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ECONOMICS AS AN INPUT IN ENVIRONMENTAL LAW: ANDERSON V. ATLAS CHEMICAL INDUSTRIES, INC.*

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For several years economists have advocated legal institutional arrangements which tend to internalize externalities (e.g., Mishan; Kneese and Bower). The capacity of existing citizen-initiated legal remedies to accomplish same has been analyzed (Levi and Colyer). The purpose of this paper is to report the input of economic theory in a recent leading pollution lawsuit and to outline the economic implications of the legal rules involved in selected legal remedies.

ANDERSON V. ATLAS CHEMICAL INDUSTRIES, INC.

A recent Texas case illustrates that in at least one instance economics was given considerable attention in the disposition of a pollution-based lawsuit. Anderson v. Atlas Chemical Industries, Inc., involved a business whose manufacturing processes used acids and large quantities of water to convert lignite into activated carbon. Waste water from this plant was discharged into a small creek which ran through a 60 acre tract of pasture owned by plaintiff. The waste water is an inky, black color, leaving a black deposit as it settles out.

The jury found that it would cost $45,000 to restore this tract to its original condition, and that the fair market value had been decreased $10,500 ($175/acre) by the presence of the deposit and the stream pollution. Thus, as is the usual case, the court granted the lesser of the two ($10,500) as actual damages, and $25,000 in punitive or exemplary damages.[1]

The case is particularly interesting for economists because 1) it constitutes a clear departure from a "growth at any cost" philosophy which some argue has existed, and 2) the language used in the opinion suggests that economics was a significant issue in this legal decision. To Quote:

> We further believe the public policy of this State to be that however laudable an industry may be, its owners or managers are still subject to the rule that its industry or its property cannot be so used as to inflict injury to the property of his neighbors. To allow industry to inflict injury to the property of its neighbors without just compensation amounts to inverse condemnation (emphasis added) which is not permitted under our law. We know of no acceptable rule of jurisprudence which permits those engaged in important and desirable enterprises to injure with impunity those who are engaged in enterprises of lesser economic significance. The cost of injuries resulting from pollution must be *internalized by industry as a cost of production and borne by consumers or shareholders, or both* (emphasis added), and not by the injured individual.
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> During the industrial revolution in this country, the law shifted to accommodate economic growth and those who invested therein and was changed to the detriment of isolated individuals who have collectively come to bear the cost of such growth. In recent years, however, the U.S. Congress and the State Legislatures have recognized that we literally cannot live with the pollution caused by industrial waste and have passed various statutes, rules and regulations controlling the disposal and emission of pollutants . . . . The *social utility* (emphasis added) of allowing uncontrolled pollution without compensation for the injury caused thereby is no longer tolerable. Neither the benefit of pollution causing activity to the community nor the comparative investments of plaintiff and defendant will be factors considered in determining whether there is compensable injury. Citizens who are injured should be allowed to maintain an action for an interference which is unreasonable and offensive to persons of ordinary sensibilities. During this century, the course of the law has been to incorporate economic growth and the protection of important business activities into the law as a value which quickly became the paramount value in the resolution of conflicting interests in pollution litigation. "But in this age of environmental concern it is clear that this value warrants no greater emphasis than others. Thus, it is time for

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[1] Punitive or exemplary damages are defined in the next section.

the reassessment of the law to the end of redressing its imbalance, a time for reflection on where responses to legitimate needs in another time carried the law" (Atlas Chemical Industries, Inc., v. Anderson, p. 316).

The language in this judicial opinion recognizes economic rationale which economists have been espousing for some time. However, even with the granting of punitive damages, the internalization of externalities is still an imprecise legal science. Thus, we now turn to an explanation of relevant legal rules and their economic consequences.

THE LEGAL THEORY OF RECOVERY

The legal theory of recovery in the Anderson case was that of strict liability for the intentional discharge of pollutants. Other legal theories for recovery which logically could have been advanced include that of nuisance (i.e., that such discharge unreasonably interfered with others' enjoyment of their property) or possibly negligence (acting differently than the mythical ordinary reasonable and prudent man would have acted under the same or similar circumstances). Presumably counsel elected the intentional discharge theory because of relative ease of proof; i.e., under strict liability less proof is required because one need show only an intentional discharge rather than proving, for example, an unreasonable interference with enjoyment of property (using a mythical person of ordinary sensibilities) under the nuisance theory of recovery.

Under the English common law, those responsible for the "escape of dangerous substances" from their land were strictly liable for damages caused thereby, irrespective of whether such "escape" was intentional or unintentional. Many U.S. courts (e.g., Texas) do not go this far, but rather hold the polluter liable only where an intentional discharge is involved. (Others may reach similar results by making distinctions between public and private nuisances, negligent nuisances, nuisances with negligence, etc.).

In intentional discharge cases, polluters are held strictly liable where they intend to discharge the pollutant. However, it is not necessary to show intention to injure a particular plaintiff. In such cases a plaintiff may seek actual and/or punitive damages.

Actual Damages

Where a lawsuit seeks actual damages, the plaintiff is asking to be placed in the same financial position he would have occupied in the absence of the externalities forced on him. Here the jury is asked to quantify the sum of out of pocket expenses, lost profits, decreased land values, aesthetic factors, etc. If transaction costs (primarily attorneys fees and court costs) are ignored, then, theoretically, actual damages are an adequate tool for internalizing the externalities. But it should be recognized that the "pollute now–sue later" legal philosophy does give the polluter an advantage in a bribery (market) solution to externality problems when transactions costs are included in the analysis because 1) transactions costs faced by the polluter may be lower and fixed in nature, and 2) transactions costs may outweigh projected damage recovery for those affected a relatively small amount.

Punitive Damages

The basic idea of "punitive" or "exemplary" damages is that they will deter this and other polluters from similar future conduct. Legally, they are granted when the polluter is guilty of "malicious" conduct (often defined as "the intentional doing of a wrongful act"). They bear no relation to the magnitude of the externalities, and are not necessarily paid to those suffering the greatest injury (i.e., they are paid to the plaintiff). They may, in part or in full, pay transaction costs, but they bear no defined relationship to internalizing externalities. Therefore, the granting of $25,000 punitive damages in the Anderson case[2] is not necessarily consistent with the basic concept of internalization of externalities. Clearly they constitute a windfall gain to the plaintiff-recipient in so far as they exceed his transactions cost.[3]

INJUNCTIVE ACTIONS

Certainly most economists will be encouraged by the externality internalization approach of the Anderson case rather than the all-or-nothing injunctive action approach that is often used. An injunction against a polluter may be sought in many instances, perhaps employing the legal theory of nuisance. Where an injunction is sought the "scale of justice" is the legal concept governing the outcome. That is, the court simply weighs the interests of the parties, and the facts of each case determine whether a given externality generating business should be closed down–no economic calculus is forced on either the polluter or the affected parties that would tend toward an optimal level (balancing) of pollution and economic activity.[4]

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[2] The Texas Supreme Court recently reversed the lower court decision but only on the issue of punitive damages.

[3] A more equitable disposition might be to divide punitive damages among all affected parties, thereby (at least partially) reimbursing those who face prohibitive transactions costs under current institutional recovery rules.

[4] This statement needs some qualification. Presumably the "scale of justice" weighs (among other things) the relative benefits and costs (including community impacts) of continuing versus closing down the operation.

A nuisance may be classified as either private, if it unreasonably interferes with the rights of a few, or public, if the rights of many are unreasonably imposed on. This classification is important in injunctive actions, since it is more likely that a business will be closed down where public rights are weighed on the scale of justice as being subject to "unreasonable interference."

In a growth-conscious economy, injunctions are seldom granted against polluters–particularly where a private nuisance is involved and the polluter provides employment for a substantial number of local citizens. External costs of pollution have seldom been considered to be sufficiently grave to outweigh the community economic benefits, although the polluter has been required to modify his operation in some cases. The Anderson case is refreshing in that it did not follow either the extreme of an injunction or of the traditional "growth at any cost" oriented legal philosophy.

WHO SHOULD BEAR THE COSTS?

An important area of economic logic explicitly embedded in the language of the Anderson case involved the issue of economic equity. Again, the court stated specifically that, "the cost of injuries resulting from pollution must be internalized by industry *and borne by consumers or shareholders, or both, and not by the injured individual"* (emphasis added). In effect the court was following the philosophy of a full liability rule,[5] which Randall argues is superior both in terms of allocative efficiency and equity to a zero or intermediate liability rule.

Randall has shown Coase's doctrine of the allocative neutrality of liability rules to be false except in those rare (perhaps even nonexistent) cases where all involved parties are producers, the price of capital is zero, and transactions costs are zero. Furthermore, following a full liability philosophy has important redistributive or equity implications–implications that, in effect, amounts to reversal of the "growth at any cost" judicial philosophy and a transfer of property rights from polluters to affected parties.

[5] A full liability rule holds the perpetrator of an external diseconomy liable for damages imposed on affected parties, thus giving the perpetrator incentive to offer compensation. This is contrasted to a zero liability rule which permits pollution with impunity, thereby leaving the incentive fully on the affected party to bribe the perpetrator (Randall).

The language of the decision on this point reaffirmed the judge's earlier statement regarding inverse condemnation. Where external diseconomies drive land values to zero, the usual result of granting actual damages while denying an injunctive request amounts to "inverse condemnation". Inverse comdemnation differs from the usual condemnation proceeding in that here the proceedings is initiated by the affected party. Arguably, what amounts to inverse condemnation should be permitted in the pollution area only when it is in the public interest (to make it parallel with the general power of condemnation).

CONCLUSIONS

While the Anderson case is a step in the right direction, it does not help solve the problems arising when transactions costs are considered. If actual damages are granted to all affected parties the result is full internalization of externalities, but the affected parties receive less than full compensation because they must pay transactions costs. What is needed is a new institutional approach which minimizes the transactions costs of damage recovery. Further research is warranted in developing such institutional arrangements which will meet the further test of political feasibility.

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