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Advising the Board on **Environmental Law Risk in CEE**

Reports looking at the full range of commercial risk

Risk, Resilience and Reputation

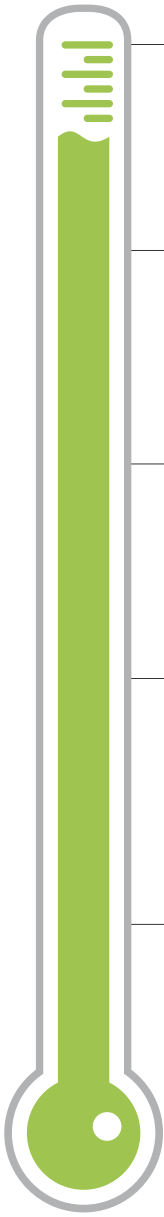
Directors' risk report

Environmental law is firmly and undoubtedly a board-level issue and all businesses need to focus on how it impacts their activities. Environmental authorities expect directors to play a key role in establishing and maintaining a culture of compliance in their organisations regarding environmental law. Any board that gets these issues wrong risks significant penalties not only for the business, but also for themselves as individuals. It is therefore critical that the proper management of environmental law issues is at the forefront of any responsible business compliance strategy.

Environmental regulations increasingly require businesses to perform better when it comes to environmental impact and this in turn often represents a significant increase of CAPEX on pro-ecological investment.

The level of changes required by environmental regulations can range from restructuring daily operations to complete changes in a company's business model. It is no longer an incidental issue and this is particularly apparent for the CEE where environmental issues may not have played such a crucial role in the past. This change is evident and lasting can be seen in the fact that compliance with environmental law is often now a starting point in the financial world, e.g. where businesses are now required to demonstrate how they deal with Environmental, Social and Governance (ESG) risks.

Stakeholder risk thermometer



HIGH RISK

Board
— a Board member who is responsible for environmental performance supervision risks serious personal penalties.

Employees
— can often be at risk of personal penalties, although directors are more often expected to 'know better'.

Shareholders
— the share price of companies involved in environmental law violations can be depressed due to the risk of damages claims.

Funders
— some risk of repayments being impacted by environmental law infringements, especially where they lead to a suspension of operations.

Customers/Suppliers
— their business may be impacted, especially where the environmental law infringements lead to a suspension of a company's operations.

LOW RISK

Consequences of breaching environmental law

The consequences of breaching environmental law are serious and far reaching.

For the business these can include:

- very high financial penalties imposed by administrative authorities with limited possibility for mitigation;
- very high financial penalties imposed as a result of a criminal conviction under the rules on liability of collective entities;
- suspension of operation including operation of production plants;
- cancellation of permits resulting in the suspension of business operations;
- inability to obtain new permits for the business;
- damages actions from those who have suffered harm as a result of the infringement;
- the need to cover costs of damage to the environment, clean up and restoration;
- inability to participate in procurement procedures or restrictions in this respect;
- significant problems with obtaining financing for further projects.

For Directors these can include:

- criminal convictions with high fines or even more than 10 years in prison;
- a ban on acting as a director;
- inability to perform directors functions;
- damage to professional reputation/ difficulty in securing new roles.

Environmental issues during investment process

Environmental regulations are already at play during the investment process. If a company is building or expanding a factory, an environmental impact assessment will most likely have to be conducted first. The purpose of this exercise is to ensure that the new business will not impact people or the environment in an unacceptable way. Skipping this obligation may result in serious sanctions, as well as financial and reputational damage to a business. In practice, a low-quality environmental impact assessment may result in hostile reactions by local communities or ecological organizations and might even put large scale projects at risk. It is recommended that any investment project have a fixed roadmap which should include advance liaison with environmental authorities with a view to clearing any legislative or regulatory obstacles.

Additionally, if the environmental impact is not properly assessed at the outset, it may later transpire that business operations cannot start or continue, e.g. due to noise emission violations. Apart from noise, the issues that need to be reviewed and analysed in the environmental impact assessment usually include air emissions, water intake and sewage discharge, waste management, hazardous substances management, and CO_2. Before acquiring any land where the investment is to take place, it is worth checking it for soil and groundwater contamination. If it occurs, there are many technical and legal ways to deal with it, but some of them will involve high costs.

Environmental permits for operation

Even if the environmental impact assessment is performed before development, it does not close the list of environmental obligations. Before a factory or other business starts operations, in most CEE countries it needs to obtain further environmental permits. These may include various sectoral permits such as air emission permits, water permits or waste permits. However, in some cases it is possible to obtain one integrated permit (an IPPC permit) which covers various environmental impacts. If a business operates without the necessary permits or in violation of an environmental permit (e.g. higher air emissions than allowed by the permit) this can result in severe financial penalties, suspension of operations or cancellation of permits. If the business operation results in any environmental damage, there is also the risk of criminal sanctions. Non-compliance with environmental permits may lead to administrative or even civil law litigation which apart from obvious financial risks, also has negative PR impact.

Environmental services

Apart from environmental permits, it is also important to secure the necessary environmental services. These may include, e.g. waste or sewage collection and management. Not only should these services be rendered on good commercial terms, but it is also important to be sure that they are provided by a trustworthy contractor. For example, in some CEE countries the responsibility for waste management will not pass from its producer unless the collector operates fully in line with the law and in particular has the necessary permits. If the waste collector does not operate in line with environmental law, the producer of waste still bears liability for this even if the waste was handed over to that collector. As a result, the producer may be required to collect the waste from the place of illegal storage, pay very high financial penalties or even be held liable for damage which such waste caused.

Environmental fees and formalities

Under environmental law in most CEE countries, it is necessary to incur fees and related expenses for using the environment for business purposes. Such fees can relate to, e.g. sewage discharge, landfilling waste and air emissions. In many cases, there are also specific reporting obligations which usually involve completion of paper forms but recently it is more common that reporting takes place online. Whether environmental impact reporting is done in paper form or online, there are specific time scales to adhere to and environmental impact must be accurately reported. Late or improper reporting may result in penalties, including financial and criminal.

Monitoring the constantly changing regulations

Environmental law is changing rapidly. It is essential to keep an eye on the legislative pipeline to avoid unpleasant surprises. Monitoring goes beyond assuring compliance of day to day business operations with the law, although that is critical for the continuity of the business. For example, it may be crucial to know that a new, stricter chemical substances regulation has recently come into force, which may entail a reorganisation of business operations. It is as important to pay attention to other developments, such as the adoption of BAT conclusions at the European level, which set much stricter emission levels for many businesses and hence require significant investments to reach compliance. Some new regulations introduced at the European or national level may have an even greater impact on businesses as they can undermine the whole business model. In this vein, the single-use plastics ban has changed the landscape for many businesses connected to the plastics market. Additionally, other notions such as the circular economy or climate change related regulations will, in the long run, result in a need to reconsider the business model.

Environmental due diligence

"Prevention is better than cure" when seeking to keep up with environmental law requirements. It is advisable to periodically carry out environmental due diligence. This should be done by both environmental lawyers and technical advisors. It helps identify the areas which may expose the company to legal or factual environmental risk. Due diligence is absolutely crucial during any M&A. Each target business should undergo strict scrutiny of environmental matters. Issues which tend to crop up during transactions include soil and groundwater contamination and non-compliance with environmental laws or permits. Once these are properly assessed and addressed in transaction documents, the risk associated with them drops significantly.

ESG and sustainable investing

Businesses that do not keep up to date with environmental developments and new technologies may have problems with obtaining necessary financing due to new European rules on Environmental, Social and Governance (ESG) compliance reporting and sustainable investing. The European Union is at the forefront of development on this aspect, establishing the actual list of environmentally sustainable activities by defining technical screening criteria for each environmental objective. The aim of this is to enable objective assessment of sustainability and its comparison between businesses. Business which do not meet set requirements may face difficulties in advancing their commercial interests both now and in the future. Every Board member and director should be aware of ESG requirements well in advance and equip themselves with the necessary advice to navigate a path forward.

Expert perspective

Robert Adamczyk,
Senior Environmental Advisor
EBRD

EBRD is an international financial institution founded in 1991. As a multilateral developmental bank, with a private sector focus, the EBRD uses investment as a tool to build market economies. The Bank supports projects which comply with its Environmental and Social Policy and National legislation.

What does Compliance Mean?
Environmental compliance is now a requirement for any decision maker regarding any investment reporting decision. A lack of valid permits or risk of litigation will make financing even more difficult and there are regulatory and litigation risks related to non-compliance. This will be associated with increased reporting requirements whereby environmental liabilities and Environmental, Social and Governance (ESG) risks have to be disclosed in ever more detail. In a digital social media-savvy world reputations can be quickly impacted and tarnished. There is also a broader scope of liability, including reputational risks, which may be too big a burden for a company to carry in a digitally connected world.

The implementation of the EU Directive on non-financial disclosure and subsequent requirement of various stock exchanges places higher focus on overall ESG reporting, which in the future will require listed companies to assess and disclose the impact of company operations on climate risks and ascertain risks. It is therefore clear that traditional environmental compliance has moved on as stakeholders take a more holistic view of ESG performance.

How does EBRD and other IFI approach this?
The EBRD, like all International Financial Institutions (IFIs) has an Environmental and Social Policy and strict compliance requirements. Projects subject to the EBRD's financing need to comply with the Bank's Performance Requirements, which at a minimum need to comply with national law and EU substantive environmental standards. These include not only environmental, but also labour, social, health and safety etc. EBRD Environmental and Social Policy will often facilitate an investment process by meeting international best practices.

How do you see the trend?
Stakeholders will increasingly seek more transparency and set higher ESG reporting standards as well as compliance thresholds.
The adaption of the EU Sustainable Financing Package and the development of the EU Taxonomy for sustainable finance will set out a new path of financing in Europe and encourage private investment in sustainable growth and contribute to a climate neutral economy. The taxonomy will enable investors to refocus their investments on more sustainable technologies and businesses.
It will be key to enabling the EU to become climate neutral by 2050 and achieving the Paris agreement's 2030 targets. In this context, it is important to build consistency across the ESG criteria and develop uniform standards to be applied by investors and companies. This will have to be taken into consideration as financing will be available to projects that meet the highest ESG thresholds, which often go well beyond minimal compliance standards.

Summary: practical risk management for directors

Directors should actively manage environmental law risks by ensuring that the following compliance principles are followed:

Awareness
Staff at all levels of the organisation are reminded by their supervisors that compliance with all applicable environmental laws is a requirement of their employment.

Training
Adequate and regular training is compulsory at least for the staff responsible for any environment-related operations.

Audits
Periodic internal or preferably external legal and technical environmental audits of operations are performed to allow for higher comfort of compliance.

Reporting
There are clear guidelines to refer issues to managers, internal legal teams and where necessary external legal advisors to manage any potential issues swiftly and avoid the risk of penalties.

Monitoring
The changing environmental regulations are monitored to keep up with developments which could threaten a business's operations or impact its CAPEX or OPEX.

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