

## **ENVIRONMENTALLY SENSITIVE PROPERTIES: Factors to Consider in Sale or Lease**

By: Shari Elliott and Marshall Green \*\*

When presented with an offer to purchase or lease lands formerly used as a landfill or other use that may impose environmental risks, Ontario municipalities have a number of issues to consider. The first question to be asked is what are the advantages to the transaction? The second – and more important – is what are the disadvantages?

The factors to be considered for each transaction include liability, liability protections under brownfields amendments and ways it can be lost, importance of repair and restoration obligations in lease, environmental audits as baseline, polluter pays principle, restrictions on use, release, indemnity, ministry approvals, ongoing monitoring obligations and liability.

### 1. Liability

The biggest facts to be considered before selling or leasing any land that has or had known environmental issues is control of on-going liability. As a general statement, liability under the current legal regime runs with the land. Liability can arise under contracts such as the lease or agreement of purchase and sale, or at common law in nuisance and negligence to a neighbour, purchaser or even subsequent owner or user of the property. The liability often crystallizes years after the disposition of the property.

In addition to these common law liabilities, any current or former owner or person who has or had management or control of property could become the subject of one or more of the administrative orders that the provincial officers and directors of the Ministry of the Environment are empowered to issue under the *Environmental Protection Act* and the *Ontario Water Resource Act*.

### 2. Liability Protection and Ways It Can Be Lost

The only explicit protection afforded in Ontario is by the amendments to the *Environmental Protection Act* referred to as Brownfield Protection under section 168 of the Act.

The protection that is provided is not unlimited, and it must be earned through strict compliance with the requirements of the statute and regulations. Further, the protection is limited to certain circumstances and is afforded to a specific class of persons. In order to benefit from the liability protection and qualify as a class of persons entitled to protection, the municipality would have to include the requirement to file a “record of site

condition” in compliance with the new regime in the agreement of purchase and sale, and the purchaser would have to file the record of site condition. This is the only way that a former owner can obtain the protections that will be granted upon the filing of the record of site condition. The protections will be granted to the current owner who files the record of site condition, and to all future owners, tenants or persons in charge of management and control.

When determining whether to sell property rather than lease, the fact that the municipality would no longer be able to control the use of the property if sold is important in the context of liability protections under the *Environmental Protection Act*. The record of site condition regime is dependent upon the specific use of the property as identified in the record of site condition documents. The regulatory remediation criteria are tied to specific uses, and are generally more stringent for more sensitive uses. If the actual use of the property is different from the use specified in the record of site condition, and more stringent site condition standards would apply to that use, the record of site condition exemption does not provide any protection to the person causing or permitting the actual use of the property.

While this restriction appears on the face of it only to remove the protections provided to the new owner or tenant, and not former owners, the removal of protections and resulting cost for actions that are required would increase the risk of the Ministry of the Environment and others looking to the former owner dependent on the circumstances. The Imperial Oil case-law referred to later in this article illustrates how one cannot rely on MOE approval of a clean up to avoid liability. While it is true in the Imperial Oil case there was no legislative protection granted as there now is under the brownfield regime, this case warns of how far the courts will go to ensure the original polluter pays.

### 3. Obligations to Repair and Restore

Leasing is often the preferred method to pursue for a site with environmental issues because, through the lease, the landlord can control and restrict the use. In addition, commercial leases contain obligations on the part of the tenant to keep the premises in a state of repair. There are also obligations as to how the premises are to be returned to the landlord at the end of the lease term.

It is not uncommon for the tenant and the landlord to have differing views on the state of repairs required. Accordingly, these obligations should be clearly set out in the lease.

### 4. Environmental Audit

The requirement for an environmental audit has become all but standard. In many real estate transactions, an issue arises as to who is responsible, as between the vendor and the purchaser or landlord and tenant, for the clean-up of contamination on or under the property that was purchased or leased.

The requirements for an environmental audit applies to both leasing and sale. Given the unpredictability of the court systems, the parties should agree that they want to know the state of the property prior to the sale or lease. For a lease, the environmental audit will be relied upon for the obligation, on the expiry of the lease, to return the property to the condition at the commencement of the lease.

The requirement for an environmental audit for a sale is even more important. This environmental audit will be relied upon to evidence the fact that the vendor has been given full access to the site and related documentation to ascertain the state of the property. The purchaser will be given an opportunity to terminate the transaction on the base of the results of the environmental audit. Of course, the terms of the access to the land and the documentation will include a confidentiality clause, and full access by the purchaser to the field results and any reports generated. This audit may affect the purchase price.

Most importantly, in both the lease and sale situations, the environmental audit will be evidence of the state of the site at the commencement of the lease or the date of closing the transaction if future contamination issues arise. This is especially applicable if the purchaser's operations may result in contamination; the baseline will be useful if future issues arise.

## 5. Polluter Pays Principle

Readers should be aware of two court cases involving Imperial Oil – one in Quebec<sup>1</sup> and one in Alberta<sup>2</sup>, which leave the authors to believe that, regardless of the disclosure provided and whether or not the MOE provides an approval, the polluter pays principle will continue to be applied by the courts.

## 6. Restrict Use

To avoid costly remediation at the end of the lease term, municipalities must ensure that offers to lease: limit what tenants can do on the property; require tenants to obtain and provide copies of all government approvals; provide the municipality with the right to inspect the property for contamination; and, most importantly, require tenants to post financial assurances. This would include, but is not limited to, a letter of credit and the addition of the municipality to the insurance policy, before taking possession. To determine what amount of financial assurance should be posted, the municipality should retain an expert to determine what the clean-up costs might be as a result of the operations to be undertaken by the tenant.

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1 Imperial Oil Ltd. v. Quebec (Minister of Environment) [2003] 2 S.C.R. 624, 2003 58.

2 Imperial Oil Limited and Devon Estates Limited v. Director, Southern Region, Regional Services, Albert Environment (6 April 2005), Appeal Nos. 03-124 and 125-DOP (A.E.A.B.)

## 7. Release

A key advantage of a sale is a release of liability from the purchaser. After the parties have made full disclosure and an environmental audit has been performed and the parties agree to proceed with the sale transaction, the granting of release from liability from the purchaser to the municipality is a positive result of the sale. The release as between the purchaser and the vendor is straightforward and a clear benefit to accepting the offer to purchase property.

## 8. Indemnity

In addition to any release, the municipality should also insist on an indemnity from the purchaser that any claims by third parties will be their responsibility. However, it is important to understand that a release with regard to actions by third parties is only good if the party giving it can satisfy the claim being made. If the purchaser is insolvent or otherwise not in a position to satisfy the claim of a third party, the third party will no doubt successfully look directly to the municipality.

In addition, neither the indemnity nor the release will avoid any orders that might be issued directly to the municipality by the MOE. The municipality could attempt to enforce an indemnity after the fact, but could not stand behind this contractual agreement to avoid orders to take preventive measures or other actions as required by the MOE.

The environmental audit will be important for the indemnity. A condition of sale should be that the purchaser provides an environmental indemnity for all environmental matters other than the ones known at the time of closing. This indemnity will be a very important aspect of the negotiations and the agreement. It would include clear procedures for any claims and dispute resolution. As the environmental audit will be used as the baseline, consultants should assist with this process to ensure the audit is performed with the indemnity procedures in mind.

## 9. Section 46 Approvals

If the property in question is in Ontario and it is not a de-listed landfill, there will be a requirement to obtain a ministerial approval under section 46 of the *Environmental Protection Act*. The purchaser should be required to obtain this approval with the cooperation of the municipality as required.

## 10. On-going Monitoring Obligations and Liability

If the property has controls in place like groundwater monitoring and annual reporting, the on-going responsibility and associated costs will be an issue. This is further complicated if the operations of the purchaser could cause contamination. If the use is known to be one that might cause contamination, this obligation will need to be restricted and limited considerably. Additionally, any obligations taken on by the

municipality should be limited to this purchaser, and should not run with the title to the land.

## 11. Municipal Sale Procedures

In Ontario, the procedure for a municipality to sell land is governed by section 268 of the *Municipal Act, 2001*. The municipality must first pass a by-law establishing procedures governing the sale of land. In addition, section 268 sets out the following conditions that must be met:

- By by-law or resolution, the land must be declared surplus;
- At least one appraisal must be obtained; and
- Notice of the proposed sale must be given to the public.

The land procedure by-law for the individual municipality must be consulted, and will govern the balance of the procedure.

## Summary and Conclusion

In summary, listed below are the potential advantages and disadvantages of a sale and a lease.

### Sale Advantages include:

- Revenue from sale;
- Revenue from property taxes;
- Indirect financial and other benefits from the employment that could be generated from the new use;
- No longer property in municipal inventory so no further on-going maintenance expenses;

### Sale Disadvantages include:

- Loss of control of use for this purchaser and subsequent purchasers;
- On-going liability indefinitely;
- Might be required to provide indemnity;

### Lease Advantages include:

- Continuous revenue stream;
- Collect tax revenue through lease and changed use;
- Indirect financial and other benefits from the employment that could be generated from the new use;
- Maintain control including restricting use;
- Right of inspection;
- Include condition to keep in good state of repair;

- Include condition to restore to condition at commencement of lease;
- Require financial assurances;
- Shift maintenance costs to the tenant.

Lease Disadvantages include:

- Remaining the owner and subject to liability.

Selling any municipality-owned property formerly used as a landfill or suspected to have environmental issues is future liability under the polluter pays principle, no matter what safeguards and legislative protections the municipality might rely on for partial comfort.

There is also an additional factor that has to be considered when one of the parties involved is a municipality. Even if the municipality has a solid defence to avoid future liability, the political pressure might be such that the municipality finds it cannot rely on the defence of the contractual wording or the legislative protections provided under brownfields legislation in the various provinces.

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