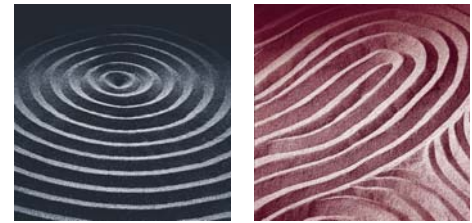


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Managing Environmental Risks in Real Estate Transactions

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MANAGING ENVIRONMENTAL RISKS IN REAL ESTATE TRANSACTIONS

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Introduction

When it comes to environmental liability, real estate transactions require careful management to ensure that the right property is transferred under the right circumstances. While most environmental liabilities cause an early visceral reaction, environmental risk management measures can facilitate rejuvenation and economic success. This paper will address some current environmental risk management measures and provide some insight into common considerations in environmental transactions. The start of any such discussion is an understanding of the appropriate regulatory structure, the potential liabilities involved, and the appropriate environmental due diligence to be undertaken. These form the basis of the culminating examination of particulars of environmental provisions in agreements of purchase and sale. As not all environmental risks can be allocated through agreements of purchase and sale, insurance will be discussed as an alternative risk management measure.

1. Environmental Liability Primer

In broad terms, potential environmental liabilities attach to owners, occupiers, and people who have managed or have had control over a contaminated property, or those who caused or contributed to a discharge or spill into the environment. Liability attaches to an owner or occupier as soon as an individual acquires such status, and therefore it can be like regulatory quicksand to acquire ownership or occupancy first, and find out later that a contamination issue exists. Depending upon the severity of the contamination, regulatory liability, civil liability, or both, may follow.

1.1. The Regulatory Structure

Regulatory liability in Ontario is governed largely (but not exclusively) by the *Environmental Protection Act*, R.S.O. 1990, c. E. 19 (the “EPA”) and the *Ontario Water Resources Act*, R.S.O. 1990, c. O.40 (“OWRA”). While this paper is not intended to review either Act in detail, suffice

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it to say that there are broad powers under the EPA², facilitating anything from an order to monitor or study, to full remediation, and such orders can be made against a person who owns or owned or who has or had management or control of an operation or property. The penultimate order for the purposes of our discussion is an order to pay the Ministry of the Environment's (MOE) costs in carrying out a remediation that was the subject of an original order to remediate. These can be collected as a judgment or municipal taxes. The impacts upon a real estate transaction begin to take form.

The EPA's order provisions do not require that the person or company that is the subject of the order be responsible for the original source of the contamination. Liability can lie with current owners of historically contaminated land, even where such owner did not know about the contamination at the time of the purchase of the property. In fact, it is common for vendors to discover they have environmental contamination only after a prospective purchaser engages a consultant to conduct on-site environmental investigations and discovers the condition of the property is "challenged". While mere discovery may not involve the Ministry, the risk has been born. Its metamorphosis depends upon the nature and extent of contamination and the nature of the neighbourhood in which the property is located. The risk may simply be that of an MOE order, or, where there is an active discharge of contamination causing or likely to cause an adverse effect, regulatory liability can take the form of a prosecution for an offence under the EPA (as opposed to an administrative order). Breaches for discharges or permitting discharges can lead to charges, penalties, fines, and even imprisonment in certain circumstances.

1.2. Civil Liability

Civil liability is a separate consideration from regulatory liability. Environmental claims may be based upon traditional common law causes of action: negligence, nuisance, trespass, strict liability, breach of contract, etc. Such claims can take the form of historical site contamination, off-site migration, on-site claims by future owners of the same land, indemnity actions under existing contracts that may restrict liability, improper operations under tenancies, failure to effect repairs at the end of the lease term, or insurance coverage denial claims - just to name a few. Consider, for instance, a current vendor who knowingly originally purchased contaminated land

² see sections 7, 8, 17, 18, 99.1, 124, 157, 157.1

at a discount, and provided the original vendor with a release. Would a new purchaser have any rights against the original vendor if the contamination migrated off-site?

Remedial costs on neighbouring land can be a significant consideration in the viability of a transaction. Without proper investigation of the source of contamination, damages under such a civil claim can include remediation costs, barrier walls, losses in property value, and opportunity losses, among others.

The only certainty in civil claims associated with contaminated land is that multiple parties will be named in a lawsuit. Civil liability in Ontario is, in some respects, in a state of uncertainty in terms of potential liabilities for innocent owners, largely, in my view, due to increasing litigation costs and a corresponding increasing frequency of settlements. The decision of the Ontario Court of Appeal in *Tridan Developments Limited v. Shell Canada Products Ltd.*³ is perhaps the most highly cited recent case involving assessing damages in cases involving land contaminated by the activities of a neighbour, in this case a spill. It leaves open the issue of the appropriate measure of damages in environmental contamination cases. While the Court upheld the decision that remediation to pre-spill “pristine” levels was appropriate, it did so with extreme qualifications on the facts and evidence before it. It left open the door to future claims based upon stigma damages and it left open the door of the reasonableness of imposing government standards of remediation in civil disputes.

2. The W's of Environmental Due Diligence In Real Estate Transactions

What then is a vendor or purchaser to do in investigating land and protecting itself in real estate transactions where the potential for civil or regulatory liability exists - effectively in all cases where contamination is found on the real property in question?

Environmental due diligence generally involves the selection and retainer of an environmental consultant, historical research, on-site interviews and/or investigations, with the result being an overall understanding of the potential for soil and/or groundwater contamination, and where applicable, identification of designated substances in interior building conditions that may require environmental management (asbestos, PCBs, lead, mould, etc.). The level of

³ [2002] O.J. No. 1 (CA).

environmental investigation and due diligence can vary depending upon the nature of the transaction, the property, requirements of financiers, and the degree of risk the parties may be willing to assume. It involves both legal and consulting expertise.

2.1. When – know thine enemy

Make the appropriate inquiries before the transaction take complete shape. The purpose of the inquiry is to use the information to decide whether or not the transaction makes fiscal sense. It may be difficult to convince a vendor to allow for access or investigations early on in the process before the general nature of the deal takes shape, but if they are resistant to allowing full due diligence to be undertaken prior to the transaction, they might have something to hide. Vendors who play hardball may find that the issues do not simply go away by virtue of selling the property “as is”.

The earlier environmental investigations take place, the earlier decisions and negotiations can be focused on the real issues. This involves both legal expertise in planning for contingencies, facilitating retainers of environmental consultants with appropriate qualifications, determining whether the MOE could or should be involved, and environmental consulting expertise in deciphering the information collected, and planning for redevelopment.

2.2. Where – know your boundaries, building and bases

The property in issue is of key interest. However, “soft” searches (government databases) on both the property at issue and on neighbouring sites should be conducted. While on-site operations from the property of interest may have little to do with environmental concerns, neighbouring sites may well have contamination or the potential for contamination to have migrated onto the site of interest. Adjacent sites that now look like pristine woodlots could have once housed a gas station or a garbage dump. Similarly, the client’s property could also have been the source of contamination, which then migrated into the soil and groundwater of the neighbour’s property.

Existing / historical environmental reports relating to a property may only tell part of a story. Beware of reports focusing only on soil, with no mention of groundwater. Also consider whether on-site buildings have been investigated for designated substances. If renovation or retrofitting of a building is planned (and it usually is), latent asbestos may become a costly

balance sheet addition. The point of the due diligence exercise is not to assign liabilities, but to quantify risk for appropriate transactional consideration. Defining the scope of the search in terms of physical boundaries is one key component.

2.3. With Whom and How – retain the right consultant, request the right information

Retaining the right consultant involves consideration of the nature of potential site concerns. While some consultants are experts in petroleum hydrocarbon contamination, some are experts in volatile organics (TCE, PCE), and others are experts in remediation techniques. It is important to consider the purposes for which the consultant is retained – purchase, sale, lease, financing, on-going due diligence? Consider what services are required – Phase I, Phase II, risk assessment, designated substances survey, compliance audit, transactional due diligence?

Consider whether the consultant has the qualifications necessary for the assignment, including specialized expertise where necessary, appropriate accreditation (e.g. professional engineer or professional geoscientist licensed to practice in the jurisdiction), relevant experience, quality control measures in place, a good working relationship with regulators, and appropriate insurance coverage. It may also be important to consider whether the retainer agreement should be with the client or the client's lawyer. In the latter case, the work product may be protected from disclosure by solicitor-client privilege, which may be advisable if the client has a need for such protection. Where the consultant is to be retained as part of the transaction, consideration should be given to approval of the person or team based upon the above noted aspects.

Details of the retainer with the consultant should also be determined – the particular scope of services, costs, confidentiality, limitations of liability, conflict of interest scenarios, reliance issues should be negotiated in advance. Reference to particular standards (CSA Z 768-01 and 769-00) are specifically required for purposes of compliance with the Record of Site Condition regulation (discussed later) and should be referenced in retainer agreements in Ontario. It is also common for consultants to limit liability to the value of the services provided. Consider the impact of such a limitation in cases where only a Phase I was conducted, but where contamination is later found.

In certain circumstances, transacting parties may make arrangements that only one is to retain the consultant. The non-contracting party should obtain reliance from the consultant on its findings,

opinions and conclusions. The failure to obtain reliance on an environmental consultant's report can be fatal in subsequent litigation. Such was the case in *Wolverine Tube (Canada) Inc. v. Noranda Metal Industries Limited*, [1995] CanLii 785 (Ont. C.A.), where the purchaser sued the environmental consultant when it discovered damage resulting from extensive environmental contamination of the properties purchased. Its claim against the consultant was based on the fact that the three reports prepared on the properties failed to disclose the extent of the areas of contamination and did not identify violations of environmental laws.

The consultant's reports each contained a disclaimer stating that any use made of the report by a third party, or any reliance on or decisions to be made based on it, were the responsibility of the third parties. The disclaimer went on to excuse the consultant from any responsibility for damages suffered by any third party as a result of decisions made or actions based on the reports. The Court of Appeal held that the language of the disclaimer was broad enough to preclude the assumption of a duty of care by the consultant in favour of the purchaser, when combined with the fact that the consultant had explicitly prepared the reports for its client (the vendor) and was unaware that the reports had been forwarded, or even of the sale of the properties, until the action was commenced (over five years after the reports had been delivered to its client).

2.4. What – Broad Spectrum of Investigative Tools

It is essential to conduct a complete due diligence search on the property of interest (and surrounding land) as early as possible in the transaction, in order to assess risk before moving too far into negotiations. Often times, contamination may be known to exist but with limited information provided, a purchaser may be pressured to sign a letter of intent that may have liability implications. The searches listed below may be typical in contaminated land transactions. They can include in-depth examinations by the purchaser of whether the operations carried out on the site in question meet its internal environmental protocols, and consequently, can involve numerous materials such as corporate organization information, financial statements, past and pending litigation, material agreements and contracts, employments records, insurance policies, operating procedures and policies and licenses:

- Consider whether there are environmental management systems (including all procedures and policy manuals and all other procedures, policies and plans with respect to environmental matters) relating to on-site operations;

- existing environmental reports, audits, assessments and results of monitoring and testing should be requested and reviewed;
- Review environmental permits with respect to the on-site operations of the real property;
- Contact appropriate environmental regulatory authorities to determine whether:
 - any notices, directions or orders, licenses, approvals (including remediation, stop and control orders) have been issued against the real property owner;
 - any environmental concerns, complaints, inspections or abatement records exist;
 - there are reported spills or discharges;
- Consider requesting copies of insurance policies covering liability in connection with environmental matters;
- Consider conducting a designated substances survey to determine if there are asbestos issues, PCBs, underground storage tanks, etc.,
- Review all information regarding environmental liabilities that have been or may be retained by owners of the real property (i.e., by agreement);
- Consider existing or potential civil litigation with respect to environmental matters;
- Conduct environmental records searches:
 - EcoLog ERIS
 - MOE Environmental Site Registry (Records of Site Condition)
 - Environmental Bill of Rights Registry
 - National Pollutant Release Information

- MOE Hazardous Waste Information System
 - MOE Inventories of Waste Disposal Sites (1991), Coal Gasification Plant Waste Sites (1989), and Coal Tar Sites (1998)
 - MOE PCB Inventories
 - MOE Index Record of Orders and Approvals
 - MOE Freedom of Information and Protection of Privacy Act Search
 - Ministry of Labour Freedom of Information and Protection of Privacy Act Search
 - Technical Standards and Safety Authority Fuels Safety Branch
 - Local and/or Regional Municipality
 - Ministry of Natural Resources
 - Regional Conservation Authority
 - Local Health Unit
 - Environment Canada
 - Department of Fisheries and Oceans
- Consult with potential planners where development is proposed to determine what could trigger the filing of a Record of Site Condition;
 - Conduct Phase I environmental site assessments and/or compliance audits as appropriate (which may incorporate some of the above searches);
 - Conduct Phase II environmental site assessments as appropriate.

A Phase I ESA is largely a “desktop” or paper review to identify risks associated with a property, using CSA Standard Z768-01 or ASTM E1527 as frameworks for environmental assessment of the property. The standards allow a “qualified person”⁴ to exercise their professional judgment to determine what steps are necessary and appropriate in order to adequately complete the ESA. A Phase I ESA carried out according to the CSA Standard is mandatory in order to file a Record of Site Condition, and involves four components: records review, land title history, regulatory searches, and preliminary site inspection. Note that a Phase I ESA, by its nature, does not involve intrusive sampling and will therefore give no concrete information on any subsurface or groundwater contamination. Where preliminary concerns are identified in a Phase I recommending on-site testing, a Phase II ESA is necessary.

As part of the Phase I ESA, a land title history is undertaken to determine past historical activities on the land that may have caused contamination, for example industrial or commercial operations, as well as agricultural uses. This should involve, among others, searches of the land title registry as far back as possible to ascertain what uses were made of the property itself and the neighbouring lands. Obtaining a history of the property’s ownership could have avoided problems in *66295 Manitoba Ltd. v. Imperial Oil Ltd.*⁵ In that case, the numbered company purchased commercial land in 1984. Unbeknownst to the purchaser, Imperial Oil had owned the land between 1951 and 1977 and operated a gas station on the property. In 1999, petroleum chemicals were discovered in the soil. The chemical impact apparently presented no health risk, but when the numbered company attempted to sell the property it found that the impacted soil created a stigma. The court dismissed the numbered company’s claim against Imperial Oil, and suggested that the numbered company could have avoided the situation had it done its appropriate due diligence in the first place.

Regulatory searches are essential to determine whether there are any outstanding orders against the property, or whether records of contamination already exist within the government. The responses from regulatory agencies can take months to be received, meaning that searches must

⁴ a defined term under section 5 of the Records of Site Condition Regulation, O. Reg. 153/04 made under the EPA.

⁵ [2002] M.J. No. 12451 (QB)

be requested as early as possible. Not all of the searches suggested above are included in a Phase I and it is important to inquire which are being carried out by the consultant.

In addition to these searches, a Phase I ESA involves a preliminary site investigation, including walk-throughs, or possibly interviews of personnel in current occupation of the site. These can prove to be significant sources of information with regard to historical industrial or commercial activities undertaken at the site, the location of fill materials used in site development, the existence of any underground or above ground storage tanks, the location of former chemical storage or manufacturing areas, historical spills, waste management techniques that were used at the time, former remedial activities, and if any remediation was carried out, what remedial standards were applied. Where historical reports exist, these will generally be reviewed by the consultant as part of the Phase I and assist in determining whether current risks remain.

If any potential environmental issues are identified in the Phase I ESA, a Phase II ESA may be conducted. In contrast to the mostly “desktop” nature of a Phase I ESA, a Phase II ESA is a field investigation that involves sampling, characterizing and potentially delineating any environmental concerns identified in the Phase I ESA. A “qualified person” performing the Phase II ESA has full professional discretion to assess what tests are necessary. Nonetheless, the consultants take instruction from their clients and testing can be limited by budgetary concerns. A typical vendor may limit testing to obtain a report that it presents to a potential purchaser, based upon only a few boreholes, with no groundwater sampling. Such vendor may allow further testing or not, or may specifically require that if further testing is carried out and if the purchaser is not content to waive environmental conditions, it does not want to be advised of the purchaser’s findings. Although atypical, such a vendor may not wish to know further details for implications relating to its financing or future sale. In most transactions, though, clarity of information, whether favourable or not, facilitates better negotiations.

Phase II ESAs can range depending upon the nature of contamination, the size of the site, the clarity sought, and it is common for iterative approaches to be used, incorporating successive rounds of testing and narrowing of areas or potential sources of contamination. Consequently, costs of a Phase II can range from several thousands to upwards of \$100,000 or more, depending upon the site of site and nature of the contamination.

Remedial site assessment reports, sometimes referred to as Phase III ESAs, may also be requested where contamination is detected and remedial proposals have been discussed. In typical transactions, remediation will either be negotiated as part of the deal, or required as a condition of waiver.

3. Records of Site Condition (“RSC”)

Part XV.1 of the *EPA* prescribes a methodology and a set of standards for remediating contaminated sites (including whether remediation is required) and the filing of an RSC in the Environmental Site Registry. In essence, the legislation offers a limited form of immunity from regulatory orders of the Ministry of Environment (MOE) to landowners who file a "Record of Site Condition" (RSC).

If a record of site condition is filed in the Registry in accordance with section 168.4, no order shall be issued to any of the following persons under section 7, 8, 12, 17, 18, 97, 157 or 157.1 in respect of a contaminant that was discharged into the natural environment before the certification date and was on, in or under the property as of the certification date:

1. The person who filed the record of site condition or a subsequent owner of the property.
2. A person who is in occupation of the property or who was in occupation of the property at any time after the record of site condition was filed.
3. A person who has charge, management or control of the property or who had charge, management or control of the property at any time after the record of site condition was filed.
4. A person who meets the requirements prescribed by the regulations and who, before the certification date,
 - i. owned the property,
 - ii. was in occupation of the property, or
 - iii. had charge, management or control of the property.⁶

⁶ *EPA, supra*, s. 168.7(1).

An RSC can be voluntary or mandatory, but will be mandatory in cases where land is being developed that involves a change of use - that is, from a less sensitive use to a more sensitive use in terms of potential environmental receptors (industrial to parkland or residential).

In simplified terms, an RSC is a document signed by the property owner (or purchaser) and their environmental consultant (who must be a "Qualified Person" under the *EPA*) that

- provides certain general information about the property (description, ownership, etc.);
- provides a description of any soil removal or other action taken to reduce the concentration of contaminants on the site to acceptable regulated levels;
- provides information on the maximum concentration of contaminants that remain on site;
- provides certifications by qualified environmental consultants to the effect that the property meets the current regulatory environmental standards – either by virtue of the property now meeting acceptable regulated levels of contaminant concentrations, or by virtue of there being no need to do on-site testing for contamination (i.e. no need to conduct a Phase II environmental site assessment for any part of the property since the Phase I raised no issues warranting further investigation);
- any environmental site assessments carried out on the site, such as a Phase I or Phase II Environmental Site Assessment, are listed in the document as confirming the consultant's opinion on the land. If the site has been previously impacted with contamination, the RSC would have to include a certification that both a Phase I and Phase II ESA were conducted, and that the site conditions meet the regulatory standards (depending upon which standards are relevant). It could also potentially include a certification that if part of site does not meet the standard for a particular contaminant, that a risk assessment has been conducted and approved by the Ministry of Environment, and that the contaminants in issue meet the approved risk assessment standards.

At a minimum, a Phase I ESA must be conducted on a site in order to file an RSC, which determines the likelihood that one or more contaminants have affected all or part of the property.⁷ If Phase II turns up actual contaminant concentrations in excess of the regulated standards, then remediation or risk assessment may be required. The risk assessment regime is complex and permits the development of alternative contaminant concentrations to the standards based upon consideration of receptors in the area and the potential for any adverse impacts. In some cases, no remediation will be required and acceptance of the MOE is based upon the strength of the risk data. In other cases, limited remediation may still be required, or restrictions on use may be imposed.⁸ As will be seen in relation to agreements of purchase and sale, a requirement for an RSC or a risk assessment can involve significant drafting considerations.

The main restriction on immunity, however, is that it only applies to contamination that was discharged into the environment prior to the certification date (which can be no later than the filing of the RSC), and that was on, in or under the property as of the certification date. Therefore, it does not apply to contaminants that migrate to other properties after the certification date. For this reason (known as a “re-opener”), the liability protection has come under some scrutiny, given that the protection can be revoked. With respect to the migration of contaminants off-site, the MOE has commented:

It should be stressed that even though the migration of historical contamination off-site may remove the protection from orders, this does not mean that there is any material risk that a “clean-up order” will be issued for a RSC property. To issue an order, a Ministry of Environment official must first have the grounds specified by the applicable order provision. In many cases, even if the protection from orders is removed because of the off-site migration of historical contaminants, there may be no legal basis to issue an order.⁹

There is not always agreement between MOE policy and practice, and practitioners have noted this issue as one that has been hampering brownfield redevelopment. As a result, the MOE is considering changes to the brownfield regime to attempt to re-focus the protection provided.

RSC provisions are entirely voluntary except when there is a change in property use from industrial or commercial to residential, parkland, school, prison or health use. The use of the

⁷ EPA, *supra*, s. 168.1.

⁸ known as Certificates of Property Use.

⁹ Environmental Bill of Rights Registry Notice, January 16, 2007.

regulated standards related to RSCs¹⁰ may not strictly apply to a transaction where there is no change of use proposed. Nonetheless, the standards are generally used for comparative purposes to benchmark current site conditions, and potentially require remediation. Municipalities may also require that a site be remediated and an RSC filed as a condition of development approval, and this is the more often basis upon which the RSC provisions are triggered. Where land is proposed for redevelopment, and where it involves municipal approval requirements, the municipality may require an RSC for all or parts of the land. This is especially the case where land will be transferred to the municipality (eg. road allowances, etc). The rationale is a municipality's reluctance to assume environmental remedial obligations in its service / utility maintenance role. As long as contamination can be shown to be below the level of servicing to be provided by the municipality (sewers, utilities, etc.), the municipality may not require an RSC for those portions of the land. It will, however, for land above that level.

One of the main advantages to a landowner in filing an RSC, however, is that it creates a record of the state of the property, frozen in time. While the MOE makes no representations or even comments on the content in most cases (excluding a risk assessment), it can be a useful evidentiary tool in any future civil action involving the property.

The RSC is registered on a publicly accessible Registry maintained by the Ministry of the Environment. This Registry can be searched prior to land transactions to determine if a property has ever been the subject of an RSC. In this way, it acts to potentially signal prior contamination, but does not necessarily mean the land was contaminated to begin with. It is simply a database of sites for which an RSC has been filed.

Once registered, the RSC will afford immunity from Ministry orders to the registering owner, and all future owners and occupants, or persons who have charge, management and control of the property. The protection does not extend to prior owners, except in the case of a specifically negotiated land deal where the RSC is filed by the purchaser, but acts to protect the vendor as well.¹¹ It is important to emphasize that the protection will not apply if the RSC is deemed to

¹⁰ “Soil, Ground Water and Sediment Standards for Use under Part XV.1 of the *Environmental Protection Act*, March 9, 2006” as referenced in Regulation 153/04 under the EPA.

¹¹ Section 20, Records of Site Condition Regulation – Part XV.1 of the EPA, O.Reg. 153/04

have contained "false" or "misleading" information, or if contamination moves offsite after the registration.

There are practical costs to registering an RSC. Owners are required to sign fairly onerous declarations as part of the registration process. Transactions that depend on registration of an RSC may take more time to complete. Owners will need to plan ahead and allow sufficient time for preparation and filing of an RSC to ensure that unexpected development delays do not arise. This can be quite challenging in cases involving formal Risk Assessment approval, as the timing for MOE approval (12-15 months) could have a significant impact on development.

RSCs are just one tool to manage environmental risk. Environmental insurance, qualified indemnities, environmental site assessments, audits and other similar risk management tools have all been used successfully to satisfy risk concerns on both sides of a transaction.

4. Addressing Environmental Issues in Negotiating Purchase and Sale Agreements

To be capable of influencing an Agreement of Purchase and Sale, it is critical to be involved in the transaction from the negotiation phase of the agreement. Your client chooses to involve you following the letter of intent or following the signing of the agreement at his or her peril, as you will have more trouble protecting them from liability if you cannot ensure the appropriate indemnities have been signed, clauses have been drafted, terms have been defined, and appropriate consideration has been given to transactional aspects that could influence civil or regulatory liability.

Consider, for instance, an indemnity negotiated with a shell corporation, an ambiguous definition of "contamination", or a reference to "remediation" without consideration of the appropriate standard or the uses to be made of the property. These are but a few examples of common issues arising in agreements resulting from a failure to recognize the ambiguity and available interpretations.

A sobering example of an agreement of purchase and sales drafted less than diligently arose in *862590 Ontario Ltd. v. Petro-Canada Inc.*¹² The numbered company purchased property from Petro-Canada that had been used as a fuel depot and bulk sales plant. As part of its due diligence, the numbered company received a report prepared for Petro-Canada and a letter from the Ministry of the Environment concluding that there were no environmental concerns with the property. Interestingly, the report did not address the extent of hydrocarbon contamination. In the agreement of purchase and sale, Petro-Canada made no warranties with respect to the property, and the numbered company agreed to indemnify Petro-Canada for any property contamination claims. Prior to closing, a report prepared by a different company came to light, indicating that there was, in fact, contamination. The Ministry of the Environment therefore required an environmental cleanup of the site, and Petro-Canada arranged for another site cleanup, which was completed and the transaction closed. The plaintiff did not obtain a reliance letter from the remediation consultant, incorporate the second report into its transaction documents, or require any amendments to its agreement reflecting the new information and subsequent clean-up.

Several years later, the numbered company attempted to sell the property but was unsuccessful due to environmental studies obtained by potential purchasers showing contamination. The numbered company claimed against Petro-Canada in fraud and negligent misrepresentation. The court dismissed the action, chastising that if the numbered company had wished to rely on the report from the second cleanup, it should have specifically referred to it in the agreement of purchase and sale. Any reliance on implied negligent misrepresentation was barred by exclusions in the agreement of purchase and sale.

4.1. Agreements of Purchase and Sale – Provisions of Interest in Environmental Transactions

As a starting position it is important to note that each agreement must be drafted individually, and that different risk allocation concerns (vendor versus purchaser or landlord versus tenant) will result in different forms of agreements. Ultimately, however, the agreement of purchase and sale will govern all environmental risk allocation between the parties. Some of the key components of agreements that may be impacted by environmental terms are outlined below.

¹² [2000] O.J. No. 984 (Sup. Ct.)

4.1.1 Definitions

Determine whether your client's interests are better suited to broad or narrow definitions: whether the terms of the agreement apply to specific contaminants, whether they encompass the area under or inside a building, and whether they extend to neighbouring land. Careful and clear delineation of the purchased assets is critical. "Environmental Laws", "Hazardous Substances", "Environmental Claims" are standard terms without standard definitions. A sample definition of "Environmental Claims" is provided to illustrate the potential depth to a definition:

[Sample] any and all enforcement, clean up, removal, remedial or other governmental or regulatory actions, complaints, tickets, notices, directives, citations, charges, proceedings of any nature or kind, penalties, fines, prosecutions, inspections, investigations, injunctions or orders (including, without limitation, pollution prevention, pollution abatement and remediation orders) pursuant to any Environmental Laws which pertain to Contaminants, or alleged Contaminants and whether known or unknown at the Closing Date, or the threat of Contamination and any and all liabilities, claims, demands, causes of action, losses, damages, costs and expenses of any nature or kind made or asserted by any third party against the Vendor relating to damage, contribution, cost recovery, compensation loss or injury resulting from the presence, Release or threatened Release of any Contaminants or alleged Contaminants, exposure to Contaminants or the violation or alleged violation of Environmental Laws in connection with the Contaminants, but specifically excludes any claims from full or part-time employees (current or former), contractors, representatives, agents of the Vendor or any of the other Indemnified Parties arising out of the course of their employment or other authorized duties on behalf of the Vendor or other such Indemnified Parties, whether now know or unknown and whether manifested prior to or after closing of the transaction contemplated by the Agreement of Purchase and Sale

Consider whether it is necessary for a claim to be made or whether a mere regulatory request will trigger liability under the agreement. Common pitfalls in agreements are ambiguous terms, such as "clean-up", "standards", "pristine", and "contamination", which require careful consideration. Exclusions, acceleration clauses, or any terms that may affect other definitions should be clarified with as much precision as possible to avoid later conflict in interpretation.

4.1.2 Representations and Warranties

Ensure that representations and warranties are drafted so that a party does not walk into environmental liability unknowing and unprotected. Consider what the vendor or purchaser is able to disclose, and then ensure that this is reflected in the standard representations and warranties. Typically, these include the following:

- Absence of contamination;
- Former use does not include contaminants;

- Absence of underground storage tanks;
- Absence of waste or hazardous substances;
- Absence of notices, orders;
- Possession of proper permits;
- Compliance with environmental laws.

Consider also the value of environmental representations and warranties when qualified. Unrestricted representations and warranties are of higher value to a purchaser, whereas representations and warranties that are limited by time, “best of knowledge”, or which may have a “material adverse effect” are of lower value to a purchaser.

Representations and warranties may also be limited in time or for a limited amount of money in the event of a breach. Indemnities, as will be seen below, may require a breach of a representation or warranty as a condition.

4.1.3 Indemnities

An indemnity is only as good as the party providing it. It has no value if the indemnifier is or may become insolvent. Will the indemnifier actually have the resources to satisfy a claim 1 year, 2 years or 10 years later? Typical limits on indemnities include contamination “caused” by their activities and monetary or time limits. An indemnity, however, will have no affect on the MOE’s ability to issue orders, and require compliance. It can, however, defray some or all of the costs of such compliance if properly drafted.

There can be entire agreements relating to indemnities, or less detailed clauses within a purchase and sale agreement. The clause can bind the vendor or the purchaser or a plethora of related or affiliated entities. It can be tied to breaches of representations and warranties, or restricted to broad or narrow definitions of Environmental Claims. It can require action based upon simple regulatory requests, or defy involvement until a third party judgment. It can relate to on-site contamination alone, or off-site contamination. Often there are cross indemnities provided depending upon who caused current known conditions versus future contamination. Other times, clauses can include both known and unknown contamination.

If secured by an escrow fund or letter of credit, indemnities can act as a form of self-insurance. Their diversity is the precise reason that they have become one of the key tools for allocating risks in environmental transactions.

4.1.4 Releases

Release provisions, which are related to indemnities, may be required by vendors on “as is” sales. The benefit of a release to the vendor is clear – to secure a waiver of any claims the purchaser may now have or may have in the future against the vendor by reason of environmental defect. If the purchaser was sued by a subsequent purchaser, it could, without a release, claim against the original vendor, on the basis that the intermediary owner did not cause the contamination.

4.1.5 Disclosure, Access, Reliance

Confidentiality considerations are associated with environmental documentary disclosure during the due diligence period, and these are important to keep in mind both as the purchaser and as the vendor.

As the purchaser, when carrying out on-site investigations during the due diligence period, consider timing, cooperation of on-site personnel, site access, reliance on former consultants’ reports, and retaining a peer reviewer for work done by the other side. As noted previously, reliance on other consultants’ reports can be critical to establish a future claim against the consultant.

Access can be particularly important in cases dealing with off-site contamination and associated off-site work. If details of access rights need to be outlined, they should be specifically referenced so that the parties are aware of the exact nature of access granted, thereby avoiding future disputes.

4.1.6 Remedial Work

Remediation is the most complex issue to deal with in an agreement of purchase and sale, and involves a number of different considerations, and allocation of costs or liabilities. The options run the gamut from environmental escrow funds to hold-backs on the purchase price, to straight abatements, and can involve simple excavation to complex, long term bioremedial methods.

If a Record of Site Condition is required, who undertakes to carry out the process, and to pay for that process? What about ensuring that the RSC is appropriately filed? What if the possibility of a risk assessment is not addressed but ultimately required? Time lines are critical for ensuring that development does not get caught in risk assessment approval delays. Depending upon who bears responsibility under the contract for the risk assessment, penalties for failing to achieve deliverables at particular points can also be implemented.

It is essential to build contingencies into the risk assessment process to combat Ministry delays or substantive problems with the approval. If an RSC including remediation is required, ensure that remedial criteria are specified in the agreement of purchase and sale, and determine whether control is divested to the consultant. If the agreement references or involves a consultant, set out which party(ies) will retain the consultant, and who and how their invoices will be paid. In addition, provide a dispute resolution process in the event of disputes between consultants, if one party does not like a consultant's opinion or strategy. Arbitration or the independent opinion of a third party expert (agreed upon in advance) may be preferable.

Leaving decisions to the discretion of one consultant can be dangerous, if it later turns out that the consultant's decisions were unfavourable to one side. In *Michael Johnston v. Shell Canada*,¹³ the parties came to agreement on the scope of, and procedures for, remediation, including the retainer of a consultant who had complete discretion as to the testing and remediation required, and the particular MOE standards that were applicable (Table B versus Table A). Johnson sued Shell, claiming that additional testing was required despite the consultant's view (the consultant was retained by Shell) that it was not. The court held that

...the Minutes of Settlement delegate to Golder the authority to determine the appropriate further testing to be conducted on the Property and consequently, whether further remediation is necessary. Absent demonstration of palpable and overriding error, the motion judge's conclusion that Shell met its obligations [despite the fact that it did not test in a particular area of concern to Johnson] under the Minutes of Settlement is entitled to deference in this court.¹⁴

If demolition is required as part of the development, cover which party is to pay for added environmental costs, whether contaminated soil and groundwater need to be treated in a special

¹³ [2006] O.J. No. 3516 (CA).

¹⁴ *Ibid.* at para 35

way, whether financial security is in place to ensure Vendor compliance with the demolition criteria, and whether escrow agents are required.

Note that there are increased costs associated with environmental work where excavation must also take place, and these costs should also be reflected in the agreement of purchase and sale. A sample provision is provided:

All costs associated with the Excavation Work shall be borne by the Purchaser, except those incremental or additional costs associated with the following:

- Any excavation, demolition, removal and/or disposal of Hazardous Substances;
- Remediation of soils or groundwater impacted with Hazardous Substances to Applicable Standards;
- Sampling or investigative consultant fees and disbursements to determine the extent and nature of Hazardous Substances on, in or under the Property, including groundwater, aquifers, or other underground water sources;
- Increased offsite disposal fees;
- Increased storage fees;
- Increased excavation equipment fees;
- Increased costs for clean fill to be brought on site for backfilling purposes;
- Increased fees associated with any requirement for specialized personnel dealing with Hazardous Substances being excavated, remediated, removed or disposed of off-site;
- Increased reporting requirements, including any and all costs associated with the preparation of reports or documents required for a Record of Site Condition pursuant to Ontario Regulation 153/04 made under the Environmental Protection Act; or
- Any other fees, disbursements, costs and taxes associated with the excavation, demolition, removal, remediation and/or disposal of Hazardous Substances that would not otherwise be incurred by the Purchaser but for the existence of Hazardous Substances in, on or under the Property,

All of which shall remain the Vendor's obligation

While there are many varieties of agreements involving the transfer of contaminated land, a cookie cutter approach is not feasible given the spectrum of liabilities that need to be protected against. The examples and contingencies referenced above are collected from a vast array of transactions and litigation claims, ranging from single family residences to multiple corporate commercial and industrial real estate holdings. The agreements in all examples allocated risk to each party. Those that ended in litigation allocated risk with perhaps less clarity than required.

5. Alternative Risk Measures - Environmental Insurance

A final word is devoted to environmental insurance, which can be incorporated in agreements of purchase and sale, or obtained separately to protect the interests of a purchaser or lender, given that it barter an unknown or variable financial risk to the client for a known amount.

Insurance carriers continue to offer a number of different types of insurance products against contamination liabilities, but they tend to fall under four main headings:

- **Pollution Legal Liability** - Covers unknown pre-existing pollution conditions or third party liability. Coverage is generally granted for first party remediation costs and may include business interruption. Third party claims may be protected for remedial costs, property damage, or defence costs where unknown contamination is later discovered.
- **Clean-up/Cap Cost** - Caps remediation costs based upon remedial plan. There is generally extensive examination of the proposed costs of remediation with contingencies built in. As a result, the possibility of cost-overruns becomes a lower risk, but with high premium costs.
- **Secured Creditors / Lender Liability** - May provide comfort to lenders based on value or loan balance, but most insurers will only insure lesser value of clean up costs or outstanding loan balance. The policy may also include property damage, injury and defence expenses for the site in question.
- **Errors and Omissions liability insurance** for environmental consultants, engineers, etc. These policies can insure contractor's third party claims results from environmental consulting services provided or can cover claims for errors and omissions arise out of consulting services, or both. A form of such policy also exists for project owners protecting against professional liability losses for third party claims on a specific project.

These insurance contracts are tailor-made for particular transactional needs. In practice, the policies covering remedial work or unknown environmental contaminants come at high premiums, focusing their utility on larger land parcels with high remedial costs. The few

insurers that offer these products have found a similarly narrow market - Cherokee Canada and Kilmer Brownfield Equity Fund are a few who have found that unquantifiable risks may well benefit from external insurance, even in the short term. These products are typically available for 1 to 5 year terms, with 10 years being an exception.

Environmental insurance is often used in conjunction with indemnity provisions. It may be requested by financial institutions lending on larger brownfield redevelopment, providing comfort to lenders that a specified amount of insurance will be available to cover remedial costs overruns or unknown pollution conditions (or changes in standards making once acceptable properties now caught by improved detection limits). As noted above, this is usually limited to the lesser of the outstanding loan balance or the remedial costs.

Conclusion

Performing the appropriate due diligence, obtaining a Record of Site Condition, negotiating an agreement of purchase and sale, or obtaining environmental insurance are all options to manage environmental risk in a real estate transaction. No two transactions are identical. Understanding the regulatory structure and potential liabilities on both the regulatory and civil side clearly affects the way properties should be investigated and agreements drafted. If a transaction is negotiated properly, environmental risk should be clearly understood and, perhaps not entirely quantified, but allocated appropriately in accordance with risk tolerances on both sides. Transactions that fail will do so for right reasons if a full assessment of environmental risk has been undertaken, and usually, there are other reasons for the transaction failing to move forward as originally proposed. If the transaction fails for environmental liability concerns that cannot be properly allocated, complete transfer through ownership may not always be the solution. Creative lease deals, stratified sales, and other techniques have been used successfully where the risk acceptance to a purchaser is too great. In the end, the desired result of clear agreements that have dealt with contingent liabilities has hopefully been accomplished.