

Environmental Litigation Risks – D&O Liability Insurance

“Environment: *Inter relationship which exists among and between water, air and land, and human beings, other living creatures, plants, micro organisms and property”*

- The Environment (Protection) Act, 1986

The Hon'ble Supreme Court of India, in a recent judgment held that *“If a Government Department fails to comply with the order of the NGT, by a legal fiction under sub-section (1) of Section 28, the Head of the Department shall be deemed to be guilty of such failure and shall be liable to be proceeded against.”*

This is due to the vicarious liability provision which is found in almost all statutes. Link to the judgment is given below:

https://api.sci.gov.in/supremecourt/2023/53610/53610_2023_6_120_55513_Order_1_1-Sep-2024.pdf

What is vicarious liability? Vicarious liability is a liability that is fastened on one party because of the actions of another party. The relationship could be employer – employee, or partnership – partner, or agent – principal etc. Vicarious liability can occur under both civil and criminal laws. Vicarious liability provisions are found in almost all statutes. Vicarious liability provisions in the National Green Tribunal Act, 2010 are given hereunder:

Section 27. Offences by companies. —(1) Where any offence under this Act has been committed by a company, every person who, at the time the offence was committed, was directly in charge of, and was responsible to the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

(2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by the company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation.—For the purposes of this section,—

(a) "company" means any body corporate and includes a firm or other association of individuals; and

(b) "director" in relation to a firm means a partner in the firm.

Section 28: Offences by Government Department. —(1) Where any Department of the Government fails to comply with any order or award or decision of the Tribunal under this Act, the Head of the Department shall be deemed to be guilty of such failure and shall be liable to be proceeded against for having committed an offence under this Act and punished accordingly:

Provided that nothing contained in this section shall render such Head of the Department liable to any punishment if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

(2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a Department of the Government and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any officer, other than the Head of the Department, such officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Addressing Environmental, Social, and Governance (ESG) risks:

ESG issues are becoming a major source of emerging liabilities for corporate boards. At present climate damage / climate change risks dominate the ESG risk landscape. Directors / officers responsible could be exposed to liability if they fail to grasp the seriousness of the issue and act diligently. The World Economic Forum's Global Risks Report highlights climate risks as a major concern for 2024 and beyond.

Pertinent to the discussion on ESG, "Confederation of Indian Industry (CII) and PricewaterhouseCoopers (PwC) have collaborated to develop an "*ESG guidebook and ready reckoner for boards of directors*" under the aegis of the CII Corporate Governance Council. This guidebook provides a practical, step-by-step reference to ESG and sustainability strategies based on leading global practices and frameworks." Ensuring compliance with all the relevant laws is the baseline. Needless to add – companies must go beyond checkbox exercise. Otherwise, they may face liabilities.

How does the liability arise?

1. Inadequate oversight of environment related exposures including supply chain risks.
2. Failure to comply with various legislative provisions
3. Negligence in regulatory disclosures

4. Active or passive role in green washing
5. Failure to take remedial measures

What are the likely consequences?

1. Regulatory enquiries / investigations / fines and penalties
2. Reputation damage
3. Shareholder actions
4. Legal action from other stakeholders
5. Personal liability for directors
6. Compensation clawback. This is does not appear to be a serious concern at the moment. But caution is warranted due to the signals emanating from various sources.

For example, Reserve Bank of India (RBI) has issued, vide notification RBI/2023-24/DOR.SFG.REC./30.01.021/2023-24, "Draft Disclosure framework on Climate-related Financial Risks, 2024" on February 28, 2024. This is applicable for all Regulated Entities (REs) This notification lists base line disclosures as also enhanced disclosures. Details of disclosure, besides substantial issues, include:

"Disclose whether and how climate-related considerations are factored into remuneration of Whole Time Directors/ Chief Executive Officers/ Material Risk Takers. Also disclose the percentage of remuneration recognised in the current financial year that is linked to climate-related considerations."

What are the directors expected to do?

1. Stay up to date on all the environmental legislations / regulations
2. Continuous engagement with stakeholders on key issues.
3. Ensure compliance with all applicable regulations in letter and spirit
4. Full and truthful disclosures
5. Track and address environmental performance issues and where necessary initiate corrective actions promptly
6. Develop a robust litigation monitoring framework for effective litigation management

What are the key Indian laws/provisions governing environmental risks?

1. The Companies Act, 2013
2. Regulations framed by Securities and Exchange Board of India (SEBI)
3. The National Green Tribunal Act, 2010
4. The Environment (Protection) Act, 1986
5. Guidelines issued by sectoral regulators like IRDAI and RBI
6. Guidelines on extended producer responsibility (EPR) issued by the Ministry of Environment, Forest, and Climate Change
7. Guidelines for 'Prevention and Regulation of Greenwashing and Misleading Environmental Claims issued by Central Consumer Protection Authority

The primary purpose of all these enactments is sustainable development. In 1987, the United Nations Brundtland Commission defined sustainability as "*meeting the needs*

of the present without compromising the ability of future generations to meet their own needs.”

By understanding these exposures and taking proactive steps, directors can mitigate environmental risks and ensure sustainable business practices. Since climate risk has become a major concern for corporate boards, besides taking all proactive steps and remedial measures, it becomes imperative to have proper D&O insurance protection. This D&O policy is equally important for government companies also, as directors and Officers who run public sector organizations broadly run the same risks as their counter parts in the private sector. The concept of sovereign immunity is not applicable for all transactions and it is primarily applicable and relevant only with reference to sovereign functions.

Now, shifting focus to the coverage under D&O liability insurance policy, the following questions also merit attention.

1. Has the limit of indemnity sought factored ESG exposures of the company?
2. Is the coverage for investigation costs clear and the limit adequate? Policy needs to provide for the legal and public relations expenses.
3. Is there any absolute exclusion which may negate the primary purpose of the cover and may result in unintended consequences. Ideally, direct causation only should attract the exclusion. Where possible, carveback of coverage needs to be obtained.
4. Final adjudication Clause: Final adjudication clause needs to be clearly defined. This exclusion should get triggered only upon a “final non appealable adjudication,” or a “judgment after the exhaustion of all appeals,” and not merely based on a judgment by any court or order in any proceedings.
5. Severability / Non imputation clause: Generally, it’s a given. But, as a matter of abundant caution, it is necessary to have certainty. Rights of one insured person cannot be prejudiced because of wrong of another insured person.
6. Is there coverage for fines and penalties and what are the associated conditions?

The first line of defence when faced with litigation is Business Judgement Rule which presumes informed decision making with the best interests of the company in mind. A fit for purpose D&O policy facilitates clear articulation of defense strategies and provides vital protection for directors as per its terms and conditions. That said, environmental risks require protection from various insurance policies. D&O policy should be considered in conjunction with other policies such as Commercial General Liability (CGL) and Pollution Legal Liability (PLL) policies, to ensure comprehensive protection.

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References / Suggested further reading

1. PWC- CII: ESG guidebook and ready reckoner for board of directors
<https://www.pwc.in/assets/pdfs/esg-guidebook-and-ready-reckoner-for-board-of-directors.pdf>
2. <https://www.livelaw.in/top-stories/head-of-department-guilty-if-government-dept-fails-to-comply-with-ngt-order-supreme-court-269929>
3. <https://www.weforum.org/agenda/2024/09/top-5-climate-change-related-liability-issues>
4. PSU Directors: Sovereign Immunity- A myth or reality?
<https://www.liabilityinsurancepractice.com/2012/07/03/icsi-corporate-secretary-psu-directors-sovereign-immunity-a-myth-or-reality>
5. RBI: Draft Disclosure framework on Climate-related Financial Risks, 2024".
Notification no., RBI/2023-24/DOR.SFG.REC./30.01.021/2023-24)
6. World Economic Forum – The Global Risks Report 2024
https://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2024.pdf