

Hiding environmental reports: a risky business!

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A recent decision of the Ontario Court of Appeal clearly illustrates the kinds of problems caused by site contamination at a shopping centre. The case should be of interest to anyone who works on commercial transactions. If there is something to be learned from this story, it is that you need to understand risk before accepting it.

THE FACTS

Below I relate the facts of the case in detail because they are key to understanding the conclusions to be drawn from what happened. “Sumra” and “Yang” are principals of numbered companies. Yang and his company are the plaintiffs. The defendants are Yang’s former lawyer as well as Sumra and Sumra’s company. The names of the principals are used for ease of reference.

PROPERTY ACQUIRED WITHOUT AN ENVIRONMENTAL SITE ASSESSMENT (ESA)

Sumra purchased a shopping centre in Ottawa in 1997. The mortgage lender did not request an environmental report. During the same period Yang, who has a Ph.D. in chemistry and had just arrived from Australia, went into business and purchased and sold several properties and businesses in the Ottawa area.

PHASE I ESA FOR MORTGAGE RENEWAL

In 2003, Sumra had to renew his mortgage. The lender requested a Phase I ESA. Sumra hired AMEC to perform a visual inspection of the site and review available documents regarding earlier uses of the land. AMEC’s report indicated that the premises had once housed a dry-cleaning business.

Dry-cleaning is a well-known source of groundwater contamination that is caused by leaks and spills of chemical products that took place during a period when people were less concerned about the dangers of such products for the environment and human health.

In this case, however, there were unconfirmed reports that the business had used a closed circuit cleaning system and so the report concluded that AMEC had identified no environmental risks that would justify doing an intrusive assessment, that is to say, taking soil and groundwater samples for laboratory testing. The bank accepted AMEC’s Phase I report and approved the loan. Sumra’s lawyer kept a copy of the report on file. In 2005, Sumra put the property up for sale.

FIRST POTENTIAL PURCHASER AND DISCOVERY OF CONTAMINATION

A potential purchaser hired the Paterson Group to conduct a Phase I ESA at the site. At the outcome of the Phase I, Paterson recommended drilling a borehole at the spot where the dry cleaning business had operated in order to check soil and groundwater conditions. The soil met applicable standards but the groundwater sample exceeded the applicable standard for perchloroethylene (PERC), a product used in dry-cleaning operations. Paterson recommended

advancing several additional boreholes in order to circumscribe the affected area. The potential purchaser backed out.

SECOND POTENTIAL PURCHASER AND ADDITIONAL DRILLING

A second potential purchaser came forward. Sumra paid the first potential purchaser half the cost of Paterson's first report so that he would allow Sumra to use the report. The report was disclosed to the second potential purchaser.

Sumra then followed Paterson's recommendation and hired the firm to do the additional assessment. PERC concentrations in groundwater exceeded applicable standards in three of the five additional boreholes. Paterson concluded that the contamination was a significant source of liability but that it did not pose a risk for the health of the building's occupants or the environment. Asked for an estimate of clean-up costs, Paterson said it was not possible to provide an accurate estimate based on the information available, but that a figure in the range of \$100,000 to \$150,000 could be used for discussion purposes. The second potential purchaser backed out.

The real estate agent then told Sumra that the environmental reports would have to be provided to any other potential purchaser and that no bank would finance the acquisition of the shopping centre as long as the environmental problem was not addressed. The "For Sale" sign was removed and the agent stopped presenting potential purchasers to Sumra.

YANG PURCHASES THE PROPERTY AND DECIDES TO IGNORE THE ENVIRONMENTAL CONCERNS

It was at this point that Yang became interested in the property. Yang, an experienced businessman, called upon the services of an Ottawa lawyer who had been self-employed for many years and who had experience advising Yang in real estate and other transactions. Yang had already bought property which he knew to be contaminated. He had then resorted to private financing in order to get around the environmental requirements of banks. Yang requested and obtained a reduction in the sale price of roughly \$200,000. He ignored the advice of his lawyer, who recommended that he commission his own environmental studies (and had him sign a waiver in this regard). The conditions to closing were lifted and the deal was done.

A NEIGHBOUR SUES YANG

According to Yang, it was not until 2009, when a neighbour filed a nuisance action against him because contamination from the shopping centre had migrated onto the neighbour's property, that Yang became aware of environmental issues at the property. He hired Paterson to propose remediation options. Depending on how much time was available, the options ranged from natural attenuation (a multi-year solution involving no costs) to excavation of the contaminated soil (instant solution costing \$1.7 million).

YANG CLAIMS THAT HE WOULD HAVE NEVER PURCHASED THE PROPERTY AND SUES HIS LAWYER ALONG WITH SUMRA AND SUMRA'S COMPANY

With these facts in mind, it is readily apparent that the main issue for the trial judge - when Yang brought an action for damages against Sumra and his own lawyer - was to determine whether or not the plaintiff was telling the truth when he said he only became aware of the environmental issues at the site in 2009.

BACK TO THE STARTING GATE

The following is the wording of the environmental condition found in the offer to purchase (subsequently Schedule A in the Agreement of Purchase and Sale):

This Offer is conditional upon the Buyer determining, at the Buyer's own expense that: all environmental laws and regulations have been complied with, no hazardous conditions or

substances exist on the land, no limitations or restrictions affecting the continued use of the property exist, other than those specifically provided for herein, no pending litigation respecting Environmental matters, no outstanding Ministry of Environment Orders, investigation, charges or prosecutions respecting Environmental matters exist, there has been no prior use as a waste disposal site, and all applicable licenses are in force. The Seller agrees to provide to the Buyer upon request, all documents, records and reports relating to environmental matters in possession of the Seller. The Seller further authorizes listing agent, to release to the Buyer, the Buyer's Agent or Solicitor, any and all information that maybe on record in the Ministry office with respect to the sold property. Unless the Buyer gives notice in writing delivered to the Seller not later than 8:00 p.m. on the 26th day of November, 2005, that the preceding condition has been fulfilled, this Offer shall become null and void and the deposit shall be returned to the Buyer in full without deduction. This condition is included for the benefit of the Buyer and may be waived at the Buyer's sole option by notice in writing to the Seller within the time period stated herein.

Looking at this paragraph, it should be noted that the very long first sentence contains a list of environmental representations normally made by the seller. Here, the clause is worded in such a way as to transfer the risk to the purchaser. It is the purchaser who must ensure that environmental laws and regulations are complied with; the seller guarantees nothing. It should also be noted that a clause of this type is usually worded so that the seller agrees to provide the potential purchaser with all environmental documentation in its possession or under its control. Here, the documents are provided "upon request". As a result, the seller is not hiding anything from the purchaser, but it is up to the purchaser to make the first move.

In our view, this is a situation where the parties sought to pretend that the usual environmental due diligence review had taken place, without however putting anything in writing that established the purchaser's knowledge of the environmental situation at the site. This approach backfired when a third party sued Yang because the contamination had migrated offsite.

Let's look at the situation more closely and then review the lessons to be learned from this case.

Pursuant to the first sentence in the environmental condition, Yang had to determine that all environmental laws and regulations had been complied with. As a practical businessman who was likely pressed for time, Yang probably gave considerable weight to Paterson's conclusion that the PERC posed no risk to the environment or human health. From a legal point of view, even though groundwater contamination exceeded the generic criteria, in the absence of a clear statutory obligation to inform the Ministry of Environment and/or to decontaminate the site in the event of the discovery of historic contamination, a businessman could conclude that the laws and regulations were being "complied with" in the sense that while the groundwater did not meet applicable standards, seller's behaviour did not violate the law. As a result, the parties' main objective became making sure that the information provided by Paterson did not fall into the hands of a mortgage lender.

In court, Yang claimed that he never asked Sumra to provide him with the environmental reports that Sumra had in his possession, that he relied on his lawyer to take care of that part of the due diligence review and that his lawyer never talked to him about environmental reports. Yang also claimed that if he had been informed of Paterson's conclusions, he would have never purchased the property.

As for Yang's lawyer, she claimed that Yang never gave her the mandate to conduct due diligence of any kind (environmental or other). This explains why she did not ask the seller to provide her with access to the seller's environmental files. However, the appraiser hired by Yang to assist with getting financing from CIBC did obtain a copy of AMEC's report, which the appraiser presented to the bank. The bank extended financing based on the report. In court, the appraiser could not remember who

provided him with AMEC's report.

Having heard all the witnesses, the court concluded that Yang obtained all three environmental reports from Sumra and that he had them in his possession when he gave only one report to the appraiser who, in turn, forwarded it to the bank. The court dismissed Yang's claim for damages against his lawyer and Sumra.

LESSONS TO BE LEARNED

Quebec law mandates site assessment and clean-up upon cessation of activities or change of use at properties where potentially polluting activities – listed by regulation - have been carried on. Dry-cleaning does not appear in the list of activities that are covered by a regulation adopted pursuant to the *Environment Quality Act*. Consequently, if the site of a former dry-cleaning operation is assessed, it is usually at the request of a bank.

Returning to the case of Sumra and Yang, some comments are in order.

The CIBC was duped. It would be nice to know how often mortgage lenders are provided with misleading information regarding the condition of properties on which they take security. Yet it's also true that the discovery of "legacy" site contamination is bad for the economy, sometimes forcing companies and individuals to choose between obtaining financing from private lenders at exorbitant rates and going bankrupt. Generally speaking, only healthy businesses have the means to finance site clean-up.

Yang was far too cavalier in his business dealings. He negotiated a price reduction but had no intention of using the money he saved to deal with the environmental problem. Sumra should have required, by contract, that an amount equal to the reduction in the sale price be used for that purpose.

The parties to this deal probably believed that they had thought of everything. Yet they forgot to agree on what would happen in the event of a claim from a third party. A neighbour, for example.

Finally, and as glaringly demonstrated by the facts, no one in this case retained an attorney with the right skillset. Yang's lawyer strongly recommended that he commission his own environmental reports and she was right to do so. She should also have referred Yang to an environmental lawyer, to make sure he fully understood the risks associated with becoming the owner of contaminated land and the means available to manage them.

One may be tempted to equate environmental risk management with choosing the right engineers. It's a good instinct, but it only gets you halfway there. It can actually be very risky to ask an environmental consulting firm to generate data and issue reports on the status of a particular property without understanding the associated legal risks. The decision to protect oneself by contract or by site clean-up depends on a series of factors that vary from one case to the next. Finding the right solution (in terms of timing, risk, costs, etc.) requires the cooperation of specialists in both law and environmental sciences.