Environmental Variable: Key Agenda for Boards

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Environmental risks are financial risks. Dealing with environmental matters as a romantic, ethereal, rhetorical, or ideological matter is an absolute outdated behavior reflecting unawareness of the strict link between environment and economy. The pandemics has given clarity to a simple fact: without natural resources there is no economy; any and all businesses depend, to some extent, on natural resources as raw materials or inputs. That is why assessment of the environmental variable in its perspectives of risk and opportunity is of the essence in our current world context.

Environmental risks are directly proportional to the business complexity. The higher the complexity, the higher the risk; as a result, denser will be the environmental rules applicable as of its planning, licensing, daily management up to its decommissioning.

Brazilian environmental regulation is broad and precedes our Federal Constitution from 1988. Our Federal Environmental Policy (Law No. 6,938), published in 1981, provides principles and grounds our environmental laws; our Federal Constitution supports the Federal Environmental Policy, imposes triple environmental liability (administrative, civil and criminal)[1] and states that economy and environment are indissociable.[2]

Such triple legal liability systems grounds environmental regulatory risks. Civil environmental liability seeks for remediation and/or indemnification of damages and is strict (regardless of fault or willful misconduct), joint and several (reaches all parties involved directly or indirectly with the action/omission that contributed to the damage, as long as there is causal link).[3] Case law and jurisprudence have not delimited

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[1] Art. 225, § 3º Actions and operations deemed as harmful to the environment will subject violators, individuals, or corporations, to administrative and criminal penalties, regardless of the obligation to remediate damages.

[2] "Art. 170. The economic order, founded on the appreciation of the value of human work and on free enterprise, is intended to ensure everyone a life with dignity, in accordance with the dictates of social justice, with due regard for the following principles: VI - environment protection, which may include differentiated treatment in accordance with the environmental impact of goods and services and of their respective production and delivery processes;"

[3] "Federal Environmental Policy. Art. 3. For the purposes of this Law, definitions are: IV - polluter, an individual or corporation, public or private, responsible directly or indirectly for the business that caused the environmental damage. Art 14, paragraph 1 – Regardless of the sanctions foreseen herein, the polluter must, regardless of fault or willful misconduct, indemnify or remediate damages to the environment and to third parties impacted by its business."

extensions of this chain of liability and it is not subject to statute of limitation[4] and is grounded on the inversion of the burden of proof.[5]

Administrative environmental liability envisages compliance with environmental rules in force, stating that actions or omissions that violate the use, promotion, protection and recovery of the environment are violations and shall be punished with administrative penalties, which range from warnings to fines and, in a worst case scenario, suspension of the activities and shutdown of the plant.[6]

Criminal environmental liability provides for actions and omissions that qualify as crimes and their respective penalties, either for individuals or corporations (whenever crimes derive from decisions taken by their representatives in benefit of the company).[7]

The traditional model to assess environmental regulatory risks is driven by their financial valuation, grounded on the following rationale: environmental fines do not have pedagogic value, i.e., are not relevant to induce compliance with rules (administrative liability); lawsuits seeking for remediation or indemnification of damages take decades to reach closure, which means that when parties are condemned, the executives responsible are not part of the business anymore or that the budget was preserved for decades (civil liability); imprisonment penalties are only applied in extreme situations and for short periods (criminal liability).

The pandemics has put environmental risks into the limelight. There are dozens of news on environmental risks and associated liability, especially within the discussions on the ESG criteria. Besides, some news regarding international trade and environmental compliance on traceability of products have proven to be of great impact on our exports and can be used as non-tax barriers.

Materialization of environmental risks have been occurring in proportions and periods that differ from those historically known. They have been negatively impacting Brazil's GDP[8] and have resulted in shutdowns of operations (worst-case scenarios in risk management).

Such scenario has driven businesses to reinforce their compliance programs, imposing significant changes to risk management systems and has made it clear that environmental compliance cannot be a part of the *business judgement rule.*

As a result, the environmental variable must be included in boards of directors' agenda. The traditional risk management model is not effective anymore.

4 Superior Court of Justice, appeals REsp 647.493-SC and REsp 1.120.117/AC.
5 Precedent 618 from Brazil's Superior Court of Justice: "Inversion of the burden of proof applies to lawsuits regarding environmental degradation."
6 Decree 6,514/2008, art. 2.
7 Law 9,605/98.
8 "Cut on production from Vale shall reduce in 10% the GDP growing in 2019", news published by Estadão newspaper on April 14, 2019.

As per the rules of corporate governance, the board of directors is responsible for defining long-term strategies, ensuring shareholders' value and businesses longevity. Long-term strategies must incorporate the environmental variable, envisaging compliance, mitigation of risks and assuring that natural capital (environmental resources) will remain available to keep the business alive.

To ensure survival in the long run and shareholders' value, directors, who are invested in the fiduciary duty, shall be qualified to discuss the environmental variable, shall be provided with accurate environmental data and shall validate them.

Validation of environmental data is a crucial action to be taken by directors. If directors are provided with inaccurate or summarized data, business strategy is jeopardized, and its profitability and longevity are put at risk.

Strategic decisions must incorporate the environmental variable in all economic sectors. If a new business is to be installed, there will be environmental impacts to be managed, mitigated and compensated; if a business or real property will be acquired, there will be environmental contingencies to be assessed to ensure that the asset does not contain liabilities that will reduce its value or limit its use; if a new product is to be launched, the concepts of circular economy and legal take back obligations will apply and so forth. Likewise, decisions on environmental investments to optimize processes, do have strategic value.

The main obstacle to include the environmental variable within boards' agenda is the lack of methodology and precedents to monetize its risks and impacts. When assessing the environmental variable data will only refer to potential risks, which are not included in the financial statements, whose materialization is hard to predict and impact valuation is unfeasible.

However, such scenario cannot represent a boundary to include the environmental variable within boards' agenda. Short-term assessments grounded on tangible risks are not enough anymore. Long-term assessments encompassing intangible risks are a relevant part of the attributions from the boards of directors, besides preserving reputation.

Due to the worldwide discussions regarding adherence to ESG criteria and ESG rankings driving investments and providing compliance status, this is the moment for boards of directors to fulfill their fiduciary duty and give the necessary step forward to assess environmental risks. Afterwards, boards shall ensure that sustainability plays a key role in corporations' purpose, driving the decision-making process.