# In Practice

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# Environmental, health and safety liability Issues: the tension with the insolvency regime

**KEY POINTS**

- Do not assume that insolvency law and the protection of creditors trump all other legal regimes.
- Where there are significant EHS concerns, take advice on the legal position and how to minimise liability exposure.
- Always consider the risk that a statutory EHS liability will arise during insolvency proceedings.
- Engage early with EHS regulators where a business with environmental permits and liability concerns needs to be transferred.

## INTRODUCTION

Financial difficulties and environmental, health and safety (EHS) problems often go together. This can cause difficult management issues. In particular, where a company is subject to insolvency proceedings, it can be hard to balance the interests of the creditors against the need to protect the environment and ensure safety.

This tricky balancing act is reflected in the law. The interests of both creditors and the environment are protected by different areas of law. There is a tension between these areas of law. Insolvency law is designed to protect creditors, and generally requires managers to limit expenditure. EHS law is designed to protect the environment and ensure safety: complying with it is likely to involve expenditure.

This tension can result in some awkward decisions for managers. For example, should money be spent on current environmental management or safety concerns? If so, what is "reasonable" for them to spend, and how can the interests of the creditors be protected? What are the risks for the insolvency practitioners and/or the directors if they decide not to incur expenditure on addressing environmental or safety concerns? Should expenditure which is necessary to comply with environmental law rank as an expense of the administration?

While the law provides some guidance on these issues, it does not provide an easy, one size fits all solution. Each situation has to be considered on its individual facts. In this article we focus on some of the common areas where clients ask us for advice.

## ENFORCING EHS LAW AGAINST COMPANIES IN ADMINISTRATION

Environmental and safety law is usually enforced by government regulators in the exercise of statutory powers and functions. If a business is non-compliant, the regulator will have a range of powers available to persuade the business to comply. Formal enforcement tools range from criminal prosecution of the company and company officers, to statutory notices requiring compliance.

Non-compliance with the terms of such notices is generally a criminal offence. There tend to be statutory appeal mechanisms for businesses aggrieved by the service of the notices.

A common question which arises is the extent to which environmental and safety regulators are, in fact, at liberty to take statutory enforcement action against companies in administration. The statutory moratorium for companies in administration under para 43(6) of Sch B1 to the Insolvency Act 1986 (IA 1986) prevents any "legal process" which includes "legal proceedings, execution, distress and diligence" from being instituted against the company or its property except with the consent of the administrators or the permission of the court.

Will this prevent the regulator from taking enforcement action against the company? Each case has to be assessed by reference to the specific enforcement power in question. Environmental prosecutions against the company are generally caught by the statutory moratorium as a "legal process" (see *Re Rhondda Waste Disposal Ltd* [2001] BCC 653), but it is, of course, still open for the administrators or the courts to consent to the prosecution.

There are also arguments that statutory notices issued by EHS regulators can be caught by the statutory moratorium on legal proceedings. However, the law is not definitive on this point, and, as there are multiple legal regimes under which such statutory notices can be served, the law may apply differently to different types of statutory notice. This is not an area that has been fully tested in the courts and the safest starting point for an insolvency practitioner would be to assume that the full arsenal of regulatory powers are available to regulators, despite the statutory moratorium. And note, of course, that the moratorium would not prevent separate action being taken against current and former directors.

## LIABILITY CONSIDERATIONS FOR INSOLVENCY PRACTITIONERS

EHS legislation is replete with liability issues for professionals charged with managing the operations of a company in financial difficulties. Here are some of the issues:

### Safety and environmental compliance

Many companies in financial difficulty will have operational problems which require attention. These can include rectifying ongoing compliance problems which regulators have identified, complying with improvement programmes which are required by environmental law, or complying with statutory notices which have been served. In such cases

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advice will be required as to what steps have to be taken, and what can be deferred. In an administration, it is often necessary to ensure that in-house expertise in EHS matters is retained during the period of administration so that the administrators can have the benefit of the necessary technical expertise to help them take these decisions. Sometimes it is necessary to appoint a specialist EHS consultant to advise.

### Expenses of the administration

Environmental and safety law is statutory in nature and is enforced through the criminal system, with criminal and civil penalties being available in the event of non-compliance. Penalties or costs imposed under statutory law during the period of administration have the potential to rank as an expense of the administration. The Supreme Court's decision in *Re Nortel Companies and others* [2013] UKSC 52 (24 July 2013) has provided guidance on what statutory liabilities may rank as a provable debt or an administration expense. While this is of some use, the case was not in the context of EHS statutory liabilities. For the particular EHS regime in question, it will be necessary to analyse whether the company incurred the relevant "obligation" before the insolvency arose in accordance with Lord Neuberger's test. Was the company subject to, or has it submitted to, a legal duty where there is a real prospect of that liability being incurred and is it consistent with the regime that that liability should be capable of giving rise to an obligation that can be proved as a debt in an insolvency? If so, then any statutory liability imposed during the insolvency is likely to be a provable debt. If not, then the intention of Parliament or the actions of the insolvency practitioner will be key in deciding whether the debt ranks as an expense. Much will turn on the particular statute in question. Nevertheless, avoiding incurring statutory liabilities is usually a priority for insolvency practitioners. Early engagement with the regulators to head off enforcement action is usually a key facet of the administrators' strategy for addressing this risk.

### Personal liability

Insolvency practitioners, like other company officers, are frequently concerned about the risks of personal liability. It is true that potential liability exists in a number of areas. For example, almost all environmental and safety law provides that, where a company commits an offence, a senior company officer (including, potentially, an insolvency practitioner) also commits that offence where s/he "consents or connives" in the commission of the offence, or the offence is attributable to their neglect. There are also other areas of potential personal liability for insolvency practitioners under EHS law. In reality, however, the risk of personal liability is usually remote. Indeed in certain areas (eg, contaminated land) insolvency practitioners enjoy some specific protection from personal liability. Nonetheless, where a business involves acute EHS risks, insolvency practitioners would be advised to seek some guidance on how to minimise the risk of personal liability.

## DISCLAIMING ENVIRONMENTAL PERMITS

It is usual for liquidators to consider disclaiming onerous leases and contracts under their s 178, IA 1986 powers. Companies may also have environmental and other operational permits issued by EHS regulators that could contain onerous obligations, requiring considerable on-going financial outlay. Liquidators will be keen to try to disclaim these as well.

It is possible in principle to disclaim these following the Court of Appeal case of *Celtic Extraction Ltd v Environment Agency* [2001] Ch. 475, in which the court decided that liquidators were entitled to disclaim a waste management licence as "property" or an interest incidental to property. This power of disclaimer is essentially at odds with the usual environmental permit surrender rules. For example, the Environment Agency will not usually accept a surrender of an environmental permit (and thereby release the permit holder from its obligations) until the risk of pollution has been removed. No such constraint applies under insolvency law to a liquidator's right to disclaim. For obvious reasons, the exercise of a right of disclaimer to extinguish onerous obligations in an environmental permit can be of concern to environmental regulators. Indeed in a recent Scottish case, the Scottish Environmental Protection Agency challenged the use of disclaimer by Scottish liquidators to disclaim environmental licences, as well as land rights (*Joint Liquidators of the Scottish Coal Company Ltd* [2013] CSIH108).

Some environmental regimes specifically prevent liquidators from disclaiming licences. For example, s 36 of the Coal Industry Act states that Coal Authority Operating Licences are not to be considered "property" for the purposes of IA 1986, meaning they are not capable of being disclaimed as onerous property.

Even if compliance with an environmental permit is onerous, it does not follow that an insolvency practitioner will always seek to disclaim the permit. The existence of the permit will often be essential to enable the sale of the property/business to a third party.

## EHS ISSUES ON BUSINESS TRANSFERS

When selling or transferring a financially troubled business, EHS issues can cause both seller and buyer difficulty and it is generally advisable to take advice on the relevant legal regimes which apply both to the operations of the company and the liability risks attaching to the business. Issues can include:

- **Permit transfer.** To take over the operation of the business, a new operator will need to take a transfer into its name of all EHS permits. EHS regulators can take a long time to process applications and this can cause difficulties on a transaction which is on an urgent timescale. It is difficult for companies to "take a view" since failure to have the permit transferred can result in criminal liabilities. Early liaison with relevant EHS regulators is generally advisable.
- **Liability apportionment.** Buyers of businesses from insolvent companies will be looking to restrict the environmental liabilities they assume when they take over the business. On the other hand, especially where insolvency practitioners are looking to rescue a business so that it can continue trading after the sale of certain assets, the selling company will be looking to restrict its exposure to environmental liability. This can become a major issue in negotiations. ■