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# THE EFFICIENCY OF THE LIABILITY SYSTEM

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# POSSIBLE INEFFICIENCIES

- Civil Liability as an *ex post* regulatory system
- European Directive: assignment of liability on the base of the Polluter Pays Principle as in U.S. CERCLA and
- INEFFICIENCY SOURCES:
  - judgement proofness:  
Solution: lenders' liability and financial responsibility
  - dispersed victims  
Solution: Class Action

# JUDGEMENT PROOFNESS

- The experience made with the implementation of legal provisions in the US shows that cases may occur where liability is escaped by transferring dangerous activities to firms that have minimum capital resources.
- This is the issue of the judgement proofness that, in the light of the relative comparison between the firm's financial resources and the extent of the damage, does not only concern “catastrophic” events, but also minor environmental accidents, including those causing limited damage, which is however not internalized due to the polluting firm going bankrupt.
- Two kinds of considerations may be made on the judgement-proofness issue, thus defined, considering on one hand the firm's viewpoint and, on the other, the viewpoint of society at large.
- From the firm's viewpoint, the judgement proofness may offer an opportunity to avoid damage refund. The above-described US experience itself was characterized by the choice of small-sizing the companies operating in risky sectors, to have limited financial resources to cope with environmental damage.
- From the social viewpoint, however, an only partial or a totally absent internalization of damage result into the victims of accidents not being indemnified and in the polluted areas not being decontaminated.

## THE LENDERS' LIABILITY

- The lender's liability solution as a remedy to the judgement proofness provides for extending liability to other parties related to the firm and, in particular, to its lenders, that are considered at least partially liable for the consequence of the activity carried out by the firms financed by them.
- This solution was occasionally adopted in the United States where, within the system of strict liability of the polluting firms established by the CERCLA, we find an application in some cases expanding the notion of owner and operator used by the wording of the law to include lenders.
- In one case, a bank was judged liable for the damage because the Court claimed it had been significantly involved in the supervision of the firm's operations; the Court stated that, in this case, the firm's lenders could be considered either as the owners or as the operators and, as such, liable for the damage (the famous case United States vs. Fleet Factors Corp.)
- With respect to these specific cases, the term lender's liability was introduced, and then used to describe all those cases where the firm that is directly liable for the environmental damage may not refund such damage and therefore the judges involve the lenders of the firm if these have carried out some sort of supervision or have exerted some influence on the production activity and on the adoption of preventive measures.
- DEBATE IN US. DIFFUCULT IMPLEMENTATION IN EU

# FINANCIAL RESPONSIBILITY

- The term financial responsibility refers to the whole set of instruments that provide for the potential polluters to demonstrate ex ante that their financial resources are adequate to the restoration of potential environmental damage they may cause.
- In one of its practical application, financial responsibility provides for production activities in risky sectors to be only authorized if the companies concerned may demonstrate their ability to provide an appropriate financial or insurance coverage for future obligations resulting from the assignment of environmental liability.
- Financial responsibility includes various kinds of instruments: letters of credit and surety bonds; cash accounts and certificates of deposit; selfinsurance and corporate guarantee.
- In this broad definition is included also a kind of instrument such as e-bond that can be defined as “compulsory deposit which must be paid by anyone who wants to utilise certain natural resources the disposal of which may damage the environment”.

# ECONOMIC ADVANTAGE OF FINANCIAL RESPONSIBILITY

- First, financial responsibility ensures that the expected costs related to environmental risks are recorded in the firm's balance sheet and accounts.
- Other benefits result from the fact that, since financial guarantees are purchased by banks or insurance companies, a contract relation is established by which the latter are keen on protecting their investments through the monitoring of the production activity of their corporate customers.
- As in the economic models included in the relevant literature with respect to the lender's liability, also in the case of financial responsibility the bank, as the principal, is encouraged to monitor the environmental risk prevention activity of its corporate customers; the agent firm, in turn, pays to the principal, through the loan's cost, also the cost related with these risks and is therefore encouraged to adopt preventive measures to reduce the risks and, as a result, the loan's cost.
- Perfectly informed "financial guarantors" force the firm to take into account the whole extent of the damage ex ante and to pay a premium adjusted to the granted financial guarantees: also in this case a perfect internalization of the damage resulting from environmental accidents is achieved.

# MAIN CLASS ACTION ECONOMIC FEATURES

Class action is a legal device able to bind individuals with related claims represented by the class counsel after a certification procedure by judges.

- It favors the emergence of efficiency in judicial market, ‘judicial economy’, by means of economies of scale both on plaintiff and courts.
- It solves the failure in judicial market (suboptimal demand of lawsuits) by increasing the affordability of legal protection and enforcement for the possibility of indirect representation.
- It allocates the risk to the subject in the better positions to manage it because of the utility function (plaintiffs are normally risk averse while lawyers are more likely to have a higher risk propensity).
- It eliminates asymmetries in risks (the defendant has the risk diversified in a portfolio of lawsuits).

## DETERRENCE

- A judicial system without class action permits a higher degree of impunity because of the low incentive for injured parties to sue an infringing firm.
- The would-be defendant will have low incentive to adopt virtuous behaviours from a dynamic perspective.
- Facilitating, lawsuits that would otherwise not be brought to court can provide, under certain conditions, the internalization of externalities.
- This externality is just partially addressed by ex ante regulation because of imperfection.



# THE TODAY NORMATIVE FRAMEWORK

- In the US system class action exists and, though sometime criticized, it is still defined a versatile and useful legal device permitting the enforcement of ex-post regulation.
- In EU the Directive 98/27/EC seems to push towards the adoption of class actions in national law, but until now it did not happen.
- Since January 2010, introduction in Italy, particularly for consumers' protection.