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# CIVIL LIABILITY OF FINANCIAL INSTITUTIONS FOR ENVIRONMENTAL AND SOCIAL DAMAGES

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## ABSTRACT

This paper proposes criteria to define, considering regulation, self-regulation, market best practices (identified through empirical research with Brazilian and European financial institutions) and their own rules and procedures, in which situations financial institutions may be held liable for environmental and social damages caused by financed enterprises, either by lending or investment activities. It also examines the various theories on the nature of this liability, which aims to define it as objective or subjective, if it is possible to limit this liability over time, and if it is possible to adopt a system of joint liability (and if possible, on which basis). Moreover, it analyses Brazilian courts decisions on the topic. Finally, it examines whether it is the case of recognizing bank secrecy in which concerns social or environmental relevance produced or gathered by financial institutions with the purpose of assessing these kinds of risks.

**Keywords:** Civil Liability; Financial Institutions; Social or Environmental Damages; Credit; Investments.

*RESPONSABILIDADE CIVIL DE INSTITUIÇÕES  
FINANCEIRAS POR DANOS SOCIOAMBIENTAIS*

**RESUMO**

*O trabalho propõe parâmetros concretos, à luz das normas regulatórias, tanto os de iniciativas autorregulatórias das melhores práticas de mercado (identificadas a partir de pesquisa empírica com instituições financeiras brasileiras e europeias) como os das normas e procedimentos adotados por cada instituição financeira, para definir em que situações e em que medida elas podem ser responsabilizadas por danos sociais ou ambientais causados por empreendimentos por elas financiados, seja mediante concessão de crédito, seja mediante realização de investimentos. Também são examinadas as diversas correntes doutrinárias atualmente existentes sobre o assunto, que buscam definir como objetiva ou subjetiva essa responsabilidade, examinando-se se é possível ou não limitá-la no tempo e se é o caso de admitir-se um regime de solidariedade (e com base em que critérios). Ainda, é analisada a jurisprudência brasileira sobre o tema. Por fim, examina-se se é possível reconhecer sigilo bancário em relação a informações de interesse socioambiental detidas por instituições financeiras com o propósito de realizar análise de riscos desta natureza.*

**Palavras-chave:** *Responsabilidade Civil; Instituições Financeiras; Danos Socioambientais; Crédito; Investimentos.*

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## INTRODUCTION

First of all, I must clarify the scope given to the subject in this paper, distinguishing it in part from the approach made by other Brazilian authors (and also some Europeans) who have examined it.

With regard to foreign doctrine, the exploration carried out in this research was by no means exhaustive – specially because the peculiarities of the legislation and the latest jurisprudence on the subject in Brazil are not present in several countries. Even among the European authors who examined the subject, the focus is usually on the description of the US experience, both in terms of legislative developments and case law, as the first country in the world where the matter was taken to courts. However, the judicialization that occurred there seems to be restricted to the problem of contaminated real estate offered as collaterals. This is the most evident repercussion of environmental legislation on lending activities, but, in the Brazilian case, this issue is far from being the only one that has already been considered in lawsuits. As a matter of fact, with respect to this specific point, in the case of Brazil, there is not really what to discuss, given the real estate nature of environmental obligations (as has been evident since the 1965 Forest Code, for example, regarding rural properties and permanent preservation areas) – they follow the property upon each transfer of ownership.

The most relevant issue for Brazil is, rather, the definition of the contours of civil liability for environmental damages caused by financed enterprises – and, in this sense, it has already been examined by some authors since the pioneering work of Ana Luci Esteves Grizzi and others, published in 2003.

What no author has yet examined – and this is what I intend to focus on – is the liability of financial institutions for damages caused by projects/activities not only in loans in which the use of the borrowed resource is previously known, but also in every kind of lending including that carried out to individuals or companies due to regular business activities, such as working capital.

Another innovation of my approach is the fact that it's not restricted to environmental damages – an approach chosen by all those who have analysed the subject previously, due to the own regime of civil liability

defined in Law 6938, of 1981, which created the National Environmental Policy. The reason for this choice is simple and any study that researches the subject can prove: a good part of the regulatory norms (and this is the Brazilian case, notably with the Resolution of the National Monetary Council 4327, of 2014), self-regulatory standards and financial market practices address the environmental and social dimensions univocally<sup>1</sup> – and this seems to be the most appropriate approach, since both are pillars of Sustainable Development, alongside the economic dimension.

Finally, this paper also addresses investment transactions. The only Brazilian author who has already preliminarily examined the theme (involving only the transactions carried out by investment banks) was Rômulo Sampaio, in a book published in 2013. I will depart from this initial contribution and seek to develop the theme.

With regard to environmental risk itself, there is a jurisprudential trend that considers financial institutions have joint and objective liability for the damages caused by funded projects/activities. The Superior Court of Justice has, in some judgments, understood that the liability of the financier of enterprises with environmental impacts is objective<sup>2</sup>, based in the provisions of article 14, paragraphs 1<sup>st</sup>. and 3<sup>rd</sup>., IV, of Law 6938, dated August 31, 1981. Although, in general, the doctrine on the subject defends this positioning, there are those who adopt diverse understanding, in the sense that it must be subjective.

I will also position myself on this controversial subject, seeking to detail my position as much as possible, so that all possible consequences can be extracted for the proper functioning of financial institutions and for environmental protection, in light of the principles and norms applicable to the subject in Brazilian law, while also seeking subsidies in the best practices of the national and international market, taking as reference the postdoctoral research on Environmental and Social Sustainability and Financial System that I developed<sup>3</sup>.

<sup>1</sup> In the case of the investment market, the issue of governance is also treated alongside environmental and social issues, including the use of the acronym ESG for “Environmental, Social and Governance”.

<sup>2</sup> See, for example: REsp 1. 071. 741-SP and REsp 650. 728-SC, both having Justice Herman Benjamin as Rapporteur. In these two judgments, the Justice-Rapporteur, with regard to joint liability in the matter of compensation for environmental damages, stated: “for the purpose of establishing the causal link in environmental damage, are considered equally liable: who does, who does not when should do, who allows to be done, who does not care when they do, *who finances them to do* and who benefits when others do” (highlighted). It should be noted that no financial institution was a party to referred lawsuit and that there was therefore no decision against any bank to that effect.

<sup>3</sup> The mentioned research was developed between December 2014 and April 2016, under the supervi-

## 1 THE DIFFERENT APPROACHES REGARDING THE NATURE OF THE LIABILITY OF THE INDIRECT POLLUTER

Before we begin to address the nature of liability, it's necessary to clarify the concept of environmental damage. I will adopt the broader concept defended, among many others, by Celso Antonio Pacheco Fiorillo (2001, p. 19-22), which includes, in addition to the natural environment (protection of biodiversity – including fauna and flora, resources water quality, air and soil quality, establishment of specially protected areas, etc.); the cultural environment (so that legislation protecting the historic, cultural and landscape heritage is fully covered); the artificial environment (set of buildings and public equipment) and the labor environment (health and safety of employees). Strictly speaking, none of these categories includes public health issues in general, which are, however, expressly encompassed in environmental protection, according to article 3, III, of Law 6 938, of 1981. As for the cultural, artificial and urban environment, protection is ensured, as Fiorillo emphasizes, at constitutional level (articles 182, 216 and 200, VIII).

Some damages, such as those caused to the culture of tribal people – which, as we all know, live in perfect harmony with nature – offer a higher degree of difficulty in framing: would they be environmental or social damages? In fact, they deserve exactly the same degree of protection as the dominant culture, considering what is prescribed by the Brazilian Constitution (article 215<sup>4</sup>), so that Law 6938, of 1981, which is prior to the constitutional text, must be interpreted in a way that harmonizes it with the

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sion of Professor Ana Maria Nusdeo, in the University of São Paulo (USP). It included a period in which the author was a Visiting Researcher at Università Luigi Bocconi, Milan, in 2015, during which I conducted empirical research on the topic in seven Western European countries (Italy, Switzerland, the Netherlands, Germany, the United Kingdom, Sweden and France). The methodology adopted involved the application of questionnaires to ten categories of respondents: a) large commercial banks; b) development banks; c) social, ethical or alternative banks; (d) Italian small and medium sized (usually cooperative) banks; e) banking regulators; f) pension funds; g) asset managers; h) third sector institutions that work in this area; (i) international organizations active in the field; j) specialized consultancies that work on the theme. The same methodology was applied in Brazil.

4 “Art. 215. The State shall guarantee to all the full exercise of cultural rights and access to the sources of national culture, and shall support and encourage the promotion and dissemination of cultural expressions.

Paragraph 1st. The State shall protect the manifestations of popular, indigenous and Afro-Brazilian cultures and those of other groups participating in the national civilizing process.” (translation of this author)

In addition, art. 231 recognizes indigenous peoples the right to occupy their lands permanently and to see them demarcated, and art. 68 of the ADCT recognizes the same right to communities of slave descendants (quilombolas).

Major Law, including also the protection of tribal people.

It's always good to remember the article 170 of the Federal Constitution, which brings some fundamental principles of the Economic Order. The latter, "founded on the valorization of human labor and free enterprise, aims at ensuring everyone a dignified existence, according to the dictates of social justice", among others:

V – consumer protection;

VI – defense of the environment, including differential treatment according to the environmental impacts of products and services and their elaboration and delivery processes (wording given by Constitutional Amendment 42 of 2003, translation of this author)

Furthermore, article 192 established that "[T]he national financial system [shall] be structured in such a way as to promote the balanced development of the country and to serve the interests of the community, in all its constituent parts"<sup>5</sup> (wording given by Constitutional Amendment 40, of 2003; translation of this author).

In the case of purely social damages (for example, that caused to the consumer community but that does not involve public health), there is no doubt that it is not the application of environmental legislation, because there is legislation itself establishing another protection regime (although there are several points of contact, including because the Consumer Protection Code was the first standard that defined the different categories of collective rights).

The relevance of this discussion derives from the fact that Law 6938, of 1981, established an objective civil liability regime <sup>5</sup> for the person/entity causing the environmental damage (article 14, paragraph 1), whether it is the direct or indirect polluter (see concept of article 3, IV). The financial institution which grants credit for a polluting enterprise, of course, can only be considered as indirectly causing environmental damages – and in this regard there is no doctrinal dissent. The controversy

<sup>5</sup> This is a consequence of the polluter pays principle. Dal Maso reports (2001, p. 39) that similar rules (objective liability regime for environmental damages) exist in several EU countries, and some of them, however, (such as Italy and Denmark), limit objective liability to some specific situations of activities especially dangerous for the environment. The first countries that created a specific civil liability regime for environmental damages, he says, were the Scandinavians, followed by Germany and Austria. As early as 1992, the Lugano Convention on Liability for Environmental Damages caused by Dangerous Activities, issued by the Council of the European Union, established an objective liability regime for such damages.

is, in fact, whether there is a distinct legal regime for the direct polluter and the indirect polluter, as argued by Rômulo Sampaio (2013) or if the legal regime is identical, as Alexandre Raslan (2012) argues.

Considering both those who, like Raslan, defend a single legal regime, and those who advocate distinct legal regimes, it is possible to identify diverse currents:

- a) the one that, in addition to understanding the liability of the lender as objective, adopts the theory of integral risk and does not accept the possibility of incidence of unforeseeable circumstances and force majeure as excluding liability, as Alexandre Raslan (another possible exclusion is the fact of a third person, on which he did not issue any opinion; but there are other authors who advocate integral risk theory, such as Annelise Steigleder, cited by Nusdeo <sup>6</sup> and by Raslan himself, that admits it);
- b) the one that admits that the liability of the financier is also objective, but assuming some exclusions of liability (and thus removing the theory of integral risk), as Paulo Affonso Leme Machado points out <sup>7</sup> ;
- c) the one that, in theory, states that the liability of the financier is also objective, but admits full incidence of reasons excluding the liability and, in addition, understands that there must be a violation of a duty, adopting the theory of risk created, as Ana Luci Esteves Grizzi *et alii* (2003, p. 27) and Rômulo Sampaio.

It should be emphasized, however, that the “theory of the created risk” produces quite similar effects to the recognition of a liability of subjective nature, since it presupposes the violation of a legal duty – therefore, fault, even if by mere omission.

See, for example, the position of Ana Luci Esteves Grizzi *et al.* (2003, p. 36):

6 NUSDEO, Ana Maria de Oliveira. Instituições financeiras e danos ambientais causados por atividades financiadas. YOSHIDA, Consuelo; PIAZZON, Renata; KISHI, Sandra; VIANNA, Marcelo Drügg Barreto (coord.). *Finanças Sustentáveis e Responsabilidade socioambiental das instituições financeiras*. Belo Horizonte: Fórum, 2017, p. 29.

7 For Paulo Affonso Leme Machado, “[. . .] although co-liability is not expressly defined in this law, it seems to us that it is implicit. The allocation of resources from the financier to the financed enterprise, with the undue transgression of the law, places the financier in a cooperative or co-operative activity with that financed in all the harmful environmental acts that he does, by action or omission.”. (2004, p. 306, translation of this author). With regard to the exclusion of liability, he argues that facts of nature (force majeure) may exclude the liability of the agent if, in the concrete case, he demonstrates that the natural phenomenon could not be avoided or prevented, however, without taking into account the diligences of the agent (*Direito Ambiental Brasileiro*. São Paulo: Malheiros, 2015, p. 420-421 – translation of this author).

[...] the funder. . . has the duty to initially require the submission of the necessary documentation, which, in the present case, corresponds to the licenses, so only after verifying the regularity with the defined criteria, to grant financing, without, however, ceasing to control the activities of the financed, otherwise it will be fully liable for the damages caused by it (translation of this author).

## 1. 1 Objective liability and proof of causation

Another position whose effects are identical to the third one seen above (theory of the created risk) is defended, among other authors, by Professor Ana Maria Nusdeo (2017, p. 42), who, while advocating also that the liability of the indirect causer of the environmental damages has an objective nature (in view of the wording of the legal text), believes that there must be proof of causation. For her, given the existence of “concauses” (different causes that contributed to the damage), it would be necessary to indicate *what was the norm violated by the financier*.

On the other hand, she asserts, based on the wording of art. 225 of the Federal Constitution, there is “a constitutional duty that each one, individuals, associations and companies adopt the practices at their disposal to achieve the objective of environmental preservation” (2017, p. 35, translation of this author)<sup>8</sup> – which represents nothing but an implementation of the principles of prevention and precaution (*in dubio pro ambiente*).

She proposes, in order to prove the existence of the causal link and the occurrence of environmental damage, to adopt the “theory of the scope of the violated norm”, which has as its starting point (2017, p. 31):

[...] the legal rule whose breach resulted in the occurrence of the damage. The method of application of this theory is that, in a given hypothesis of injury, identify as its cause the one without which the damage would not have occurred (*sine qua non* cause), in a naturalistic and material analysis of causality. Identifying the potential causes of the damage, the conduct should now be analysed, from a legal point of view. That means, [it is necessary] to find the answer to the question: is any of the conducts, in the *sine*

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<sup>8</sup> Nevertheless, she understands that “this broad constitutional mandate that imposes efforts to preserve the environment is not in itself capable of generating civil liability for damages to the environment to the agents of the community.” (2017, p. 12, translation of this author)



*qua non case*, prohibited by a certain norm? Or, in other words, was the conduct that potentially led to harm included in the scope of the breached rule? If the answer is affirmative, that is the cause of the damage, naturalistic and legally determined. (translation of this author)

The risk of adopting such an understanding with regard to financial institutions is that it may always be argued that the credit or investment could have been obtained from other sources. It should be noted that Ana Luci Grizzi and others affirm: “Financing must be indispensable for the development of degrading activity” (2003, p. 51, translation of this author).

On the other hand, it is relevant the observation of such authors regarding the reversal of the *burden of proof to demonstrate the causal link*, so that “the defendant is the one who would have to prove that it has no causal link with the damage occurred” (2003, p. 50, translation of this author).

Later, Nusdeo reinforces his position in a synthetic way: “one must pay attention to the importance of the existence of the causal link between the violation of a legal duty – clearly characterized – and the damage.” (2017, p. 34, translation of this author). It was already noticed that the essential element for the author is the prediction of legal duty and the existence of its violation in the concrete case.

This understanding sounds quite accurate – and that is why I understand that it is not merely a demand of causal link but subjective liability. In the following items, I proceed to define the elements for analysis of fault in concrete situations, considering both the general regime of civil liability and the existing regulatory rules on the subject, as well as market practices.

## 1. 2 Subjective liability for omission

Another very interesting element that can be gathered from the lessons of Prof. Ana Maria Nusdeo refers to the coincidence of the liability regime of the indirect causer of environmental damages in situations where: a) the Public Power has incurred in omission in the exercise of

police power; b) financial institutions fail to comply with their obligations under legal or regulatory standards.

In fact, the regime must be absolutely identical. What is noticeable is that, in both cases, liability is given by omission and not by action. For this reason we must go beyond the mere literal interpretation of article 14, paragraph 1st, of Law no. 6938 of 1981, and recognize that the system of liability cannot be other than subjective liability, the one resulting of fault. This discussion has already been extensively dealt with in the scope of civil liability of public entities, established in article 37, paragraph 6<sup>th</sup>., of the Federal Constitution, but there is no doctrinal consensus on the subject<sup>9</sup>.

The understanding of Dionis Blank and Maria Claudia Crespo Brauner is similar:

[...] it is possible to establish that the banks' liability for environmental risks caused by the financed companies is joint and subjective, and it is not enough, for the bank's accountability, to simply finance the venture. This liability will only be recognized if it is proved the absence of demand of legal requirements to grant the loan or the occurrence of any act of management of the bank that implies its participation in the decision-making process of the company. (2009, p. 272; translation of this author)

The failure to recognize such a circumstance (the need of existence of fault ) would be to consider legally relevant all omissions of indirect polluters – which would be too broad, uncertain and would even discourage more cautious behavior, since, if the risks assumed are independent of the degree of caution adopted, it becomes not compensatory to incorporate the costs of being diligent.

I therefore describe what can be meant by fault of a financial institution in order to recognize the duty to repair environmental (and also social) damages arising from enterprises that have made loans or obtained investments.

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<sup>9</sup> Romeu Felipe Bacellar makes a brief inventory on this subject in Brazil Administrative Law doctrine: Celso Antonio Bandeira de Mello, Jacinto de Arruda Câmara, Lúcia Valle Figueiredo and Diogo de Figueiredo Moreira Neto defend that this is a subjective liability of the Public Administration. Toshio Mukai, Carmen Lúcia Antunes Rocha, Odete Medauar and Weida Zancaner understand that this is an objective liability (*Direito Administrativo e o novo Código Civil*. Belo Horizonte: Editora Fórum, 2007, p. 216-217).

## 2 EXPANDED SUBJECTIVE LIABILITY PROPOSAL

The guidelines that I propose to recognize the presence (or not) of fault of the financial institution that granted credit or made investments in the venture based, on the one hand, on the principle of prevention in Environmental Law, which, in my opinion, is addressed to all members of the collectivity (see article 225 of the Major Law), and, on the other, to the *duties of a prudential nature already established in Brazilian legal and regulatory rules regarding the management of environmental and social risks*, especially those arising from the impacts of activities financed by financial agents.

### 2. 1 Relevance of the constitutional, legal and regulatory norms of the financial system

It is an elementary consequence of the precautionary principle that there is a duty to be cautious in any decision-making process in which risks of environmental and social nature are present.

In addition, several legal <sup>10</sup> and infralegal <sup>11</sup> norms (some of these

10 Others are, for example, Law 8171, of 1991 (article 50, paragraph 3<sup>rd</sup>, which states that “the approval of rural credit shall always take into account agroecological zoning”); Law 11105, of 2005 (article 2, which repeated a provision that was already contained in Law 8974 of 1995, which regulated the National Biosafety Policy); Law 9605, of 1998 (article 72, § 8. IV), which includes among the restrictive legal sanctions arising from administrative administrative infractions the “loss or suspension of participation in credit lines in official credit institutions” and Law 12305 of 2010 (articles 16 and 18), Law 12651, of 2012 (art. 78-A), which prohibits the granting of rural credit to owners of properties not registered in the Rural Environmental Registry (created by article 29 of the same law – new Forest Code).

11 They are, in the Brazilian case: Decree 99274, of 1990 (article 19, paragraph 3<sup>rd</sup>); Ordinance 1150, dated November 18, 2003, from the Ministry of National Integration (which recommended that financial agents should refrain from granting financing or any other type of assistance with resources under the supervision of said Ministry for individuals and legal entities that to integrate the Dirty List of Slave Labor, prepared by the Ministry of Labor and Employment); Decree 6,321, dated December 21, 2007 (article 11, which establishes the obligation for federal banks and official agencies not to grant credit of any kind for enterprises whose activities are carried out in areas seized by environmental agencies as a result of illegal deforestation or that acquire, carry or market products from these areas); Resolutions of the National Monetary Council (CMN) 3545, 2008 (with wording amended by Resolution 4422, of 2015 – which prohibited the granting of rural credit to properties located in the Legal Amazon that are violating environmental legislation); Resolution 3813 and 3814, 2009 (which prohibit financing if it occurs in indigenous lands, in the Amazônia, Pantanal or Upper Paraguay Basin biomes, in areas with a slope higher than 12% or occupied with cover of native vegetation or reforestation, remaining forestry, environmental protection areas, dunes, mangroves, escarpments and rock outcrops, urban and mining areas); Resolution 3876, 2010 (prohibiting the granting of rural credit to employers on the “Dirty List of Slave Labor”), Resolution 4427, of 2017 (which authorized the use of remote sensing technologies for the purpose of monitoring rural and, in order to make this procedure viable, established a new obligation for rural credit borrowers, to be mandatorily required at the time of contracting, that is, to know the geodesical coordinates of the land whose activities are financed, whether in loans to finance

described in item 2 above), which contain obligations that vary in their degree of specificity, for the management of environmental and social risks arising from the operations of financial institutions. When there is a clear hypothesis of breach of rule, there is no possible question as to the liability of the financial institution that financed the enterprise that caused the environmental damage.

In practice, however, many situations will require a careful analysis of the factual circumstances in order to determine whether or not the financial institution has adequately performed the duties assigned to it by open standards. Therefore, it is also necessary to examine other relevant elements, such as the commitments publicly assumed by the financial institution, its internal procedures and the degrees of diligence and prudence adopted in the particular case. I will address each of these points after examining credit transactions where the availability of information to the financial institution is smaller in terms of the use of resources: lending, *leasing* and other similar operations with companies or entrepreneurs – excluded, therefore, both transactions with natural persons as final consumers and with entities of the not-for-profit sector (which, in addition, do not even require environmental licensing, since they offer very low environmental and social risks).

## **2. 2 Working capital, *leasing* and similar operations**

In the case of loans where the financial resources (or even the asset acquired, as in the financing or *leasing* of vehicles or other equipment) are not intended for a specific purpose, as in the case of working capital loans, of course the degree of diligence required of the financial institution is much lower, so that the risk of its liability is also proportionally lower.

This does not mean, however, that in the case of transactions with enterprises in which it cannot be assumed that the use will be other than the regular development of their activities, a minimum degree of diligence should not be present. Nothing prevents the financial institution from verifying, for example, the existence of valid environmental permit (when

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ordinary expenses or investments, Resolution 4327, dated April 25, 2014 (which requires all institutions audited by the Central Bank of Brazil to establish and implement a Social-Environmental Liability Policy and respective action plan) and, finally, Resolution 4661, dated May 25, 2018 (article 10, paragraph 4th), which stipulates that pension funds shall consider, in risk analysis of their investments, whenever possible, aspects related to environmental, social and governance sustainability).

the sector in which the financed enterprise operates requires licensing) and/or verifying the existence, number and nature of eventual administrative procedures investigating violation of environmental and labor health and safety rules.

This periodic verification is commonly performed by large banks, whether in Brazil or, for example, in Western Europe<sup>12</sup>. Granting any form of loan of any amount to a company that is operating without a current environmental license or that has a large number of environmental and labor health and safety administrative procedures is undoubtedly reckless and does not correspond to the degree of diligence that must be expected from a minimally responsible financial institution.

It should be emphasized that it is not a matter here of the impossibility of verifying the use of the resources lent; if the company is operating irregularly, it should not be getting credit of any kind.

Since this basic verification has not been carried out, of course, the financial institution runs the risk of being jointly responsible for the social or environmental damages resulting from the activity.

I understand, however, that, if the specific allocation of resources is not identifiable, in the case of a loan, the amount of any compensation for damages of the financial institution's liability should be limited to the amount involved in the transaction.

## **2. 3 Relevance of the accessibility of information managed by environmental and social regulators**

The degree of availability of the information to be provided by social or environmental regulators, as well as the degree of diligence employed by the financial institution in this search, is another essential element. The bank should seek the information publicly available and examine it with the necessary attention, especially in the case of sectors with higher environmental and social risks. As Rômulo Sampaio maintains, there is a “duty of care” regarding the position of the direct responsible for possible environmental damage, already recognized even in some judgments (2013, p. 29)

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<sup>12</sup> For a detailed description, based on extensive empirical research conducted with financial institutions operating in Brazil and in six countries in Western Europe, see: SOUZA, Luciane Moessa de. *Sustentabilidade socioambiental no sistema financeiro: diagnóstico e propostas*. Postdoctoral Research Report. University of São Paulo (USP), April 2016.

What the financial institution cannot do is performing the role that corresponds to the environmental and social regulatory bodies. As Ana Maria Nusdeo points out, “it is incumbent upon the Public Power to exercise the power-duty of supervision and imposition of penalties, relative to its police power. The request of these documents by the financial institution does not have the power to avoid environmental damage.” (2017, p. 38, translation of this author).

That means that, in countries where enforcement of police power is deficient, as is the case in Brazil, it is clear that a financial agent cannot be expected to replace the environmental body, which has the necessary expertise to oversee the environmental standards of enterprises. The same author notes, properly: “there are no appropriate parameters for control by a player that does not have police power. Within certain legal parameters, however, some monitoring by the institution is feasible.” (2017, p. 41). Identical considerations are made by Blank and Brauner: “the bank cannot be required to have technical control over pollution rates or the regularity of licenses issued by the competent technical bodies” (2009, p. 269, translation of this author). It is not to be disregarded, nevertheless, that, depending on the level of environmental risk of the transaction, it might be convenient for the bank itself (because of the high credit risk) to hire a company specialized in environmental and social auditing to carry out an assessment.

Likewise, verifying that environmental licensing has been carried out properly is also something that exceeds the level of reasonableness – even though licensing is one of the main elements aimed at preventing environmental damage. Once again, Ana Maria Nusdeo rightly points out:

[...] a major element. . . is the quality and effectiveness of the licenses granted. This is because the contribution of credit institutions to the effectiveness of the standard does not replace the power-of-duty of the Administration for the establishment of this effectiveness. (2017, p. 36, translation of this author)

She quotes, on the other hand, the thinking of Paulo Affonso Leme Machado (2015, pp. 394-395), for whom it is reasonable to understand that financial institutions, at least in the case of financing, should examine whether there is compliance with the conditions of environmental license.

Regarding the degree of reasonable diligence to be expected of financial institutions, it is always necessary take into account the economic sector, the size of the borrower or of the investee and even the value of the transaction, as well as the degree of exposure of the financial institution to each client and each economic sector, it is proposed to use the following tools in the Brazilian case:

a) *verification of environmental licensing, either online or through a certificate request* – transactions in which this tool must be used: all those involving activities subject to licensing, regardless of value;

b) *evaluation of environmental impacts*, either using questionnaires answered by the enterprise (preferably specific to the industry in which it operates), or through documentary analysis – transactions in which this tool should be used: all those involving activities subject to licensing; considering that it is a much more labor-intensive tool than the first one, it is reasonable to consider that it is used only for sectors with greater environmental risk, and that, for the lower-risk sectors, it is used only in transactions with higher values;

c) *verification of environmental compliance regarding the legal reserve and areas for permanent preservation of rural property* – transactions in which this tool should be used: all rural loans, regardless of value, especially in the Amazon biome (cf. CMN Resolution 3545/2008); it is also highly recommended that the same tool be used for any other activities developed in the rural area;

d) *checking with environmental agencies for possible overlapping with environmentally protected areas* (conservation units) or their surroundings (buffer zone) – transactions in which this tool should be used: all those involving rural credit, regardless of value; it is also highly recommended that the same tool is used for any other activities developed in the rural area (such as mining and infrastructure works) and even in the urban area, as there are also conservation units in the urban perimeter;

e) *verification with FUNAI of possible overlapping with indigenous areas*, included in process of demarcation – transactions in which this tool should be used: all those involving rural credit, regardless of value; it is also highly recommended that the same tool

is used for any other activities developed in the rural area and even in the urban area, since there are also (although rare) indigenous territories in the urban perimeter;

f) *verification with INCRA of possible overlapping with territories of quilombolas communities*, even in process of demarcation – transactions in which this tool should be used: all those involving rural credit, regardless of value; it is also highly recommended that the same tool be used for any other activities developed in the rural area and even in the urban area, as there are also (although rarer) quilombolas territories in the urban perimeter;

g) *remote monitoring* (using Google Earth or similar tools), in order to verify the items “d”, “e” and “f” above – the advantage of using such tool is the probable greater agility in obtaining the information given the limitation of the databases available *online* and possible slowness in the provision of certificates by the public bodies mentioned;

h) *verification of the regularity of the granting of the right to use water resources*, when applicable – transactions in which this tool should be used: all those involving rural credit, as well as other economic activities that require the exploitation of water resources, such as mining and some basic industries and processing, regardless of the amount involved;

i) *verification of the framework of the financed activity in the Ecological-Economic Zoning (EEZ)* – transactions in which this tool should be used: all, whenever EEZ is available in the region;

j) *verification of the existence of restrictions on the use of property* (for protection of cultural heritage, for example) and its compatibility with the proposed project – transactions in which this tool should be used: all those involving real estate projects, regardless of value;

k) *on-line verification* or request of certificates from environmental public agencies (federal and state) *regarding the existence and object of administrative proceedings involving the enterprise or about the existence of embargoes on the area where the financed activity will be carried out* – transactions in which this tool should be used: all those involving activities subject to licensing, regardless of the value;



l) *on-line verification* or request of certificate from the Ministry of Labor *regarding the existence, object and progress of administrative procedures involving labor health and safety compliance* – transactions in which this tool should be used: all, with emphasis on the sectors in which the incidence of work in inadequate conditions is more intense, namely: agriculture, civil construction and textile industry;

m) *request of certificates of the Labor Courts, regarding the number and object of the actions involving the enterprise* – transactions in which this tool should be used: all, and there must be a comparison with the volume of labor employed by the company;

n) *verification of lawsuits involving the enterprise in the State and Federal Courts, focusing on lawsuits related to environmental matters or involving other collective rights* – transactions to which this tool should be applied: all those involving activities subject to licensing, regardless of value;

o) *verification with the Federal Public Ministry* of civil investigations, collective lawsuits and terms of conduct adjustment involving the enterprise – transactions in which this tool should be used: all those involving activities subject to licensing, regardless of value;

p) *verification with the State Public Ministry* of civil investigations, collective lawsuits and terms of conduct adjustment (TACs) involving the enterprise – transactions in which this tool should be used: all those involving activities subject to licensing, regardless of value;

q) *verification with the Labor Public Ministry* of information on collective lawsuits, terms of conduct adjustment, as well as information on civil investigations – transactions in which this tool should be used: all those which involve activities subject to licensing, regardless of value;

r) *inspections by sending a specialist at the place of the activities financed*, compatible with the degree of complexity of the transactions – transactions in which this tool should be used: only those involving large enterprises, especially when the amounts involved are also high;

s) *media research involving the financed project or activity, as well as dialogue with not for profit institutions* with relevant and recognized action in the environmental and social field – transactions in which this tool should be used: all those involving activities subject to licensing; considering that it is a tool that, although presenting low cost, is reasonably laborious, given the need to evaluate the information obtained, it is reasonable to consider that it is used only for sectors of higher environmental risk, and, for the industries of lower risk, considering the amount involved in the transaction;

t) *contracting of independent environmental and social auditing*, preferably with prior examination of the technical capacity and impartiality of the contracted company – transactions in which this tool should be used: only those involving large enterprises, with high environmental and social risks, especially when the amounts involved are also high;

u) *environmental evaluation of real estate collaterals* – transactions in which this tool must be used: whenever the collateral is real estate;

v) *requesting an action plan to mitigate environmental and social risks*, including, if necessary, conflict resolution with the surrounding community – transactions in which this tool should be used: as a rule, only those involving enterprises with high environmental and social risks, especially when values are also high;

w) *existence of certification(s) by recognized entity(ies) as to the adequacy of environmental management and labor health and safety management systems* – transactions in which this tool should be used: only those involving large enterprises, especially when the values involved are also high;

x) *verification of the information contained in the sustainability / corporate social responsibility reports*, if the enterprise has, including the positive attributes of the mere existence of such reports – transactions in which this tool should be used: only those involving large enterprises;

y) *verification of the inclusion (or not) of stock exchange sustainability indexes*<sup>13</sup> – transactions in which this tool should be

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13 The BM&F BOVESPA (now B3) in Brazil has created, since 2005, the Corporate Sustainability Index (ISE), which includes companies that issue securities traded on it with better ESG performance governance. It was the fourth Stock Exchange in the world to adopt such initiative, being the Dow

used: only those involving large enterprises, with shares traded in the capitals market, especially when the amounts involved are also high.

## 2. 4 Relevance of self-regulation and market best practices

Another point that can never be ignored, in concrete circumstances involving the analysis of possible liability of financial institutions for environmental and social damages caused by financed projects, is the institution's voluntary commitment (or self-regulation). The assumption of such commitments in general is accompanied by widespread disclosure in a positive marketing strategy that is able to generate obvious benefits to the reputation of the financial institution. This is a legitimate strategy, provided that it is used with due seriousness and consistency, what means, followed by the proper implementation of the commitments made.

As it is well known, not only is the law (as a general rule) a source of obligations; these can also be assumed by virtue of an act of will, such as a contract or the adherence to a voluntary commitment. The fact that they originate from an act of will does not make the obligations less cogent, generating a legitimate right to its fulfillment by the interested parties – in this case, the whole collectivity.

Therefore, if a financial institution is a signatory, for example, of the Equator Principles <sup>14</sup> and does not comply with its rules in a Project Finance transaction, the fault is present so that it should be held liable for any social or environmental damages arising from the failure to comply. The same applies to other self-regulatory initiatives, such as the Declaration of Principles of the Banks that are part of the UNEP-FI (United Nations Environmental Program – Finance Initiative <sup>15</sup>), the Global Compact <sup>16</sup>, the Natural Capital Declaration (signed during Rio + 20 in 2012), the Principles for Responsible Investment (PRI) <sup>17</sup>, the Green

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Jones Sustainability Index (DJSI) of the New York Stock Exchange one of the most relevant ones (and some Brazilian companies that have securities traded there are part of the index). To know more about ISE, see: <[www.isebmf.com.br](http://www.isebmf.com.br)>.

14 To learn more, see: <[equator-principles.com](http://equator-principles.com)>

15 To know more, see: <[www.unepfi.org](http://www.unepfi.org)>.

16 To learn more, see: <[www.unglobalcompact.org](http://www.unglobalcompact.org)>.

17 To know more, see: <[www.unpri.org](http://www.unpri.org)>.

Bonds Principles<sup>18</sup>, the Carbon Disclosure Project<sup>19</sup>, to mention only the most relevant initiatives currently in the financial market<sup>20</sup>, or others that might be created.

Finally, the relevance of best practices refers to the need to establish adequate parameters for the interpretation of regulatory standards whose wording is made in generic terms, allowing to verify what would be a minimum level, a medium level and an ideal level of diligence to be adopted in each loan or investment.

## **2. 5 Relevance of information publicly disclosed by the financial institution itself, the internal manuals and the adequacy of the governance structure**

Another element to be highlighted that needs to be weighted according to the size of the financial institution, is the information that it discloses on its website (or other sources) about its criteria and procedures for the management of environmental and social risks, which must also be regarded as binding.

In addition, manuals and other internal documents addressing the issue can and should be examined, as well as the existence (or their absence) of governance structure appropriate to its effectiveness – including actions to empower responsible persons, monitoring credit and investments (when applicable) and auditing procedures of compliance with the internal and external standards – all with appropriate frequency and depth depending on the level of complexity of transactions.

## **2. 6 Relevance of the nature of the transaction, the covenants and the procedures adopted in the specific case**

Lastly, but perhaps most important of all, the depth and quality of the environmental and social risk analysis that was carried out in the specific case (considering the economic sector and geography) should be examined; if all publicly available information and other information to be

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18 To know more, see: <[www.icmagroup.org](http://www.icmagroup.org)>.

19 To know more, see: <[www.unpri.net](http://www.unpri.net)>.

20 For a description of each of these initiatives, see chapter II of the following work: SOUZA, Luciane Moessa de. Sustentabilidade socioambiental no sistema financeiro: diagnóstico e propostas. Postdoctoral Research Report. University of São Paulo (USP), April 2016.

obtained directly from the entrepreneur have been sought and examined; whether or not some adjustments were required; *if the conclusions of the environmental and social risk analysis / evaluation were adopted*; whether obligations have been inserted in the relevant contracts to comply with environmental and social obligations; if this compliance was monitored at least during the phase of resources disbursement<sup>21</sup>; if there was a suspension of the disbursement of tranches in the event of a non-compliance being detected, in other words, if the financial institution effectively did everything possible to avoid the damage – not being able, of course, to assume the management of the enterprise of course.

It is clear that any details of the existing regulatory rules have a great contribution to make in this regard. As Consuelo Yoshida and Renata Piazzon note, in the Brazilian case, the current CMN Resolution 4327, of 2014,

[...] is limited to establishing broad guidelines and general criteria, not detailing exactly what banks should ask their clients to safeguard the environmental regularity of a particular enterprise – minimum environmental due diligence. [...]

Nevertheless, the financial sector has a legitimate expectation that Resolution n. 4327 is interpreted and applied in a way that allows banks to act within a sphere of greater legal certainty<sup>22</sup>.

### 3 SOLIDARITY AND DOSAGE OF THE FAULT DEGREE

In terms of reparation for environmental damages, due to a series of factors very well summarized by Nusdeo (2017, p. 30) – as, on the one hand, the indivisibility of environmental damages, and, on the other hand,

<sup>21</sup> Ana Luci Grizzi and others also state: “The funder must monitor the application of the resources made available during the financing, thus fulfilling its constitutional duty to preserve and defend the environmentally balanced environment, essential to the healthy quality of life.” (2003, p. 37, translation of this author). It should be noticed that the Chinese banking regulator brings this obligation of monitoring throughout the operation, expressly, because in the event of high socio-environmental risks, it may be the case to establish provisions for this reason. As noted in Luciane Moessa’s Postdoctoral report, in China, “in 2007, the SEPA [the State Environmental Protection Administration], the Central Bank and the CBRC [China Banking Regulatory Commission] issued Recommendations on the Implementation of Environmental Protection Policies and Rules to Avoid Credit Risks, “requiring both environmental agencies and financial institutions to understand credit policies as tools for environmental protection, and to strengthen environmental monitoring in credit management for project construction and business financing.” (2016, p. 93, translation of this author)

<sup>22</sup> Responsabilidade socioambiental dos bancos. Valor Econômico. São Paulo, May 27th 2014, translation of this author.

the possibility of multiple authors and likely impossibility to measure with exactitude the degree of contribution of each one<sup>23</sup>–, as a rule, we adopt the system of joint liability among the various polluters with respect to the obligation to repair.

Regarding the subjective regime of civil liability for environmental damage, Dal Maso reports that, in Italy, institutions respond within the limits of their individual liability, and not in joint liability (2001, 37), as in Brazil.

In the Brazilian case, even if the rule is solidarity, when an indirect polluter is involved, it is again the case to make a distinction of regime, and, in my view, it should be recognized that this is a *subsidiary liability* – which does not prevent, of course, the filing of simultaneous lawsuits against both parties (as happens, for example, in relation to the service contractor and the outsourced company that performs labor intermediation). Thus, the assets of indirect polluter will not be affected in first place, but only in the event of insufficiency of assets of direct polluter. The reparation of the damages is ensured, but the allocation of its financial consequences is proportional to the degree of liability in its causation.

It is worth mentioning the position of Consuelo Yoshida, who advocates the adoption of a system that she calls “shared liability”, appropriate to the real chain of facts in the concrete case, replacing that of joint and several liability that has been adopted, penalizing often in the first place the financier. She maintains:

Therefore, within the logic of sustainability and compliance with environmental norms, the passive joint liability, which makes it possible to hold a single co-sponsor (**usually** the one with the biggest economic capacity) accountable for all obligations in case of noncompliance by any of the co-sponsors, becomes of subsidiary application in relation to the shared liability system, that reaches all the players (state, economic and social) in the public-private, proactive and integrated management of social-environmental issues. If the expected results are not achieved with the use of shared liability, then it is the case of joint liability, of subsidiary application. (2012, p. 122, translation of this author)

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23 This is the case of several neighboring plants which discharge pollutants into the same river or pollute the same air and also the case of previous existing environmental damages, to which more recent damages are added.

I totally agree there is no need of automatic application of the solidarity scheme, but should rather be used that one of subsidiary liability.

#### 4 LIMITATION OF LIABILITY IN TIME

Rômulo Sampaio, in his work dedicated to the theme (2013, p. 199-201), contrasts once again with the thought of Alexandre Raslan, when he defends a liability unlimited in time of financial institutions for the environmental damages caused by the enterprises financed, due to the acknowledged imprescriptibility of environmental damage (2012, p. 251). The imprescriptibility regime, it should be remembered, exists precisely because environmental damage can take a long time to emerge.

For Grizzi and others (2003, p. 56-57) and Sampaio, however, there must be a time limit, which the first ones propose is the final term of the financing agreement, provided that the funder has fully complied with the legal provisions applicable to credit, such as requiring proof of environmental licensing and compliance of activities – duties that, for them (as well as for Prof. Paulo Affonso Leme Machado), also extend to private banks. On the other hand, Sampaio proposes that this temporal limitation should be established as soon as the last credit installment (2013, p. 196) is released, even before the discharge, provided that the analysis of environmental compliance was made prior to the approval of the credit and each disbursement.

In that regard, I think that Raslan's opinion is fully justified, since it is not possible to attribute to random circumstances the consequence of consolidate a legal situation whose environmental effects are extended, but rather to recognize the imprescriptibility of the right to compensation for environmental damages, also including its indirect causer – which is another incentive for a higher degree of environmental and social diligence at the moment of approval of the transaction, thus materializing the principle of prevention in its maximum dimension.

## 5 THE PROBLEM OF CONTAMINATED REAL ESTATE GUARANTEES

Throughout the world, the first demonstration of the relevance of the environmental issues occurs when banks face real estate collateral whose value is much lower than estimated due to soil contamination, and may become even negative, depending on the costs involved in decontamination, as reported by Davide Dal Maso (2001, p. 28). Also the report prepared by ISIS in 2002 after research with major European banks states that

[...] the first event or ‘trigger’ to generate banks’ environmental awareness was the experience of becoming the owner of contaminated real estate that had been pledged as collateral whose decontamination costs could exceed the loan’s value. The second was the occurrence of serious pollution incidents. (2002, p. 9)

All the authors who examined this theme refer, as already said, to the example of the USA, which begins with the legal rule from 1980 establishing that the current owners would have the duty to indemnify the country’s government for the decontamination of the areas, even though they had not been directly responsible for the contamination in the past. The US Comprehensive Environmental Response (Compensation and Liability Act, issued in 1980) created a “superfund” of public nature for the purpose of decontaminating polluted areas, but with a right of recourse to owners. In 1986 (Superfund Amendment and Reauthorization Act), the standard was amended to provide for a regime of strict liability for damages caused by owners, while exempting creditors who became owners after enforcement of collaterals. Despite the legal wording, after enforcing their real estate guarantees, some banks were eventually ordered to pay the Environmental Protection Agency (EPA) for the costs of decontamination because they were considered to have direct interference in the management of the polluting company.

In order to address the problem, the agency disciplined the matter by administrative regulation in 1992, setting limits for the characterization of bank liability, but the Judiciary in 1994 understood that the issue could only be dealt with by law, suspending the effectiveness of the regulation.



In 1996, the Asset Conservation, Lender Liability and Deposit Insurance Protection Act was enacted, establishing criteria similar to those established in the invalid administrative rule, namely: a) banks would not be liable if they remained with the property only for the time needed to transfer it to third parties, in order to receive their credit; b) banks would be liable if it was shown that there was an effective participation in the management of the polluting company. Before this was defined by the federal law of 1996, the effects on the credit market in the early 1990s were felt: Dal Maso reports that, according to a particular oil business entity, about one third of loan requests were denied at the time, mostly because of fears about environmental risks. On the other hand, 15% of the banks complained that they had faced real estate collaterals that were not worth because of contamination. Likewise, he reports that similar cases in Europe (very high decontamination costs that hampered the guarantee) were common in the 1990s (2001, p. 35). According to him, the position most vulnerable to the risk of being held liable is the one of the owner of contaminated real estate, and “in some countries, such as Finland, the Netherlands, the United Kingdom, Sweden, Switzerland and Spain, environmental liability can also be attributed to the controlling company that exercises effective management of the business activity.” (2001, p. 39, translation of this author).

Jeucken describes the effects of the most famous court decision on the subject (The USA X Fleet Factors Corporation), whereby the bank was ordered to indemnify the costs of decontamination, on the ground that, because it was in charge of the financial administration of the polluter company, it had the “ability to influence” decisions that resulted in contamination (2004, p. 168). The effects of the decision were clearly felt in the banking industry: according to an American Bankers Association study, 88% of them changed their lending policies thereafter to avoid being held liable for environmental damages; 63% rejected credit transactions with this fear; 17% preferred to stop running real estate collaterals for fear of soil contamination; 14% had to bear the costs of properties that were received as collateral; 46% stopped lending to some environmentally sensitive sectors such as the chemical industry and agriculture (especially smaller banks). In addition, banks began to set differentiated interest rates and reduce grace periods for transactions with sectors with higher environmental risks, and also began to establish procedures for environmental audits (2004, 168).

## 6 LIABILITY IN CASE OF INVESTMENT ACTIVITIES

In relation to the activities carried out by financial institutions in the capitals market, as they usually involve large enterprises and often economic sectors that are very sensitive from the social and -environmental point of view, the issue is also very relevant.

Rômulo Sampaio, in examining the financial institution's liability for the investment market, did so in relation to a single activity, typical of an investment bank: acting as a leading coordinator or distributor of securities in the capital market, involving a series of administrative duties with the Securities Exchange Commission and the Stock Exchange, but whose main purpose is to lend its credibility to the company issuing the securities, bringing it closer to its clients that may have an interest in the acquisition. Here are his main conclusions:

[...] when structuring a market operation, should the financial institution be attentive to the environmental risk of the structured activity. It should incorporate into the risk analysis of the transaction the operational risk of the company that intends to open the capital for the exposure of the corporation to environmental risks. It should also use the strength of its reputation for the success of the IPO to force the company to internalize cautious duties with regard to its operations on what puts the environment at risk. (2013, p. 191, translation of this author)

Thus, for this author, what should be required of the financial institution in relation to this type of action is that it perform an analysis of the environmental risk of the company that intends to attract new investments in the capital market: "one must seek the level of information available at the time of the transaction and, above all, the efforts made by the financial institution to seek information on the operational risk of the company that is making the IPO." (2013, p. 192, translation of this author).

The reasoning is adequate, in line with what I proposed in terms of subjective liability: the financial institution should be required to have the degree of diligence compatible with the risks of the economic sector, the size of the company and even the value involved in the transaction.

In my view, all the parameters referred to in item 2 should be considered, including the fact that several financial institutions already disclose their parameters and procedures for assessing environmental

and social risks in investments – which is good practice, demonstrating seriousness and transparency, but also generates liability in the face of all the commitments made publicly or even contractually with its clients, as in the activities of financial asset management. The same criteria can and should be extended to other similar activities in the investment market.

Rômulo Sampaio addressed the theme again in a study carried out in co-authorship with other researchers and published as Working Paper of the UNEP Inquiry in 2016. There, they propose criteria that seek to differentiate the degree of investor liability both based on levels of technical capacity and economic capacity and according to the modality of investment. On this latter aspect, they say, “for example, investment in corporate shares (private equity) allows access to a much higher level of information about the target company and its projects than in the case of an investment fund.” (2017, page 22, my translation). Indeed, investment funds usually cover several companies and the positions of the shareholder of a limited liability company and of the shareholder of a corporation are, as a rule, quite different in terms of control and access to information. As for the investor’s situation, they propose that it be differentiated into three categories: a) institutional investors, which have a greater degree of influence in the management of the invested business, when making investments of high value, and would be considered *highly qualified*; b) institutional investors would be considered only *qualified* when making investments of smaller values or with less degree of interference in the business; (c) finally, the third situation would be for investors who receive little or no information on investment projects / projects, since they use investment managers (2017, p. 22-23).

The idea of differentiating according to the degree of control and level of access to information is adequate, but this classification is not operational, since institutional investors, for example, also hire investment managers. Many situations would raise doubts, such as the “family offices”, offices specialized in the management of the financial assets of wealthy families. Moreover, even in the case of institutional investors, it must be acknowledged that investment can often be of high value, but the percentage is too small to have a relevant influence on the management of the investee. Different situation is the one of the investor that has seat in any Council of the invested company. If he holds, then, most of the equities, as rightly understood by Sampaio and others (2016, p. 23), the

liability for environmental and social damages caused by the enterprise is complete.

Sampaio et al. suggest that, in case of use of investment fund managers (or other modalities), the last two categories of investors would not be reached, but only the managers. In my opinion, it is also necessary to analyze what the investment management contract established, if it required that environmental and social factors were identified and taken into account in terms of the risks involved and as a criterion for investing, divesting or engaging with companies recipients of investments, and how much it was detailed in terms of steps to be taken. If there has been a breach of contract, it is not necessary to enter into the area of objective liability. It is important to remember that, for retail investors, there is no possibility of negotiating contractual clauses, so that the minimum degree of diligence required of managers is independent of covenants.

Even for institutional investors, as far as higher value or proportion investments are concerned, I understand that it is not necessary to enter into the field of objective liability, simply by adopting the same criteria proposed for loans. It is worth remembering that, unlike financial institutions that grant credit, variable income investors will already suffer the financial impact in any way, as the company will have to repair environmental damages regardless of fault, and this will affect its financial results. Bearing in mind, however, the regime of limitation of liability that applies to both limited companies and corporations (except for cases of disregard of legal personality), the greatest risk for investors lies in the loss of profitability, loss of value of assets or loss of the assets themselves, if the equity of the investee is equal to or the value of the full compensation of damages.

The major question that arises, however, concerns two other fields of liability:

- a) relationship between participants of pension plans and the fiduciary duty to exercise diligently the management of financial assets, taking into account, therefore, also the environmental and social risks (a duty already referred by regulation in the case of pension funds, as shown);
- b) contractual relationship between institutional investors (pension funds and insurers) or even other investors and financial asset managers, which also requires the contracted manager to take into account any financially relevant risks.

It is clear that, in any of the above cases (loss of expected profitability, loss of value of assets or loss of the assets themselves), if this financial loss is related to environmental and social factors, participants in pension plans may demand the entities to which they are bound and investors may demand the asset managers they hired whenever they consider that there was not an adequate level of diligence in the collection and analysis of environmental and social information about the invested company(ies), real estate or other class of assets in which the loss occurred. In this case, it is necessary to analyse precisely if the duties of diligence were adequately performed, considering the parameters proposed in item 2.

## 7 THE BRAZILIAN JURISPRUDENCE

Notwithstanding the important judgment of the Superior Court of Justice (STJ), whose rapporteur is the Justice who is the greatest specialist in Environmental Law (as well as in Consumer Law) in that court, Antonio Herman Benjamin, referred to earlier in this chapter, states the opinion that banks are objectively liable (in a lawsuit in which, however, no financial institution was a party), the decisions of courts of appeal on the subject (subject to a special appeal to the STJ, of course) disagree with that understanding. The Federal Regional Court of the 1st. Region has some relevant judgments, but rendered almost two decades ago:

“CIVIL PROCEDURE. PUBLIC WORK. ENVIRONMENTAL DAMAGE. CEF FINANCING. PARTIAL ILLEGITIMACY.

I – As a mere financier of public works, not being responsible for its construction nor for the project, Caixa Econômica Federal cannot be held liable for any environmental damages resulting from its realization.

II – Illegitimacy of party that is recognized.

III – Distinguished Federal Court jurisdiction.

IV – Infringement of an Instrument dismissed.”

(TRF 1ª. Reg., 2nd.Chamber, 1997.01000643334, Rapporteur Judge Antônio Savio O. Chaves, Judgment December 11<sup>th</sup> 2000; translation of this author)

“[...] despite the fact that the Brazilian legislation supports the objective and joint

liability of financial institutions as a result of the credit grants, the activity that causes environmental damage, the exclusion or mitigation of the causal link must be discussed in view of each specific case, considering, among other hypotheses, compliance with the duty of diligence imposed on the official credit institutions by art. 12 of Law n. 6938 / 81, which perfects the embryonic discipline of art. 12 of Law n. 6803/80.

Although both legal provisions refer to the preventive performance of official credit institutions and government financing and incentives transactions, it is salutary, for the reasons stated, to interpret them extensively to reach private institutions as well [...]

As for the BNDES, the mere fact that it is the financial institution entrusted with financing the mining activity of CMM, in principle, in itself, does not legitimize it to be in the passive pole of the demand.

However, if it proves to be in the ordinary course of action that the said public company, even when **aware of the occurrence of serious and serious environmental damages** that reflects significant environmental degradation, or is aware of **the occurrence of such damages**, has made disbursements of intermediary or final installments for the mining project of said company, then, it will be held liable jointly with the other entities for the damages caused in the property, by virtue of the norm contained in the article 225, *caput*, paragraph 1<sup>st</sup>, and respective sections, notably items IV, V and VII of the Major Law.”

(AG 2002.01.00.036329-1/MG, Rapporteur Des. Fagundes de Deus, Judgment December 15<sup>th</sup>. 2003 – highlighted; translation of this author)

See also the following decision document of a State Court of Justice:

“PUBLIC CIVIL ACTION – PUBLIC MINISTRY – FAVOURABLE JUDGMENT ON 1st. COURT – RURAL FINANCING OR INCENTIVES – REQUIREMENT OF COMPLIANCE WITH ENVIRONMENTAL LEGISLATION – NON-EXISTENCE OF OBLIGATION – DEFEATED PARTY’S FEES – APPLICATION OF LAW N. 7347/85 – RESOURCE PROVIDED.

Inadmissible, especially when the Bank appealing is not in failure with require environmental compliance, hold it liable for possible occurrence of environmental damages.”

(TJ-MT, 2<sup>nd</sup> Civil Chamber – Civil Appeal – class II – 19 – n. 25408 – Capital; Rapporteur Benedito Pereira do Nascimento; Judgment on April 17<sup>th</sup> 2001).

With respect to this judgment, in which the appellant was Banco do Brasil, it is worth emphasizing that it also occurred in the distant year of 2001, adopting a literal interpretation of article 12 of Law 6938/1981 as only comprehensive of project financing and therefore excluding rural credit transactions. As mentioned in footnote 11, since 2008, CMN Resolution 3545 prohibited the concession of rural credit in the Amazon biome, when the property is not in compliance with environmental legislation. In the present case, the property did not have the legal reserve [portion of the property flora that needs to be preserved] and Banco do Brasil did not make this requirement – hence the motivation of the judicial action of the Public Prosecutors.

In addition, in a more recent (2014) monocratic judgment of the STJ itself, a Judge has already adopted a different understanding from that of Minister Herman Benjamin, but it is important to point out that, in the specific case, the project financed by the institution (a multilateral bank, the Inter-American Development Bank) was conducted by a public entity, the State of São Paulo, which also had the authority to carry out environmental licensing. I highlight the essential parts of the decision:

“The core of the issue in this lawsuit was the compensation for the environmental damages caused by the Várzeas do Tietê Project, attributed to the Public Treasury of the State of São Paulo and others.

[...]

In this case, the challenged decision extinguished the lawsuit with respect to the Inter-American Development Bank – IDB, based on the following reasoning:

[...] ‘It has not been proven, nor was it indicated by any means, that it should require studies on the environmental impact of the projected works with the resources made available.

It’s the absence or mistakes of the studies on the environmental impacts of the project, which has not been shown to be assigned to IDB, that could cause the damage, should it be proven.

In the present case, in the first analysis, no liability of the IDB for the environmental damage caused in the implementation of the Várzeas do Tietê Project is seen, being it an illegitimate party to occupy the passive pole of this lawsuit.”

(STJ – Ag. 1433170 – Justice Rapporteur Marga Tessler (convoked judge of TRF 4th. Region) – DJe 11. 12. 2014)

This framework seems to indicate that recognition of the need to characterize fault and the construction of clear parameters for this purpose seems to be a safer and wiser way for the definition of when to hold (or not) financial institutions (understood in a broad sense, credit and investors) liable for environmental damages caused by businesses, works or projects financed.

## **8 BANKING SECRECY AND INFORMATION OF ENVIRONMENTAL AND SOCIAL INTEREST**

Complementary Law n. 105, of 2001, describes the scope of banking secrecy, both for financial institutions and for the agencies that supervise them, and also defines the hypotheses in which such secrecy may be broken. It is not necessary here to analyse this complex legislation, but only its repercussion on the subject here examined.

On the other hand, the Federal Decree 99274, of 1990, in its article 19, paragraph 3<sup>rd</sup>, establishes:

§ 3<sup>rd</sup>. Once the implementation and operation activities have begun, before the issuance of the respective licenses, the directors of the IBAMA Sector Offices shall, under penalty of functional liability, notify the entities financing these activities, without excluding the imposition of penalties, administrative measures of interdiction, judicial, seizure, and other precautionary measures.

It is undoubtedly an excellent instrument for preventing environmental regulation violations. Nevertheless, given that IBAMA does not have direct access to information on which institutions are financing activities that depend on licensing or permits, since the information on loans is held by the Central Bank of Brazil (and in addition, they are protected by banking secrecy), the operationalization of this norm becomes very difficult.

Ana Luci Grizzi and others recall, quoting Paulo Affonso Leme Machado, that Public Civil Action can also be “used to obtain information on the observance of environmental legislation in financing, when this information is covered by bank secrecy” (2003, p. 61, translation of this author).

Furthermore, Alexandre Raslan points out that a good part of the



loans use real estate collaterals – and that this transaction, in order to be binding to third parties, must be registered in the real estate registry, as determined by articles 16 and 17 of Law 6015, of 1973. Thus, he points out, “a legal alternative to obtain bank information is feasible” (2012, p. 233, translation of this author), making it unnecessary, in this case, to require the judiciary to declare bank secrecy breach in order to access the information.

The ideal route would be the legislative change so that the Public Prosecutors and environmental agencies could directly request the Central Bank information on banking transactions, provided they could demonstrate the relevant collective interest involved, and because this information would be indispensable for clarifying the facts.

Regardless of normative change, however, the information obtained in the course of supervisory actions, in relation to internal manuals and procedures adopted by financial institutions for the management of environmental and social risks, as well as environmental and social risk assessments elaborated in specific transactions, and the successive monitoring actions, as they do not involve any question that affects the intimacy or privacy of third parties, but issues of relevant collective interest, are not covered by banking secrecy.

In addition, with regard to the manuals that provide criteria and tools for environmental and social risk assessment, it is even perfectly possible that the regulatory norm require in the future the duty of the institutions to carry out the disclosure, so that their clients and other interested parties may know the degree of diligence and consistency of their environmental and social responsibility policies, demonstrating to potential borrowers or recipients of investments that they will be carefully evaluated in relation to these aspects when they use the financial institution services.

Finally, it is important to mention, also as a basis for this legal reasoning, that one of the essential environmental principles enshrined both in the 1972 Stockholm Declaration and in the 1992 Rio Declaration (on the occasion of the United Nations Conference on the Environment) is the **principle of cooperation**. According to Paula Silveira Galbiatti, who devoted herself to examining the repercussions of the principle of cooperation in environmental matters for Brazil, quoting Cristiane Derani (1997, p. 42):

[...] the principle of cooperation is an expression of the generic principle of agreement or *Kompromissprinzip*, that pervades the entire legal order, including the environmental one, informing a joint action of society and the State in the choice of priorities and decision-making process, that means, is the **basis for expanding information and participation** in environmental policy decision-making processes. (2015, p. 1138, translation of this author).

Later, the author refers to the lessons of Guido Soares on the theme:

SOARES (2003a, p. 62-63) explains that the Rio Declaration, in a direct way, reaffirms in its Preamble the values already proclaimed in the Stockholm Declaration, and seeks to move forward from it. The Rio Declaration recognizes the primary objective of cooperation for preservation and conservation of the environment, for sustainable development and for the promotion of a system of scientific communication and exchange of information. **It is only with information sharing and its access by society that the environmental decision-making processes will have legitimacy and will allow a dialogue among the various sectors, seeking the best solution.** (2015, p. 1322, translation of this author)

It is thus perceived that one of the repercussions of the principle of cooperation is precisely the idea of sharing information of environmental nature (including between countries, even more within a country), since the subject is, by definition, of collective concern.

## **9 FINAL REFLECTIONS ON THE RELATIONS BETWEEN REPAIR AND PREVENTION OF SOCIAL AND ENVIRONMENTAL DAMAGES**

In order to conclude, it is important to establish a correlation between the liability system for environmental and social damages and the effectiveness of a system to prevent such damages.

One issue that pervades many of the discussions about the role of financial institutions in this area is a certain confusion between roles of environmental regulators (in charge not only of issuing environmental permits but also of the monitoring of activities potentially harmful to

environment and subsequent enforcement of administrative penalties, with repercussions in the civil and criminal spheres) and of financial institutions. I think a very basic example might well elucidate the question. It would be impracticable, in the light of legal or economic criteria, to require financial institutions to carefully examine the adequacy or accuracy of each environmental license granted to their clients. Aline Pacheco Pelucio reminds us very well that “allocating a cost to the actor capable of dealing with this cost in the most efficient manner (*the best cost avoider reasoning*) is the basic microeconomic premise of the economic analysis of law” (2017, p. 165, translation of this author). Adopting the same principle, it may not be feasible to expect the financial institution or investor to be able to analyse whether supervision is being carried out as often as necessary or if the environmental body has a technical governance and staff structure adequate to exercise its police power. The financial institution or investor may even seek information about that, since environmental and social risks may be reflected in the economic-financial performance of its clients or invested companies, but requiring that the analysis go that far seems to exceed the limits of reasonableness.

It does not seem, however, to exceed these limits to understand that it is incumbent upon all public and private financial institutions and investors to verify whether the activity financed requires environmental licensing and, if so, to request the presentation of the permit – including information, as set out above, accessible *online* to some extent. At the same time, it seems that a minimum level of care already recommends that environmental and social agencies be consulted about the existence of administrative processes (ongoing or already completed) involving the possible punishment of environmental rules violations. The question is simple and the answer is also simple.

On the other hand, it is necessary to agree with the argument of Annette Martinelli de Mattos Pereira when she argues that the adoption of the regime of objective liability would imply that

[...] there would be no incentive for financial institutions to adopt measures to encourage good environmental protection practices by those responsible for funded projects if their efforts in this direction are not recognized as capable of overcoming the causal link and removing liability of financial institutions. (2017, p. 145,

translation of this author).

In fact, either by recognizing the indispensability of fault, which, in my view, should not be limited to situations of clear violation of legally binding rules, but also cover situations of operational failure – such as violation of internal rules of the institution or even inadequate internal rules, not aligned with best market practices – and situations in which the institution fails to fulfill commitments to which it has voluntarily bound itself in this matter, , either through the recognition of the existence of a causal link in these same situations, it is not possible to give the same treatment,(that is, holding the financial institution liable for the environmental damage caused by the project financed) whatever the degree of diligence of the institution – either by approving the loan or investment, or by monitoring it. It is impossible to ignore that the implementation of a sound environmental and social risk management system within a financial institution or investor has costs, requires time and strategy to incorporate the subject into the organizational culture and acquire the necessary expertise – and these efforts need to make a difference.

Finally, we must recognize the role that a clearer regulatory framework would play in providing legal security and clear parameters that would strengthen such systems in financial institutions and investors in general. Just to illustrate, I transcribe the questions of Laurine D. Martins Lopes, who worked in this area for the largest private Brazilian bank:

[...] what environmental and social steps to take? Are the steps taken to grant a loan the same for the financing of a project? In what cases should an environmental license be required? [...] For transactions whose allocation of resources cannot be previously identified by the financial institution, such as the loan, it does not seem to make sense to require an environmental license. Still taking Vale as an example, if it were hypothesized that there would be an obligation to require an environmental license to grant a loan, which of the hundreds of licenses in its places of operation should the company present to the institution? All of them? (2017, p. 139, translation of this author).

Although the answer to this last question is very simple when the company has only one establishment, and when there are several, the solution may simply be to require the license of the establishment requesting the credit (or from where the activity will be carried out), the fact is that the

regulator should answer these questions. This same author describes the advance of Brazilian banking institutions in this area and points out that there were multiple causes for the phenomenon, referring in particular to the role of the Judiciary, the Public Ministry (Public Prosecutors) and the Central Bank of Brazil (besides civil society). For her,

[...] financial institutions sought to understand the possible implications of the effective performance of these agents and, in response, they adopted measures to prevent the scenario of risk that was gradually outlined. The incorporation of the environmental and social variables in the credit analysis helped to address not only the credit risk that could arise from a transaction that presented negative environmental and social problems or impacts, but also the risks of reputation, market and even legal risk related to the matter. (2017, p. 138, translation of this author).

This all demonstrates that an articulated action between the various stakeholders in the matter is essential and that liability systems can and should be designed in a way that even further strengthens environmental and social damage prevention systems.

## **FINAL CONSIDERATIONS**

As I have tried to make clear throughout the paper, much more than naming the legal nature of financial institutions' liability for environmental (or social and-environmental) damages arising from the economic activities they finance, it is necessary to detail parameters so that, in concrete cases, it can be assessed whether and to what extent a particular institution should be held liable, and to what extent, for social or environmental damages caused by an enterprise financed by it in any way.

I tried to point out in this work which are the appropriate parameters. Although the subjective (and not objective) nature of the liability of financial institutions in such cases should be recognized, since it is due to omissions rather than actions, it is necessary to identify which are the obligations that, if they had been carried out, could avoid the consummation of the social or environmental damage, halting the financial resources essential to the development of the harmful enterprise. Therefore, I pointed out a series of tools, which are already adopted by the

most advanced financial institutions in terms of environmental liability, whether in Brazil or in more sophisticated financial markets.

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