient legal rule could be circumvented contractually. If downstream users have a legal right to a clean river, then the polluter would compensate the users in exchange for the right to pollute, if the benefits of polluting outweighed the cost of compensation.[138]

While Coase's Theorem tells us that the initial allocation of property rights by the state is irrelevant to economic efficiency, this only holds true if transaction costs are nil. As transactions costs are greater then zero in reality, legal intervention to cure externalities and promote efficiency is therefore justified.

Legal intervention will be effective, and will promote efficiency, if it manages to internalize externalities. In other words, it is necessary to adopt rules of liability that internalize the costs of pollution into the costs of all activities, thereby increasing the cost to the polluter of engaging in the activity. Holding polluters liable for pollution damage is one method of internalizing these costs. Once pollution costs include the costs of liability, incentives will change. When faced with a choice between onerous liability for clean-up costs and pollution prevention, polluters will reduce their costs by investing in the latter. Systems of liability that enable polluters to externalize the costs of liability in any way, will not promote efficiency.

3 *Distributive justice*

Many Law and Economics scholars stress the deterrent objectives of the legal system, and ignore the role of distributive justice in the legal system. However, achieving the efficient

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Theorem" in J Eatwell, M Milgate and P Newman (eds) *The World of Economics* (Macmillan Press, New York, 1987).

138 Above n 124, 17.

allocation of resources is by no means the only goal of environmental law. In the broadest sense the goal of any legal system is to achieve justice, and few would consider the single-minded pursuit of efficiency a sufficient prescription for reaching that goal. Therefore, in addition to determining which distribution of risk or loss achieves the most efficient allocation of resources, it is proper to consider whether that distribution is fair.

Drawing on notions of distributive justice, left wing writers and economists such as Calabresi argue that the costs of activities should be borne collectively and that any system of law should be evaluated against its capacity to spread risk and provide meaningful compensation.[139] In other words, the goal of distributive fairness can be accomplished through different forms of loss spreading or risk spreading.

(a) Justification for loss spreading

One justification for loss spreading lies in the theory of diminishing marginal utility of money. This theory holds that a loss causes less social and economic disruption if many people share it. For instance, people supposedly suffer less if 10,000 of them lose $1 each, than if one person loses $10,000.[140] Hence, from a purely utilitarian perspective, liability for clean-up costs may be less burdensome if it is spread broadly among many.

Loss spreading may also be justifed where it is inequitable or unethical for one group or individual in society to bear all the risk they actually pose. It may be fairer or less discriminatory to allocate liability costs to other sectors of society. For example, it would be unethical to increase motor vehicle insurance premiums on the basis of a person's race, even if it could be proved that certain races caused disproportionately more car accidents than others.

(b) Forms of loss spreading

Loss spreading can be achieved in a number of ways. In the first place, losses can be spread through systems of private insurance or social insurance. The New Zealand accident compensation scheme is an example of such a social insurance system. The question of who would pay what taxes to establish the requisite pollution clean-up fund would depend on the degree of risk spreading sought. For example, one could aim for total loss spreading in which every member of society

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139 M Trebilcock, "The Future of Tort Law: Mapping the Contours of the Debate" (1989) 15 Can Bus L J 471.

140 See Oswald, above n 6, 596; Calabresi, above n 121, 39-40.

contributed to the costs of pollution. Alternatively, one could adopt the 'deep pocket' form of risk spreading. This method advocates placing losses on those categories of persons least likely to suffer socio-economic dislocation as a result of bearing them, usually thought to be the wealthy.[141]

A further way of spreading pollution losses is through enterprise liability. Enterprise liability holds that losses to society caused or created by an enterprise ought to be borne by that enterprise.[142] As enterprises are in a position to pass on the losses to purchasers of their product or service, this enables a fairly wide distribution of pollution costs.

As the discussion above shows, there are virtually no limits on how society can allocate or divide these costs. Certainly, in determining the allocation of pollution costs, we are not limited to placing the burden of liability on the polluter. The 'polluter pays' principle, although a currently fashionable concept, cannot be accepted as inherently determinative of who ought to bear the costs of pollution.

4 *Tensions between economic efficiency and distributive justice*

The goals of economic efficiency and distributive justice have quite different emphases. The goal of distributive justice concentrates on determining who will pay for the costs of pollution once it has already occurred. Concern with the financial consequences of a past event is backward-looking in perspective. By comparison, the goal of economic efficiency is concerned to prevent future acts of pollution that are not cost-justified. It aims to create incentives that will shape future conduct.

At a more fundamental level, the goals not only emphasise different things, but are often incompatible with each other. Any society that aims to achieve a measure of distributive justice must often do so at the expense of economic efficiency. Conversely, political or legal decisions that promote efficiency may have social or moral outcomes that are unacceptable. In the words of Lord Atkin, "justice and efficiency are seldom on speaking terms".[143] We should therefore not expect lender liability to fully satisfy both goals: what is important it that it is able to accommodate the two goals to the fullest extent possible.

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141 Calabresi, above n 121, 40.

142 See Klemme, above n 119, 158; Calabresi, above n 121, 51.

143 *Ford* v *Blurton* (1921) 38 TLR 804 at 805.

D *Does Lender Liability Achieve These Goals ?*

The previous sections have established the goals that environmental law seeks to achieve: efficient allocation of resources and a just distribution of risk. This section will examine the extent to which a system of lender liability is capable of achieving these goals. This will require an analysis of the incentive effects and the distributional consequences of lender liability under the RMA.

1 *The incentive effects of lender liability*

(a) *Realising the security*

It is important to bear in mind that local authorities under the RMA will probably seek, as a first resort, to place pollution costs on the polluter. It is only when the polluter cannot be identified or is insolvent that authorities will seek to impose liability on the owner or occupier of land. In turn, if a lender has not taken steps to realise its security, the lender will not constitute an owner or occupier and so will not incur liability. Only in the event that the borrower defaults *and* the lender enforces its security does the issue of lender liability arise.

The threat of lender liability will therefore force banks and other mortgagees to engage in a cost-benefit analysis of whether to enforce its security and run the risk of attracting liability under the RMA, or whether to abandon the property altogether. If, for example, the value of the security is $1 million (or even less in light of the fact that the property is polluted), but the estimated cost of liability for remediation of that land is $1.5 million, the bank may choose to reduce its losses by abandoning the property.

The decision to abandon would represent an efficient allocation of resources for the bank. It has chosen the lesser of the two losses. However, it is not a desirable or efficient result for society as a whole. If property is abandoned in a polluted state, the value of that resource is not maximised. If the state was determined to remediate the site, the costs of liability would have to be met by all taxpayers. In other words, the costs of liability would be externalized to society. Deterrence is not encouraged when the practical effect of placing liability on lenders is that society itself picks up the tab. Any system of liability that encourages owners to abandon land therefore does not promote efficiency.

However, lender liability need not have this effect. A lender does not act in its own best interests if it allows events to progress to the point where it is forced to choose between the lesser of the two evils of liability or abandonment. Rather, it is rational for a lender to take steps to ensure that the borrower complies with the RMA from the very beginning of the lending relationship so that a bank may safely realise its security in the event of borrower default. The fear of lender liability may therefore create incentives on the part of lenders to deter borrowers from polluting, as the following sections demonstrate.

(b) Active risk management

Lenders will have an incentive to take a much more active role in monitoring their customers' activities and managing the risks of polluting. Lenders will be forced to become surrogate regulators in order to shield themselves from liability. New Zealand banks, following the North American lead, will probably attempt to protect themselves by taking the following steps.[144] Prior to the inception of the loan, banks will need to undertake environmental risk assessments or 'audits'. These audits will include an inquiry into the previous uses and ownership of the property, review of historical records and present business practices, site inspections, and if necessary, soil analysis and sample testing for detection of any subsurface contamination.[145] Environmental questionnaires will provide useful means of obtaining representations and warrantees from the borrower as to the status of the borrower's property.[146]

Once the loan has been authorised, the loan documentation will need to take account of environmental concerns and carefully define the borrower's responsibilities throughout the course of the loan.[147] For example, lenders will require covenants from borrowers that they will comply with environmental laws. Loan agreements should permit the lender access to the borrower's property at any time to check

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144 For a description of the steps being taken by United States banks in repsonse to the perceived threat from CERCLA, see A Bryce "Environmental Liability: Practical Issues for Lenders" (1992) 4 JIBL 131 and C M Ward "Environmental Risk Assessment" (1993) 110 BLJ 204.

145 C E Davidson "Environmental Considerations In Loan Documentation" (1989) 106 BLJ 308, 315. These steps are already being taken in the United States in response to the perceived threat created by CERCLA. Environmental investigations in that country are divided up into Phase I and II audits involving site inspections, records review, interviews with regulatory authorities and extensive soil testing and analysis. See Bryce, above n 144, 135; Ward, above n 144, 212.

146 Davidson, above n 145, 317.

147 Ward, above n144, 209.

compliance.[148] The agreement should also require borrowers to undertake periodic site assessment and remediation.

Direct risk management activities of the sort described in the preceding paragraphs require sanctions for non-compliance in order to be effective. In this regard, lenders are able to impose severe penalties. For example, failure to pass pre-loan audits could result in the denial of finance. Non-compliance with environmental laws during the term of the loan could trigger punitive interest rates or could constitute grounds for demanding immediate repayment of the loan. The threat of these penalties will place borrowers under constant pressure to install environmental compliance programmes and avoid activities that lead to adverse environmental effects. In other words, because of lenders' unparalleled ability to influence and constrain their borrowers' behaviour, lender liability may have extremely efficient deterrent effects. Arguably, no other party is in a better position to force polluters to refrain from polluting.

However, there are significant costs involved in active risk management. Banks will need to spend a great deal of time and money building up an expertise in environmental matters. Environmental risk assessment will need to be undertaken by an internal department of environmental specialists or external consulting firms: either will be expensive. The cost of screening all potential borrowers will also be significant.[149]

Ironically, lenders' attempts to protect themselves from one form of legal liability may expose them to others. Active risk management requires banks to play an authoritarian role in making decisions about the way their customers conduct their businesses. Therefore, as a lender's involvement in a borrower's business increases, so too does the risk of liability under section 340(3) of the RMA as a 'person concerned in the management of a body corporate'. In addition, the courts may apply doctrines of undue influence, unconscionability, and duress to punish lenders who impose onerous or unduly restrictive lending terms on borrowers. Lenders will therefore have to weigh carefully the costs and benefits of adopting a policy of active risk management.

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148 Ibid.

149 Some New Zealand bankers fear that the potential scope of environmental credit risk is so wide that practically all potential borrowers, including residential mortgagors, would require screening. X Harding "Should Banks Police the Environment ?" (1992) 5 New Zealand Banker 17, 18.

(c) Risk classification

It may not be enough for banks to monitor and attempt to influence their customers' behaviour. Site contamination may occur despite the best efforts of borrowers or lenders. Lenders will therefore be forced to take measures to cushion the impact of liability costs by distributing or spreading losses among its customers. In this sense, they will be forced to become insurers of risk.

Insurers protect against risk by dividing insureds into risk classes and varying the prices charged for coverage according to the expected loss (probability of a loss multiplied by the magnitude of the loss if it occurs) of each class of insureds.[150] Accurate risk classification and pricing will promote economically efficient behaviour by encouraging insureds to compare the cost of insurance with the cost of investing in loss prevention, and thereby reduce the sum of the two costs.[151] Inaccurate pricing or classification results in inefficient allocations of resources: if insurance is too cheap, insureds will under allocate to loss prevention, and vice-versa. Insufficient classification can therefore allow insureds to externalize the costs of liability to other insureds. Hence, the incentive effects produced by a refined as opposed to a blunt insurance pricing system may vary considerably. The deterrent properties of insurance are therefore dependant on accurate risk classification and pricing.

These principles will apply equally to lenders if they attempt to spread risk. Banks will build the risk of liability costs into the cost of lending by, for example, raising interest rates or bank charges. Lenders will encourage cost internalization on the part of borrowers if they can accurately classify borrowers according to their expected loss. For example, high-risk customers should pay higher interest rates than customers that represent a low risk. Banks should classify risk on the basis of variables within the borrower's control, so as to create loss prevention incentives. For example, borrowers could be charged according to their businesses' levels of activity, use of toxic substances, or according to the liability they have incurred in the past. An increase in interest rates will serve as a signal to the borrower to allocate more to loss prevention, while a decrease will reward loss prevention efforts.

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150 Above n 124, 2 and 15.

151 Above n 124, 65-66.

However, there are two reasons why banks are at risk of creating inaccurate or insufficient risk classes. First, unlike the insurance industry, bankers have little experience in risk assessment and classification. Knowledge of the methods and effects of risk classification is likely to be woefully insufficient.[152] The cost of acquiring and interpreting data to define risk classes may therefore exceed the advantages of classification.[153]

Second, the task of classification is made more difficult by the problems inherent in predicting the costs of liability for remediating pollution.[154] According to Kenneth Abraham: [155]

> The amount of damage that current and past uses of toxic substances ultimately will cause cannot be predicted. Scientific uncertainty is one reason; knowledge of the hazardous properties of toxic chemicals is in its infancy. The synergistic effect of chemicals that have been mixed together during storage in waste dumps are even less clear. ... And toxic disasters tend to be catastrophic in scope and sporadic in occurrence. All this makes it very difficult to predict the ultimate riskiness of activities involving toxic substances.

The banking industry is not alone in suffering from an acute lack of quantitative information about the dangers of toxic chemicals. However, the absence of detailed, reliable data will hinder lenders' efforts to evaluate the riskiness of their customers' activities and set interest rates accordingly. In turn, inaccurate risk classification will create the wrong incentives for borrowers. Under these circumstances, there is little reason for confidence that lender liability will result in an efficient allocation of resources. Instead, imposition of lender liability creates an atmosphere of uncertainty, where it is difficult to plot a course of action which is guaranteed to minimise the risk of financial loss.[156]

(d) Conservative lending policies

As a result of the uncertainty generated, lender liability will encourage lenders to adopt a more conservative approach to commercial and industrial lending.

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152 Banking Law Association, Banking Law and Practice 8th Annual Conference, 9-10 May 1991, Auckland, New Zealand, 201-202.

153 Above n 124, 15.

154 For example, the costs of remediating a service station range from approximately $20,000 to $200,000. See Glen Smith, above n 10, 65.

155 Above n 124, 47.

156 E Welch and T Parker "A Bank's View of Lender Liability in Environmental Legislation" (1993) 6 JIBL 217, 219.

Businesses engaged in environmentally sensitive activities will experience difficulty in obtaining loans.

This phenomenon has already occurred in the United States, where as a result of the vagaries of CERCLA liability, some lenders have made policy determinations to cease lending to entire industries. Chemical manufacturers, for example, have had difficulty in obtaining finance.[157] The American insurance crisis of the mid-1980s was partially attributable to the impact of environmental liability. Insurers slashed levels of coverage provided; premiums rose dramatically; and reinsurers such as Lloyds of London retreated from the United States market, claiming "the liability insurance scene in the U.S. has lost all predictability and therefore has become impossible to assess in terms of premium rates".[158] By 1986, most of the country's 400 largest consulting engineering firms were unable to buy pollution liability insurance in any amount or at any price.[159] The effects have been lasting. A 1991 survey indicated that only three United States insurers were still offering substantial domestic hazardous waste insurance coverage.[160]

Conservative lending policies such as those mentioned above will have serious repercussions for New Zealand commerce and foreign investment in New Zealand. While it may seem to be a positive development to withhold finance from environmentally unsound businesses, it will also deny them the funds necessary to implement pollution avoidance measures. Poor businesses, like poor countries, can often be the worst polluters.

(e) Increased litigation

Perhaps the most likely, and the most damaging result of lender liability, will be the increase in litigation. Lenders are likely to challenge any attempts by local authorities to create a precedent for the imposition of liability for clean-up costs on lenders. Allocation of resources to litigation may be cost-effective for lenders if litigation guarantees lenders will avoid liability *and* it is cheaper than both pollution avoidance costs and pollution costs. If however, litigation is unsuccessful, lenders have incurred not only liability costs but legal costs as well. Either way, such

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157 Ward, above n 144, 208.

158 Lloyds insurers quoted in P W Huber *Liability: The Legal Revolution and its Consequences* (Basic Books Inc, New York, 1988), 141. See also S Saul & S Janissen "Contaminated Site Clean-up: Is Superfund the Answer ?" (1994) 1 Butterworths Resource Management Bulletin 18, 20.

159 Huber, above n 158, 140.

160 Above n 6, 340.

litigation is counterproductive and inefficient for society as a whole. It absorbs resources that could be allocated more productively toward either pollution prevention or remediation.

The North American experience reveals the inefficiencies of litigation. In the United States, billions of dollars have been spent by government and the private sector on the clean-up of fewer than 85 sites. The greater proportion of that money has been spent in defending or pursuing legal action in relation to clean-up orders.[161] The average cost of remediating a site on the National Priorities List is between US$25 million and US$31 million; nearly 30 percent of that cost represents litigation costs.[162] As a result of legal wrangling, the typical time between identifying and remediating a contaminated site can be as long as 15 years.[163]

(f) Summary

To summarise this section, lender liability is capable of creating incentive effects that promote efficiency. In particular, lenders are able to induce modifications in the behaviour of their customers that could result in a reduction of the sum of the costs of pollution and pollution avoidance. On the other hand, lenders may be encouraged to abandon their security, adopt overly conservative lending policies, or engage in futile litigation. Even genuine attempts to respond to the risks presented by lender liability may inadvertently lead to inefficiency where, for example, banks classify and spread risk inaccurately. The RMA's regime of lender liability therefore achieves only a measure of success in accomplishing the goal of efficiency. If the results of lender liability are not wholly efficient, are they at least distributively fair ?

2 The distributional effects of lender liability

(a) Achievement of loss spreading

Lender liability is clearly successful in spreading losses. There is, in effect, a double layer of loss spreading involved in lender liability: first, losses are shifted from the polluter to its lender; and second, those costs are passed on to all of the

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161 Welch and Parker, above n 156, 218.

162 Above n 4, 314; Saul and Janissen, above n 158, 20.

163 Saul and Janissen, above n 158, 20. Lawyers' fees in one trial alone can amount to US$11 million. See D Sive "Liability for Contaminated Sites: Superfund and its Problems" (1994) 1 NZELR 45.

lender's customers through the lender's pricing mechanisms. Losses that otherwise would have fallen on one party alone, possibly causing extreme financial dislocation, are shared among many.

A rationale behind a system of lender liability is that losses will be spread and allocated on the basis of 'deep pockets'. Losses are absorbed by institutions which supposedly have a revenue base large enough to cushion the impact of liability. However, this method of risk spreading can be problematic. In the first place, it assumes that lenders do indeed have 'deep pockets'. However, not all secured creditors are large and powerful multinational banks or finance corporations: many are individuals or small institutions which are vulnerable to losses of this nature. Second, if the state aims to spread pollution costs on the basis of deep pockets, why not place those costs on any or all banks ? If the crucial variable was wealth, one would not impose liability only on those lenders whose borrowers pollute; any bank would suffice. Third, if the state was committed to spreading pollution costs thinly, there would be no logical stopping point short of rendering the state, as the deepest pocket, liable for all pollution costs. Such an option would certainly be more administratively convenient.[164]

(b) Is this distribution of loss fair ?

It is not enough to query whether lender liability achieves a distribution of losses: one must then examine whether that particular distribution or allocation is equitable. In many ways, lender liability has quite unfair distributional effects.

(i) No causative link between lenders and pollution

The most obvious objection to the distribution of risk under lender liability is that it places liability costs on parties whose activities were not responsible for creating the pollution in the first place. As this paper has shown, the law generally considers that losses should be borne by the party who has created a risk or acted culpably. Lenders have done neither.

But are lenders completely without culpability in this scenario ? One can argue that even if lenders do not cause the pollution themselves, they derive financial benefits from lending to businesses which engage in polluting activities. They rely on borrowers to do whatever is necessary, including

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[164] Calabresi, above n 121, 46.

contaminating the environment, to meet interest payments and repay their debt to the bank. It may therefore be fair for lenders to take responsibility for what occurs on borrowers' property. In the words of the Senate Commission on Environment and Public Works: [165]

> [S]ociety should not bear the costs of protecting the public from hazards produced in the past by a generator, transporter, consumer, or dumpsite owner or operator who has profited or otherwise benefited from commerce involving these substances and now wishes to be insulated from any continuing responsibilities for the present hazards to society that have been created. ... Relieving industry of responsibility establishes a precedent seriously adverse to the public interest.

However, this argument is not entirely convincing. In the broadest sense, all of society benefits from activities that lead to contamination, because such activities produce goods, generate employment and wealth in the community. One commentator has argued that: [166]

> it could under some circumstances be an entirely rational posture for a legislature to suggest that because the benefits attendant on the industrialised and agricultural activities which had created the contamination in the first place were so widely disseminated across the society as a whole, that the sensible way in which to finance remediation of the environment was simply to do so out of the general tax revenues.

In other words, whether or not someone gains a benefit from an activity is not necessarily determinative of the issue.

(ii) Arbitrariness

There are further objections to the distributive effects of lender liability. This form of liability operates in an arbitrary fashion. For example, bank A and bank B may both have borrowers who have caused site contamination. Bank A will only find itself directly liable under the RMA to pay clean-up costs if its borrower has defaulted and it has taken steps to recover its security. Bank B will remain sheltered from direct liability if its borrower remains solvent, because local authorities will impose direct liability on the borrower instead. In other words, liability depends not on the nature of the pollution or the parties' behaviour, but on the financial well-being of the

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165 Quoted in Oswald, above n 6, 601.

166 Rabinowitz in Banking Law Association, Banking Law and Practice 8th Annual Conference, 9-10 May 1991, Auckland, New Zealand, 199.

polluter. Determining responsibility in this method flies in the face of the principle that like cases should be treated alike.

(iii) Inequitable results for innocent borrowers

Finally, distribution of risk to a bank's general customers is inequitable if low-risk customers are forced to subsidize high-risk customers. As a matter of fairness, people whose expected loss is minimal should not have to bear the burdens of inaccuracy.[167] Yet as this paper has shown, there is every likelihood of this occurring if banks lack the information necessary for accurate risk classification. In this scenario, failure to allocate resources efficiently is morally and well as economically objectionable.

(c) Summary

The preceding discussion indicates that lender liability results in inequitable distributions of loss or risk. If this form of liability is unsuccessful in achieving the goal of distributive justice, and is only partially successful in achieving the goal of economic efficiency, then it becomes difficult to justify its adoption as a legal rule of liability. In other words, analysis of the concept of lender liability through a Law and Economics framework points to the conclusion that the imposition on lenders of liability for remediation of contaminated sites does not accord with legal principle.

VI CONCLUSION

This paper began with a conundrum: can lenders be held liable for the environmentally unsound activities of their borrowers, and if so, should they be ? The paper first established that several provisions in the RMA have the potential to impose direct liability for the costs of cleaning up pollution on lenders who take steps to realise their security and thereby become owners or occupiers. Lenders in the role of owners or occupiers have never before been held liable in New Zealand for the actions of others. However, if New Zealand courts follow the approach of foreign jurisdictions, they are likely to impose such liability on lenders in the future.

Having demonstrated that lenders could face liability under the RMA, the paper then focused on the question of whether the concept of lender liability could be justified as a

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[167] Above n 124, 85.

matter of principle or policy. The paper adopted a Law and Economics analysis which identified the goals of environmental law as being the efficient allocation of resources and a fair distribution of loss. It then examined whether the legal rule of lender liability achieved these goals. The paper found that the incentive and distributional effects of lender liability were generally inefficient and unjust. This result means that lender liability cannot be justified as a matter of legal principle or economic policy, as it does not satisfy the goals it was designed to achieve.

In conclusion therefore, decision makers need to consider amending sections 314(1)(da) and 322(1)(b)(ii) of the RMA, so as to exclude the possibility of lender liability. Failure to do so will hinder the achievement of the goals of environmental law.

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