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An Overview of Issues With Respect to Voluntary Environmental Agreements

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A b s t r a c t

The level of interest in and use of agreements between government and industry and between industry and NGOs or communities as a means of addressing environmental issues (voluntary environmental agreements, or VEAs) has increased dramatically in recent years. This paper reviews the international experience with this category of instruments. Although there is considerable variety in the uses and designs of VEAs, this paper suggests that there are some important lessons with respect to their selection, design and implementation. The paper's main theme is that VEAs should be used only as one among many possible "tools" to promote environmental objectives, and that their selection and design should be guided by four main considerations: environmental effectiveness, impacts on corporate culture, cost and trust. The paper also describes contextual factors that appear to be particularly important in determining whether a VEA will be effective, reviews some of the possible legal issues related to VEAs, and identifies the features of VEAs that we believe are the most important in determining their effectiveness.

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1. INTRODUCTION

As governments and businesses around the world experiment with an increasing variety of new means of promoting environmental objectives, many have started to develop different types of voluntary environmental agreements (VEAs) -- agreements negotiated between industry and either the government and/or a community or public interest representative. Although these instruments are not new, the level of interest and actual use of agreements has increased dramatically in recent years. This paper reviews the experience with this category of instruments, and identifies lessons with respect to their selection, design and implementation.

This paper is divided into 5 sections. Section 1 summarizes the experience of various countries with VEAs. Consistent with the main theme of this paper that VEAs should be used only as one among many possible "tools" to promote environmental objectives, section 2 describes the main rationale for utilizing a VEA and proposes four considerations to help guide the evaluation of the potential efficacy of a VEA: environmental effectiveness, impacts on corporate culture, cost and trust. Section 3 then describes three contextual factors that appear to be particularly important in determining whether a VEA will be effective: industry structure and capacity, policy context, and political culture. Section 4 supplements these considerations with a brief review of some of the possible legal issues related to VEAs. Finally, section 5 identifies the features of VEAs that we believe are the most important in determining their effectiveness.

2. INTERNATIONAL EXPERIENCE

Many jurisdictions are utilizing a wide range of different types of VEAs. In order to illustrate this diversity, section 1.1 reviews the experience with VEAs in Europe, North America, Japan and Indonesia. Section 1.2 then summarizes the main types of agreements represented by these case studies.

(a) Case Studies

European Countries

Continental European countries make extensive — and increasing — use of agreements. As of 1997, Portugal had eleven agreements, mainly with respect to waste reduction and the elimination of toxics. Austria also considers agreements to be an important policy instrument, having signed

approximately 20, largely with respect to industry commitments to take back different products. The Danish government has used agreements for almost 10 years, and, as of 1997, had 16 agreements covering waste management, batteries and contaminated sites. Belgium had approximately 20 agreements covering CFCs, and SO2 and NOx emissions. While German government authorities have been reluctant to sign agreements, they have made use of unilateral commitments for over 20 years, and by 1997 had approximately 40 such unilateral commitments mainly related to CFCs, detergents, CO2 and waste.

Sectoral Focus of Environmental Agreements Within the European Union

State	Sector					
	Agriculture	Energy	Industry	Transport	Tourism	Total
Austria			v			20
Belgium		v	v			6
Denmark	v	v	v			16
Finland			v			2
France		v	v			8
Germany		v	v			93
Greece		v	v		v	72
Ireland			v			1
Italy			v			11
Luxembourg		v	v			5
Netherlands	v	v	v			107
Portugal	v		v			10
Spain			v			6
Sweden	v	v	v			11
UK			v			9
EU Total						305

Source: European Environmental Agency, 1996

Environmental Focus of Environmental Agreements Within The European Union

State	Climate Change	Inland Water Resources	Waste	Air Pollution	Soil	Ozone Depletion	Total
Austria	v		v	v			20
Belgium		v	v	v	v	v	6
Denmark	v	v	v	v	v	v	16
Finland	v		v				2
France	v	v	v		v		8
Germany	v	v	v	v		v	93
Greece	v	v	v	v		v	72
Ireland			v				1
Italy			v	v			11
Luxembourg	v		v				5
Netherlands	v	v	v	v	v	v	107
Portugal	v	v	v	v			10
Spain		v	v	v		v	6
Sweden	v		v	v			11
UK	v	v	v			v	9
EU Total							305

Source: European Environmental Agency, 1997

Netherlands

The Dutch are the leading users of agreements in Europe, having signed over 200 agreements ranging from agreements covering all issues related to a given sector to those addressing very specific, local problems.

The best-known environmental agreements are the Dutch "Target Group" covenants. Their development follows a fairly well established process. The government has identified a target group of about 20 sectors which are the most significant contributors to the environmental problems identified in the *National Environmental Policy* (NEP - as modified by NEP Plus and NEP 2). For each of these sectors the government has or will estimate the contribution of that

sector to each of the NEP environmental objectives. The government then initiates discussions with representatives of the sector to develop a "Declaration of Intent" - an integrated plan which describes how the sector will achieve the objectives by the target year, which is typically 2010. If the sector is homogenous, the parties then translate the Declaration into a more detailed plan that will guide branch level implementation. If the sector is heterogeneous, each member company will commit to develop company specific plans to implement the overall agreement. In each case, the government commits in the Declaration to consider the implementation plans every four years when it issues or reviews the multi-media permits prescribed by the 1995 *Environmental Management Act*.

Japan

Japan has placed heavy reliance on negotiated agreements to address conventional pollutants for at least two decades. Typically, these agreements involve individual companies and local governments, and are developed in the context of siting applications. These agreements have a variety of benefits. They can avoid conflicts between local and national laws. The 1947 *Local Government Law*, authorized local governments to enact and enforce their own ordinances over environmental issues. In principle, these ordinances must be no stricter than those enacted at the central level. If a municipality desires to impose emission standards stricter than the national law, however, it can do so by means of agreements with local companies, rather than try to pass an ordinance that might conflict with the national standard. Second, the agreement can allow municipalities to tailor specific requirements to specific polluters. Thus, even where a local ordinance has set strict standards, the pollution control agreement often specifies even more detailed controls. Third, the negotiation process often provides local governments with the opportunity to help a factory develop a pollution prevention plan - and even to provide financial assistance where required. Finally, some observers argue that agreements have helped local communities "democratize" business decisions. The unique feature of Japanese agreements is their reliance on "administrative guidance." Under administrative guidance, a local bureaucracy puts a company (for example, a potential polluter) on notice that it wants a certain result (perhaps an agreement between the polluter and local area residents as to emissions, conduct and so on). The notice has no formal, coercive legal effect. However, the bureaucracy can and will resort to collateral enforcement (such as withholding a building permit) in the event the polluter does not cooperate.

The Japanese use of administrative guidance creates "quasi rights." In the absence of a statutory or common law property-like right to a specific level of environmental quality, when the local authorities induce polluters to negotiate and bargain, they create in the affected residents something resembling a right or entitlement: while not a binding legal right, it does, within the

constraints of reasonableness, confer on the residents a private right to bargain, for example, for the proper degree of sunlight and ventilation. Because the process does not create a specific obligation, however, it creates only very limited rights of judicial review.

Lacking legal compulsion, the courts look to administrative accountability, and judge bureaucratic actions according to societal consensus rather than formal procedure, thus trying to protect the flexibility which is central to the bureaucracy's use of administrative guidance. The courts may also invoke the 'abuse of rights' doctrine, which requires that rights must be exercised only within a scope judged to be reasonable in light of the prevailing social consensus.

Given the limited application of formal judicial review in Japan, the effectiveness of the administrative guidance model depends largely on the social pressure to respect whatever consensus the agreement is based upon. Such pressure is considerable in Japan. Given that the same cultural respect for consensus does not appear to exist in Canada, it may be that the applicability of this model is limited.

United States

While neither the federal nor the state governments in the US have made use of Dutch–style agreements, both have used community based agreements under the Significant New Use Rule (SNUR) under the *Toxic Substances Control Act* (TSCA). These provisions encourage companies to enter into agreements with local communities. If an agreement is negotiated, the Act authorizes the government to issue a SNUR by executive order to enforce compliance by the signatories. The effect of this arrangement is that an existing practice or use which is being renounced by the company is deemed not to exist and any company wishing to introduce or reintroduce such practice or use must respect provisions for such as if it were a novel practice or use for which specific restrictive measures are applied.

The most high profile example of the increased interest in the agreement model is represented by the federal EPA's Project XL, an experiment with negotiated exemptions from regulatory obligations. To date, results under this initiative have been disappointing. Reviewers point to the lack of statutory base, the attendant uncertainty and the initial costs to industry to enter into the program as the main explanatory factors.

Many states have also experimented with environmental agreements. In some cases, results have been very successful. This section summarizes two particularly effective programs that each illustrate the possibility of combining negotiated agreements with regulatory requirements.

The 1991 New Jersey *Pollution Prevention Act* serves as the basis for one of the best. It

requires about 700 industrial facilities to prepare pollution prevention plans. Plans and summaries must be updated every five years and involve significant detail. The Act also authorizes the Department of Environment to designate 10 to 15 facilities as pilot projects for a "facility wide permit program." Under this program, participating companies utilize a pollution prevention approach to develop, in collaboration with government, an overall plan for their facilities which meets or exceeds all permitting requirements. In return for this investment, participants receive one consolidated permit - rather than the 60 to 100 permits that they required before participating. This program thus combines two potential environmental benefits — minimizing the pollutant transfers that occur within the single media statutory framework that prevails in the US, plus the advantages of pollution prevention over end-of-pipe controls with two potential economic benefits to facility managers — increased operational flexibility and reduced transaction costs plus the assumed financial benefits of pollution prevention.

Administration of the program has required considerable investments by the government. Participating inspectors had to be cross-trained in all permit requirements. Detailed analyses of participating plants were reviewed. A recent review estimated that each company spent about $26,000 to prepare the pollution prevention plan, plus about 60 days of personnel time. However, the Department estimates a total net benefit to the facilities of about $6.3 million per year (or about $5 to $8 for every dollar invested).

A second innovative and effective program involving agreements is the Minnesota Landfill Cleanup Program. This program was created by the 1994 *Landfill Cleanup Act* out of frustration with the time consuming and costly legal requirements under the federal Superfund program as a way to address mixed (hazardous and non-hazardous) solid waste at municipal landfills. The Act gives the state agency the authority to initiate cleanup and/or closure actions, take over long term care at the facilities, and, in certain cases, reimburse eligible parties for their past cleanup costs. To start action, the state enters into a "binding agreement" with a landfill owner or operator. After the requirements in the Act are met, the state stipulates that compliance has been achieved, and assumes the cost of any remaining cleanup work as well as the expense of operating ongoing environmental protection systems at the landfill.

This program has had two main benefits: it has cleaned up landfills faster than under Superfund; and the quicker cleanups have resulted in quicker reduction of the ongoing liability burdens borne by landfill owners and operators.

Canada

Canada has experience with a range of environmental agreements. It has a long history of

negotiating compliance agreements, and has used licensing agreements and lender liability agreements for some time. More recently, the provincial and federal governments have experimented with various forms of memoranda of understanding, primarily aimed at pollution prevention issues.

(i) *Licensing Agreements*

As in Australia, the licensing and regulation of an increasing number of major resource developments in Canada are regulated by special agreements.

(ii) *Lender Liability Agreements*

Lender liability agreements refer to agreements negotiated between a regulator and a innocent party who is willing, under certain conditions, to take possession of contaminated land. Most of these agreements have been negotiated with lenders (usually mortgagees). Creditors who are contemplating re-entry on contaminated property require such agreements because of the risk that, once in possession, they would have unlimited liability for the contamination. Governments in most provinces of Canada developed these agreements in the 1980s as a means of remedying the uncertainty with respect to the responsibilities of owners of contaminated land.

These agreements originated as an individualized, contract-based alternative to conventional regulation. However, since the practice of negotiating such agreements on an individual basis proved difficult and problematic, both regulators and the regulated community have since agreed to adopt a more standardized approach.

(iii) *Pollution Prevention Memoranda of Understanding*

In the last few years, Canadian jurisdictions have begun to experiment with the use of memoranda of understanding (MOUs) to promote environmental improvements such as pollution prevention. The Ontario government is pursuing a wide range of MOU initiatives, including informal arrangements with specific companies, provincial-municipal agreements, provincial-industry sector MOUs, and a number of provincial-federal MOUs with high profile sectors, including the Canadian Chemical Producers' Association (CCPA), the Motor Vehicle Manufacturers' Association (MVMA), the Automobile Parts Manufacturers' Association (APMA), and the Ontario Fabricare Association. While some have been developed quickly, the establishment of most of the formal MOUs has required up to two years.

Most of the Ontario MOUs, including all those co-signed by the federal government, follow the same pattern. They explicitly state that participation does not change any existing regulatory

requirements. And while they do not formally create new obligations, presumably the fact of negotiating and signing an agreement imposes some good faith obligations to cooperate to ensure the success of the endeavour. All state that regulatory compliance is a prerequisite to participation, and that they are focused on extra-compliance issues, in most cases related to promoting pollution prevention. Most provide for a government-industry steering committee which establishes a plan for information sharing within the affected sector.

In many cases, either the MOU or the steering committee also develops a candidate list of substances to be addressed, provides a methodology for developing and implementing pollution prevention plans within the sector, creates reporting procedures, and establishes the infrastructure for supporting the initiative. In most cases, the members of the sector can agree to participate individually. If they choose to participate, they undertake studies of their premises, processes and products, draft an inventory of substances used, and propose projects to reduce the use or release of these substances. While all emphasize information sharing, the nature of the public reports and the involvement of third parties in the process varies considerably. Unlike some comparable US initiatives, the MOUs do not commit industry to any changes, nor do they commit government to any relaxation of existing regulation enforcement.

The Saskatchewan government has chosen to focus on bilateral agreements with specific industries. It has one agreement in place, is negotiating two more, and is considering a number of others. Like the Ontario regime, the Saskatchewan MOUs focus on information sharing, and are not intended to be legally binding. Unlike Ontario, however, the plans negotiated pursuant to Saskatchewan agreements address regulatory obligations, and therefore take a more comprehensive approach to a participant's environmental operations.

The British Columbia government has introduced MOUs on a pilot basis as part of an overall reform of its environmental policies which may also include an increased use of performance based standards in order to decrease reliance on site-specific permits. In July, 1995, the government signed a framework MOU with the Canadian Chemical Producers' Association (CCPA) and with four specific companies from other sectors. This agreement commits the signatories to help develop more specific agreements and projects under the oversight of broad-based public advisory and steering committees. In addition to promoting pollution prevention within the participating companies, this project is designed to help the government learn how to promote pollution prevention more effectively.

Although the rationale for entering into MOUs varies by jurisdiction and by agreement, there are some common considerations. Both government representatives and industry participants look to the MOUs as a way to engender a less adversarial, more open relationship between themselves.

All participants see information sharing as one of the main benefits of MOUs. Some government representatives believe that MOUs may represent the most effective way to induce companies to adopt pollution prevention techniques. Indeed, some believe that government can only promote the type of cultural change required to support pollution prevention through a trust based process, such as that engendered by the MOUs. Some industry participants see their participation as at least in part driven by an ethical obligation. Many also perceive the advantage of creating a forum in which it has the opportunity to be proactive, thereby possibly avoiding the need for, or at least helping to shape, future regulatory developments.

Indonesia

In Indonesia, pollution control agreements are part of a program, known as PROKASIH, that is aimed at cleaning up the most heavily polluted rivers. Commencing in 1989, the program targeted major polluting sources along the 24 dirtiest rivers, with a goal of 50% reduction within two years. Program administrators encourage targeted firms to sign letters of commitment to cut pollution loads by specific amounts within an agreed time frame. In the first two-and-a-half years, more than 1000 industries signed such letters of commitment. In the provinces that have achieved the most effective results, the government has insisted on renegotiating the agreements upon their expiry, with more stringent conditions. If the conditions in the original agreement have not been met, provincial governors have issued warnings to the industries concerned. The governments have also encouraged the media to publish results - both positive and negative. Following a 1991 speech to the Jakarta Chamber of Commerce in which then Population and Environment Minister Emil Salim announced which local firms were and were not in compliance with their agreements, dozens of industry representatives visited the Ministry to inquire about their obligations.

This program has achieved fairly significant results, primarily by targeting the largest polluters in the most critically polluted areas. The extent to which it can be replicated with the vastly more numerous, smaller companies, particularly in areas of less public concern, is questionable, however.

(b) A Possible Typology of VEAs

The review above suggests that VEAs can have the following characteristics:

Negotiated compliance/negotiated performance

Agreements can either describe how participants will comply with existing regulatory obligations (negotiated compliance) or address as yet unregulated issues (negotiated performance).

Many jurisdictions have found negotiated compliance agreements useful complements to other policy instruments. Many use agreements to clarify responsibilities for contaminated sites, for example. Australia and, to a lesser extent, Canada use agreements to address in one process all licensing requirements for certain resource development projects. Some countries are also experimenting with regulatory exemption schemes in which companies can negotiate an alternative set of obligations in lieu of their existing regulatory requirements. Negotiated performance - or target setting - agreements are becoming more common, but are also more difficult to assess. They also raise difficult questions about the appropriate process by which environmental policy and objectives should be established.

Retroactive/proactive

Some agreements address past practice. Some, for example, stipulate terms for the resolution of historic contamination problems. Agreements of this nature have long been signed between private parties in many jurisdictions. Some Canadian provinces, such as Nova Scotia, also authorize governments to enter into agreements with new owners of contaminated land to limit potential clean-up liability in return for a promise to undertake certain remedial actions. Many retroactive agreements are thus designed to avoid litigation and the uncertainty of the application of environmental damage concepts in tort and even in criminal law.

By contrast, most of the European and Japanese agreements, and most of the new types of agreements with which Canada and the USA are experimenting, address obligations to prevent, minimize or reduce the environmental impacts of ongoing and future activities.

Binding/non binding

Some environmental agreements impose only general obligations regarding environmental objectives without indicating what specific action must be taken and when, how performance will be measured, or what might occur in the event of non performance. Many of the existing Canadian pollution prevention memoranda of understanding fall into this category, as do some of the agreements negotiated by European countries. Increasingly, however, agreements are designed to impose binding legal obligations related to clearly defined targets.

Statutory/non-statutory

Unless incorporated in some way into legislation or regulation, environmental agreements are basically private law agreements. The parties' rights are therefore circumscribed by the terms of the agreement and the general rules governing contract law. If the agreement is codified in legislation, however, a breach becomes statutory or regulatory non-compliance.

Pre-established goals/negotiable goals

Some agreements are predicated on pre-established objectives. Agreements such as the Dutch Target Group covenants serve as management tools for identifying how the sector will fulfil its obligations towards the pre-established objectives. In many other cases, however, the objective for the agreement is negotiated as part of the agreement. This type of agreements raises difficult questions about who should participate in the negotiation and who should be a party to the agreement. In some cases, agreements articulate specific, measurable goals; others only describe general statements of intention. The latter raise concerns about accountability.

Extent of third party involvement

The role of third parties in environmental agreements varies from non-existent to that of key instigator of, and party to, the final agreement. Many of the European agreements do not include community representatives either in the negotiations or as parties to the final agreement. Many of the recent North American agreements, and an increasing number of European ones, involve government, industry and the public. Finally, some agreements do not involve the government. Typically, these are negotiated as a means to settle a private law claim for past or ongoing damages from pollution. In some cases, however, these agreements may address more public issues. Friends of the Earth Netherlands recently signed an agreement with potato farmers, agreeing to stop their criticism provided that the farmers altered an environmentally-damaging practice.

3. WHAT CRITERIA SHOULD BE USED TO EVALUATE

The rationale for entering into a VEA depends, of course, on the specific context of the agreement. In some cases, governments may provide explicit incentives for participation (e.g. reduced inspections, regulatory exemptions, etc.). In general, industry benefits may include:

- reduced costs as a result of the increased flexibility in terms of how and when to address an issue;
- a new relationship with government, in which they are treated as equals;
- increased regulatory certainty; and
- an improved public image.

Government benefits can include:

- industry assumes ownership of the problem, which can result in a more proactive approach and reduced enforcement costs;
- more and better information about the precise nature of the problem; and
- the opportunity to avoid a protracted regulatory development process.

In some cases, the parties also benefit from the opportunity to identify and discuss more complete aspects of the problem, allowing the agreement to reflect a multi-media perspective and to be based on systematic trade-offs among all possible issues. This is the main benefit of the Dutch Target Group Approach. Similarly, compared to a lawsuit or a regulatory intervention, a negotiated resolution of a community complaint about polluting behaviour can much more effectively address intangible dimensions of the issue such as appropriate investments in risk communication.

Finally, it is conceivable that in some circumstances VEAs could help overcome problems related to divided jurisdiction. Professor Thompson has argued, for example, that resource developers should be encouraged to enter into "infrastructure agreements" involving the local community and all relevant regulators. In a recent example, we advised the federal government concerning the negotiation of a VEA with a mine. The proposal was for the mine to agree to address an issue which was of concern to the federal government, but which was not squarely within its jurisdiction. The quid pro quo for the mine would have been some certainty from the relevant territorial government concerning the type of mine tailings remediation requirements that would be imposed. While the issue has remained on the political back burner, we were encouraged with the generally positive reaction to the proposal from all parties.

Notwithstanding their potential benefits, VEAs must be viewed as only one of a suite of policy instruments for environmental protection. This suite also includes regulation, policies and guidelines, economic instruments, challenge programs, voluntary standards and codes of practice, self-management and education and moral suasion. Depending on the circumstances, these instruments can be complementary or substitutes. The key issue to consider, therefore, is:

In what circumstances would a VEA, either on its own or in combination with another instrument or set of instruments, be superior to its alternatives?

This section describes four considerations to help guide the evaluation of the potential efficacy of a VEA on a case by case basis: 1) environmental effectiveness, 2) impact on corporate culture, 3) cost, and 4) maintaining trust.

(a) Environmental Effectiveness

In what circumstances will VEAs lead to higher standards of environmental protection than regulations? VEAs may be more effective than regulations in addressing certain types of issues. Recent literature suggests, for example, that agreements are particularly effective at addressing "environmental issues for which the solution is not easily found in other market mechanisms, or where public knowledge of an issue is not far advanced, for example in the case of waste streams such as end-of-life cars".

Proponents also argue that VEAs can engender greater innovation than regulations by allowing industry more flexibility and by encouraging business to take greater ownership of environmental problems. Critics, however, argue that innovations resulting from commitments to which industry voluntarily agrees will often be limited to inexpensive and easily achievable improvements.

Some critics also express concern that targets negotiated in agreements will be lower than those resulting from regulation. Although this has undoubtedly occurred, it need not necessarily be the case. As with the Dutch Target Group Covenants and the American Project X-L, the target may not be subject to negotiation — only the means of implementation. And where targets are negotiated, the benefits that are potentially available to industry from an agreement imply that, in some circumstances, government may be able to negotiate a quid pro quo with an industry group involving a higher level of environmental protection than would be available under a regulation.

In some cases, it may be necessary to make a trade-off between the environmental standard embodied in the agreement and the number of participants. Canadian experience suggests that it can be preferable to start with a small number of companies that are committed to and capable of attaining a high environmental standard. This can allow the government to establish the feasibility of ambitious performance objectives to which an increasing number of participants will agree over time. This incremental approach may be necessary to avoid the high transaction costs and potentially diluted standards required to involve a large number of actors from the outset.

It is also important to account for the cumulative environmental impacts of VEAs negotiated at the company or community level. Critics warn about the potential adverse cumulative impacts of multiple local level agreements, where communities might be tempted to agree to localized environmental damage in return for economic benefits. Similarly, it may be very difficult to control the overall impact of multiple company level agreements. These concerns point to the importance of establishing clear overall environmental objectives, maintaining a well-defined and transparent negotiation process and establishing effective accountability mechanisms (see Section 6, below).

The environmental effectiveness of VEAs can also be undermined by free riders (companies that reap the benefit of the agreement without participating in it). Because the potential for free riders also can discourage participation, it represents a major issue both in determining whether an agreement is appropriate and in designing the agreement itself.

There are a number of means by which to minimize free riders. The most obvious is to ensure that all relevant parties are bound by the agreement. The Dutch *Provisional code of conduct for concluding environmental agreements* (1994) identifies four options for binding all parties:

- arrange for all parties to sign the agreement;
- include a provision allowing for accession at a later date;
- arrange for individuals to become a party through an authorized representative acting on their behalf under a legislative power, a power of attorney or the articles of association of the particular organization; or
- negotiate separate agreements.

Denmark's *Environmental Protection Act* offers an alternative approach. Article 10(1) authorizes the Minister of Environment to establish binding pollution prevention objectives. Article 10(2) then authorizes the Minister to enter into agreements "in order to implement" those objectives. Provided the Minister negotiates the agreements with enterprises or associations "which use, emit or dispose of a substantial part of such products, substances or materials," Article 10(4) authorizes the Minister to then "lay down rules" for enterprises not party to the contracts.

Successful sectoral and multi-industry initiatives further suggest that a combination of peer pressure and mutual support can help both minimize free riders and sustain momentum for continued improvements. Participants in the Canadian Motor Vehicle Manufacturers' Association Pollution Prevention Memorandum of Understanding exchange "pre-competitive" information to ensure that all members are aware of relevant techniques for meeting the relevant environmental objectives. This can be particularly helpful for redressing capacity differences among small and large participants.

(b) Impacts on Corporate Culture

Voluntary and negotiated approaches are usually believed to be more effective than regulations in instilling the kinds of cultural changes that can support continuous improvements in performance. VEAs can encourage pro-active behaviour by shifting the initiative to design a

response to environmental issues from government to the companies concerned. Because it can ensure greater "buy in," a VEA can, in theory, also more easily stimulate up and down-stream stewardship activities. Although difficult to measure, these "soft effects" can be very significant in many cases, particularly in increasing compliance and the effectiveness of environmental protection measures over the long term. The precise design or contextual factors that stimulate these types of benefits are ill-understood, however, making estimation of the potential for a given agreement to generate these benefits difficult.

(c) Cost

(i) Cost to Industry

VEAs are almost certainly more cost-effective from the perspective of industry than command and control regulations because they provide the flexibility to respond to stated environmental objectives in the manner that makes most economic sense. It is more difficult to compare VEAs to performance-based regulations, however, since both provide flexibility as to how an objective will be attained.

Agreements may nonetheless impose significant costs on industry. Negotiating with government and the public, implementing the resulting agreement and monitoring and reporting all will be costly. The prospective costs associated with negotiating with public interest groups, for example, has deterred participation in the US EPA's Project XL, and has limited the results achieved to date in its Environmental Leadership Program. The costs associated with agreements can be particularly onerous for smaller companies. Small and medium sized companies may not always be well positioned to take advantage of the benefits of flexibility offered by such approaches.

Increased reliance on agreements will also challenge industry to operate in new ways. Agreements can only work if all parties are capable and willing negotiators. They can only be effective if industry has a sophisticated environmental management capacity to internalize the basic objectives underlying the agreements. Increased reliance on agreements also may require the development of new accountability mechanisms – such as increased public reporting. Establishing these may challenge traditional operating norms, and will probably involve some costs.

(ii) Cost to Government

Whether or not a VEA will cost government less than developing and administering a

regulation to varies on a case by case basis. As with a regulatory process, effective negotiations should be preceded by considerable information development and analysis. A recent analysis of negotiated American initiatives concluded that all of the poorly performing measures had inadequate advance planning by the US EPA. Negotiation processes can also be time consuming. The negotiation of some of the Dutch covenants has taken as long as three years.

Government may also incur significant implementation costs. VEAs require sophisticated accountability mechanisms in order to ensure public trust, minimize free riders, and ensure compliance (see section 6). And where an agreement only covers "leaders," government will have to continue to play — and pay the costs of — a residual oversight role vis-à-vis non-participants.

Similar to industry, the promotion of VEAs will challenge government in a number of ways. It will be important to coordinate these initiatives with the development, implementation and enforcement of new and existing regulatory measures. The actual negotiation and supervision of VEAs may also require new skills that are not currently well represented within the bureaucracy.

(iii) Cost to Third Parties

VEAs may prove more difficult — and costly — than regulations for NGOs and community members to participate in and monitor. Unlike regulations, there is no well established process for their development. There is no mandatory process of notice and comment — or even of publication of the final agreement. NGOs have achieved considerable success in the past two decades in gaining access to the regulatory process in Europe and North America. They now feel threatened by the prospect that significant policy decisions will be made through other, less formal venues. These concerns go to the heart of the trust issue described below, and, again, point to the importance of transparent negotiation processes, and effective reporting and monitoring mechanisms (see section 6).

(d) Trust

The fourth important criterion by which to evaluate VEAs is trust. In order to be acceptable, VEAs must not just be effective; they must demonstrably be so in order to be accepted publicly as a credible alternative or supplement to regulations.

VEAs are attractive to industry in part because they allow companies to get involved in the policy development process at an early stage of policy formulation. This can reduce adversarial friction, and enhance buy in. This same closeness, however, raises concerns about the potential for industry "capture" — where government is overly influenced by the industry it is regulating.

Avoiding capture and ensuring trust requires that, whenever industry makes a claim in a VEA about an environmental outcome, it must be prepared to back it up with credible data before the claim will be accepted as legitimate. A guarantee of an effective public accountability mechanism should therefore be a precondition of any VEA.

Ensuring public trust in a VEA also requires addressing the concerns that critics have expressed in Europe and North America about the possibility that an increased emphasis on negotiated (and other, non-regulatory) approaches will stifle future regulatory policy development and enforcement. The widespread use of natural resource agreements in Australia "has directed pressure away from revision and improvement of the general law governing resource development ...." The process of negotiating agreements also can affect the administration of existing regulatory obligations. Covenant negotiations in Holland have had the effect of delaying the renewal and upgrading of licenses and permits in some cases. By contrast, however, research into the US 33/50 program suggests that, if anything, government enforcement officials have been more attentive to participants because of the high profile of the program.

4. IN WHAT CIRCUMSTANCES SHOULD VEAS BE USED?

Three contextual factors appear to be most important in determining whether a VEA will be effective: industry structure and capacity; policy context; and political culture.

(a) Industry Structure and Capacity

The number of firms active in an industry sector, the degree of competition present, and the degree of concentration are important variables in determining a sector's potential response to a VEA. As a general rule of thumb, the larger the number of firms, the greater the competition and the lower the concentration, the more difficult it will be to negotiate and enforce an agreement because it will be more difficult for the firms involved to reach consensus, and because there will be a greater risk of free riders. Some studies also suggest that implementation of VEAs is more likely to be effective where compliance costs are limited and relatively similar for all participants. In general, companies will be more capable of operating within a non-regulatory context if:

i. they utilize effective environmental management systems;

ii. they have effective leadership; and

iii. there is an effective industry management or representational body.

(i) Environmental Management Systems

In almost every case where governments have articulated criteria for VEAs, they have emphasized the importance of dealing only with firms with demonstrably effective environmental management systems. The prior existence of an effective EMS can demonstrate a company's readiness to assume greater self-management responsibilities.

(ii) Leadership

Sustained senior level leadership among participants is very important to the success of any non-regulatory initiative. As the ISO 14001 guidance document emphasizes, senior management support helps reinforce awareness of the changes required, and can be particularly important when introducing an initiative that cuts across traditional management boundaries. Absent such leadership, non-regulatory regimes may not provide the drive needed to motivate performance by their members over the long term.

(iii) Representational Body

The third key factor with respect to whether an industry is ready to assume responsibilities under a VEA is the presence of, or potential to create and support, a broad-based body capable of negotiating on behalf of industry participants and of helping to ensure compliance with the terms of the agreement.

It will not always be appropriate to use an existing sectoral association. It may be important, for example, to minimize the conflict between participation in, and oversight of, a VEA and the existing advocacy functions that many sectoral associations currently play. In some cases, therefore, it may be appropriate to establish a new body. In order to co-ordinate and monitor sectoral activities under a number of covenants, for example, the Dutch government has required the affected industries to fund and form an independent oversight body.

Relevant factors in considering the effectiveness of an existing or proposed industry organization include:

- representativeness: in terms of number of members and the level of participation of the sector's larger companies;
- track record: history of responsible behaviour, co-operation with government, openness to public, code of ethics, extent of self-management, public image; and
- resources: financial and technical; this is an important consideration where training may be

required.

(b) Supportive Policy Context

A recent review of programs to convince American businesses to reduce pollution voluntarily concluded that most have created only minimal benefits either for environmental protection or for industry participants. The main lesson from the study is the difficulty of creating strong incentives for industry action without a supportive legislative and policy context. Similarly, a recent OECD review of "extended producer responsibility" (EPR) programs concluded that industry-led EPR programs have only been effective when supported by legislation or regulation.

It is also important to ensure that the policy and legislative context supports the agreement, rather than work against it. Environmental decision makers respond to a wide range of influences. To the extent possible, government policy should ensure that each of these acts in a coherent manner that is consistent with the objectives articulated in the agreement.

(c) Political Culture

One of the most important factors determining the feasibility of VEAs is the prevailing political culture. A high level of public environmental awareness and the existence of effective oversight mechanisms such as media, NGOs and regulatory authorities can help create conditions conducive to participation in a VEA. Most importantly, perhaps, the Dutch and other European nations have been able to make significant progress with covenants because of a long tradition of centralized, negotiation-based public policy decision making.

5. POTENTIAL LEGAL ISSUES

The design and use of negotiated agreements raises a host of legal issues - some concerning the legal status of the instrument, and some concerning its relationship with the existing regulatory regime. This section outlines just some of the various issues that may arise on a case by case basis.

(a) Status and Remedies

Unless incorporated in some way into legislation or regulation, environmental agreements are basically private law agreements. The parties' rights are therefore circumscribed by the terms of

the agreement and the general rules governing contract law. This creates a number of limitations, including:

- the limited capacity to sue for strict performance (which is only available as a matter of equity as an alternative to the more usual remedy of damages for non performance);
- the fact that, absent a specific penalty clause, damages could be very hard to demonstrate, due to the long time required for many environmental damages to manifest themselves, the difficulty of disaggregating possible intervening causes, and the prospect that many effects may occur in other jurisdictions; and
- the inability of third parties to sue for breach of such a contract.

By contrast, if the agreement is codified in legislation, a breach becomes statutory or regulatory non-compliance.

(b) Regulatory Exemptions

Various jurisdictions are exploring the possibility of explicitly authorizing government officials to relax regulatory requirements as a reward for promises by regulated parties to exceed the spirit of the law. Some of these initiatives are exploring the possible role of negotiated agreements in such a scheme. The US EPA has made agreements with states including Illinois and Minnesota not to bring action based on the "Superfund" provisions in the *Comprehensive Environmental Response, Compensation, and Liability Act* (CERCLA) against developers that follow states' voluntary clean-up programs. Under Project XL, the US government has exempted some large businesses from a range of regulatory obligations that have developed pollution prevention plans that go beyond the net effect of existing regulatory requirements. In Canada in the few years, both the Alberta and Federal governments proposed legislation designated to provide officials with discretion to issue regulatory exemptions to parties who contract to attain the regulatory objective in a different (presumably more cost-effective) manner of their own devising. Similarly, the Dutch are exploring the possibility of more closely coordinating covenants and the existing licensing regime to leverage increased performance. They are considering offering relaxed enforcement and less detailed license requirements to companies that have implemented credible environmental management plans either as a result of EMAS or as a result of a covenant.

These initiatives have generated considerable debate, focusing on issues such as whether or not they will actually generate significant economic savings, and what would be the net impact on

public interest organization and government costs of negotiating, administering and overseeing a large number of particularized contracts as well as or instead of a single regulation. Critics have observed that there may also be legal limitations on the ability of governments to issue such exemptions.

While any legal entity can enter into a contract, the rights of governments and officials to do so are limited by the authority vested in the relevant enabling legislation creating and empowering the particular government office in question. In particular, most governments operating within the Anglo common law tradition cannot agree, by contract, to waive regulatory requirements unless a statute explicitly authorizes it to do so. To the extent to which any Canadian government desires to premise a regulated agreement on a waiver or relaxation of a regulatory obligation, it will need to ensure that it provides clear legislative authority to do so.

(c) Abuse of Process

Although government officials are precluded, without explicit statutory authority, from promising not to enforce a violation, if a responsible government official does promise to waive a regulatory requirement in exchange for certain action by others (e.g. a promise to abate pollution or remediate a contaminated site), the government may thereafter be precluded from prosecuting the person for failing to comply with the regulatory obligation. The courts consider this an "abuse of process." It will be important to ensure that the promotion, negotiation and implementation of negotiated agreements do not give rise to such a defence.

(d) Impact on the Regulatory Standard of Care

It is conceivable that a negotiated agreement could alter the standard of care to which the signing parties are subject with respect to existing regulatory obligations. Canadian courts have emphasized that due diligence requires a management system, with such elements as regular audits, clear assignment of responsibilities, training, instruction and supervision of employees, information systems and effective lines of communication. One of the leading factors relied on by the courts in defining what constitutes a reasonable management system is the prevailing industry norm.

(e) Impact on Third Party Rights

It seems unlikely that compliance with an agreement, on its own, could serve as a defence to a

claim of nuisance or negligence. Canadian courts have been very reluctant to allow defendants to avoid liability for interference with private rights on the basis that the offending activity was authorized by statute. On the other hand, a negotiated agreement could influence the civil standard of care owed by a participant to a third party. Civil suits of negligence and nuisance are based on tests of reasonable behaviour. If a negotiated agreement ratchets up the statutory standard of care reasonably expected of a chemical manufacturer, for example, it may also indirectly influence the standard of care owed by that business to its neighbours.

(f) Competition Effects

Negotiated agreements could lead to the creation of cartels and other forms of protectionism. In a 1995 seminar on voluntary agreements organized by the Union of Industrial and Employers' Confederations in Europe, the EU Environment Commissioner stated that compatibility with antitrust laws would be an important criterion for EU acceptance of voluntary agreements.

Company-specific agreements also might reduce the consistency and predictability of results, resulting in loss of the level playing field ensured by a uniform regulatory approach, and uncertainty resulting from fragmented and inconsistent decision making.

Competition related concerns also arise because not all companies may have the capacity to take advantage of the theoretical benefits of flexibility afforded by voluntary measures. Small and medium sized enterprises, for example, may prefer the certainty and assurance of a level playing field provided by a uniform regulatory approach.

Two possible solutions to these problems could be explored further:

(i) restricting the use of agreements to those issues for which clear policy objectives have already been developed (the agreements would then focus only on second level, implementation related issues); or

(ii) developing a policy document to guide the process and content of negotiated agreements. In the last few years, in response to considerable criticism on this and other points, the Dutch government developed an overall guidance document with respect to the use of agreements in all sectors and one with respect to environmental agreements in particular. Some governments — including Denmark and the State of Flanders in Belgium - have gone even farther, legislating guidelines for the development and content of agreements.

(g) International Trade Law

It will also be important to ensure that negotiated agreements do not violate international trade laws. In particular, it will be important to ensure that agreements do not violate the "Code of Good Conduct." The Code is an annex to the *Technical Barriers to Trade* (TBT) agreement under the World Trade Organization (WTO), and applies certain rules to the development and use of voluntary measures for domestic policy. It is an unsettled question as to the extent to which these measures could constrain domestic capacity to implement environmental policy through measures such as eco-labeling, voluntary codes of practice or negotiated agreements.

(h) Regulatory Negligence

Governments entering into agreements must also ensure that they do not expose themselves to a claim of regulatory negligence by creating a reasonable expectation that the government will ensure a certain mode of conduct or level of safety or risk reduction.

In a recent series of cases, the Canadian courts have indicated that governments may be liable for damages caused by failure to enforce their regulations. The Canadian case law suggests that where the government has a regulatory scheme, and where that scheme is generally enforced such that the public has a reasonable expectation of a given standard of behaviour, the government may be at least partially liable for any damage caused by failure to meet that standard it had led the public to expect. It is not clear whether the reasoning in these cases would extend to agreements which are supported by government in such a manner as to engender a reasonable public expectation that government will ensure a certain level of environmental quality.

6. What are the Most Important Features of Effective VEAs?

The review of examples and issues in the previous sections highlights the considerable variety of ways in which VEAs can be designed and the corresponding range of possible issues that may arise. Nonetheless, our review of VEAs suggests that there is a core set of features of all effective VEAs. Experience suggests that, at a minimum, VEAs should:

- be developed by means of a transparent process;
- stipulate clear, measurable targets;
- provide incentives for participation; and

- provide for the monitoring of results (by third parties if possible) and the publication of the agreement and of the monitoring results.

In the opinion of some, VEAs should also be legally binding and provide mechanisms to sanction non-compliance.

(a) Transparent Process

The role of the public in the negotiation and oversight of VEAs is a very important and controversial issue. There is widespread belief that agreements and regular reports of their results must be made public (see section (d), below). The extent to which members of the public should be involved in actually negotiating VEAs is a more difficult question, however. While the answer obviously depends in part on the culture of public participation in the jurisdiction developing the agreement, this section provides some general insights from the experience in Europe and North America on this issue.

On the one hand, early public participation is desirable, particularly where there is a danger the initiative will be perceived as an attempt to influence the regulatory process. Critics warn that VEAs can "substantially increase industry opportunity to influence the process by which government controls pollution." Business can be expected to have the most bargaining power, often controlling the information required to make decisions. Few public interest groups have the resources to monitor or participate in a wide range of industry specific negotiations. Government support of such processes might also create incentives for the government participants to conclude agreements: even when an agency retains the authority to impose regulations, failure to reach the preferred option of an agreement could be regarded as a failure of the officials involved (Latin, 1985). On the other hand, American and European experience suggests that the absence of public involvement increases openness and leads to more cooperative working relationships between industry and government.

The appropriate role for third parties may depend on whether or not objectives will be negotiated. The Dutch have resolved this dilemma by inviting public involvement in the setting of objectives which then frame the negotiation of certain high profile "Target Group" covenants. Some environmental NGOs (ENGOs) report that they are content to be excluded from the negotiations of these VEAs, since they are assured that the environmental objectives which they helped define will not be modified and that industry will have to account for its performance. Where VEAs do not reference pre-established objectives, however, ENGOs in Europe and North America have voiced strong concerns about the potential for industry to "capture" the policy

agenda through bilateral negotiations.

(b) Clear Objectives and Targets

Clear, measurable objectives are critically important for motivating and measuring performance and for ensuring public trust. Statements of objectives should include an implementation timetable and intermediate targets. Both objectives and targets should be based on performance rather than technology. A review of selected innovative environmental programs in the United States and Europe notes that "successful programs have objectives that are relatively simple and clear." The European Commission has recently stated that it will only support VEAs that articulate clear, measurable targets.

(c) Incentives for Participation

Incentives, both positive and negative, play an essential role in ensuring participation in VEAs.

Positive incentives can include:

- a *legislative exemption* from regulatory requirements for parties to designated agreements (e.g. the compliance plan model provided in the Ontario *Environmental Protection Act*);
- *recognition* through awards, publicity, sanctioned use of a logo;
- *technical assistance* has been used effectively in US programs to encourage voluntary industry greenhouse gas emission reductions; is a key part of a number of current US Project XL initiatives; and is part of many successful product stewardship initiatives;
- *link to other government programs* providing privileged access to government programs such as R&D, export promotion, regional and infrastructure development can be offered as a carrot to motivate performance, see e.g., Ashford, 1996, op cit. ;
- *financial incentives* such as grants, more rapid depreciation of equipment, tax credits, and reduced fees are less available in the current climate of government deficit reduction but could be used in the future;
- *reduced transaction costs* as a result of less duplicative reporting requirements, and quicker or combined permitting. A Canadian example is REVA - Recognising and Encouraging Voluntary Action - which gives companies greater operational flexibility by combining air,

water and land permitting systems into one approvals process.

In every case, the purpose of these incentives is to create benefits that would accrue exclusively to the companies participating in the agreement.

Negative incentives can include:

- *threat of government intervention* through regulation or an economic instrument (many of the Dutch covenants are explicitly linked to the permits process, with the threat of more intrusive permit requirements for non-compliers; more indirectly, the New Zealand government introduced a voluntary climate change program with an explicit threat that it would introduce a carbon tax if the voluntary measures did not reach desired emission reduction targets by 1997);

- *economic instruments*. Several European countries use taxes, fees and user charges to encourage participation in negotiated agreements;

- *adverse publicity*. Public opinion can be a powerful driver of corporate attitudes, management and performance, although it will be ineffective where a company does not value its reputation (e.g., a small seller of an undifferentiated product);

- consumer pressure. Related to publicity, the effectiveness of consumer response will vary depending on the type of product, the type of market, the extent of public concern and degree of affinity between consumer and industry interest;

- *legal liability*. In some cases, it is conceivable that an effective agreement will create a new norm of behaviour that ultimately defines the legal standard of care owed both by participants and non-participants; and

- *making exit difficult*. A firm leaving an agreement would raise questions about its environmental commitment and invite government and public scrutiny.

Some incentives — primarily related to flexibility — may be inherent to VEAs. In some circumstances, however, those may not be powerful enough to alter behaviour in a way that would achieve public policy goals fully. In these circumstances, government may have to introduce additional incentives to motivate participation.

It is important to ensure that participation in a VEA does not work to the disadvantage of participants. Some companies worry that participation will raise their profile within the regulatory community by demonstrating the potential to "go beyond compliance" — resulting in more

stringent regulations. While the government cannot guarantee that they will not change the rules as long as a VEA is effective, an implicit understanding to that effect can often provide enough comfort for a company or industry to participate.

Incentives may work best in combination as each incentive may exert a different motivating effect on different companies. While the appropriate mix will be a function of the context and the policy objectives, a recent survey of American companies concluded that incentives providing opportunities to avoid or reduce costs are valued most. It is important to note, however, that there is little empirical evidence on the effectiveness of many of these incentives, and that their relative impact inevitably depends largely on contextual factors (such as the business cycle and the salience of environmental issues in public debate) over which participants in a VEA may have little control.

Designing effective incentives is made more difficult by the fact that companies will not all respond the same way. Their corporate history and culture, their leadership (viz., the commitment of the CEO to environmental issues), their ownership (public or private), their position in the industry (dominant or follower), their vulnerability to consumer pressure will all influence their response.

The role of incentives may also change over time. For example, factors that might induce a group of companies to participate in an agreement may not be the same as those essential to the regime's ongoing success or improvement.

(d) Monitoring and Reporting Mechanisms

One of the main reasons for establishing accountability mechanisms is to engender an atmosphere of trust and goodwill among the relevant parties to support the achievement of the VEA's environmental objectives. Accountability mechanisms such as reporting and public involvement are also important because the public needs to know about the agreement's existence and features in order to encourage compliance.

Effective monitoring and public reporting are key stimuli in ensuring that non-regulatory action is effective, and in minimizing free riders. The EU Commissioner for the Environment has stated that effective public reporting will be a pre-requisite for negotiated agreements in Europe.

The European Commission has also stated that it will require monitoring of results, by third parties if possible. Measuring results is important both for internal and external accountability. A review of American and European experience, however, concludes both that evaluation of VEAs is difficult, and that little effort so far has been devoted to evaluation by participants (EEA, 1997).

(e) Legally Binding Enforcement Mechanisms

Although many of the agreements that have been signed in North America are not intended to be legally binding, an increasing number of commentators argue that effectiveness requires that VEAs create legally enforceable commitments. If VEAs are negotiated as private contracts, absent a special arrangement, government's enforcement rights will be limited to the right to sue for specific performance or for damages. This is a very restricted power. The Danish *Environmental Protection Act* represents an interesting alternative. Section 11 authorizes government to establish by regulation the details of a penalty and arbitration scheme to be applied to VEAs negotiated under the Act.

Regardless of whether a VEA contains a legally binding obligation, its effectiveness — more so than is the case with a regulation — will depend on the capacity of the public to protect environmental quality. The general principle of Anglo contract law, however, is that third parties cannot enforce a right or benefit under an agreement to which they are not a party. When developing VEAs, it may therefore be appropriate to account for the following common law and statutory remedies available to third parties:

- nuisance - which is of only limited use with respect to environmental issues;
- prevailing laws with respect to joint and several liability;
- statutory rights of action; and
- the public trust doctrine (which has been much more developed in the US than elsewhere).

Government officials should consider whether an increased reliance on negotiated measures might also warrant new legislative measures to ease the restrictions on the ability of the public to take legal action to ensure environmental quality.

7. CONCLUSION

Many jurisdictions are using a variety of agreements for environmental purposes. In general, these initiatives should be seen as part of the trend to experiment with partnership-based, flexible, pro-active and integrative approaches to environmental protection which are alternatives to more traditional command and control, regulation-based measures.

The increased interest in VEAs in Canada and elsewhere suggests that this instrument is worth exploring. It will be critically important to ensure, however, that VEAs are used only when they will be the most appropriate instrument, either alone or in combination with others. This paper has identified a number of legal and policy issues that should be addressed on a case-by-case basis to help with that evaluation.

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