

PREVENTING ENVIRONMENTAL LIABILITY

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I. INTRODUCTION

There are many reasons to stop pollution. Protecting the environment is a prime one. More selfishly, we may recognize that a dirty ecosystem makes us unhealthy. Even if you discard these reasons, and look at things based only the bottom line, one thing becomes clear: it costs less to prevent than to clean up.

This was not always the case. Without a long-term view, society opted for a disposable world, thinking that resources were infinite. We now know that this is not the case. Fish stocks are depleted. Landfill sites are becoming scarce. Water supplies, formerly a source of pride for Canadians, are becoming contaminated. In short, the environment is not just a business issue; it is a human issue.

The short term view that prevailed in the past had a corollary: people saw the risk of being caught as minor, and not important enough to warrant the higher costs. Enforcement is now catching up, however, fines, clean-up orders, director/officer liability and even jail sentences are becoming the rule, not the exception. In other words, the incrementally higher cost of doing business in a "green" manner is now worth it, because there is a high probability that penalties will be forthcoming if you do not.

This paper will try to tie together some of these factors to show you how to avoid higher costs down the road. The main thing to recognize is that the world has changed. Operations done in a way to reduce contamination are now the norm and will be required by courts and governments. Yes, this does add up to higher costs, but they are more than offset by the decreased exposure in the future

A. DUE DILIGENCE

I. Why Due Diligence?

Due diligence is not something that can be easily defined, but it will be helpful to discuss what it includes.

The concept of due diligence stems from a type of offence called "strict liability". Strict liability offences are a bit different than garden variety criminal and civil offences. A person charged with a strict liability action is presumed to have intended to perform the illegal act. In other words, fault is not an issue. It is then up to the accused to prove that he or she took all reasonable steps to prevent the illegal activity. If this can be done, the court can acquit the party or dismiss the action.

The taking of all reasonable steps has been called due diligence, and it has extended to all sorts of legal areas. One of these has been environmental law. The main reason is to recognize fairness, while still putting a significant burden on the polluter.

This can be illustrated through an example. Suppose that an oil refinery occupied some pristine farmland 50 years ago and started operations. Those activities continue to the present day. This particular company never did take much notice of environmental laws, and spent the bare minimum on spill protection and general environmental matters. Not surprisingly, the land is now thoroughly contaminated. I think most of us would agree that this company should be

responsible for cleaning up the property. Most environmental legislation in Canada would reach this outcome.

Suppose we change the facts slightly. Assume that the company was always sensitive to its treatment of the environment. From the outset, it installed state of the art pollution controls, and implemented strong programs to keep spills from occurring. These were substantially successful, except for one instance where a pipe broke and spilled oil onto adjoining property. The neighbour's fish pond was wiped out.

Some may still say the refinery should be responsible for clean-up, and perhaps it will do so on its own. However, if we force it to be liable, we are putting it in the same position as our first sloppy refiner. There is no incentive to implement ongoing pollution prevention. The result will likely be even more pollution as controls are minimized.

To alleviate this problem, one can build due diligence into the liability legislation. If the second refiner was found to have taken all reasonable steps to prevent the accident, but it still occurred, it would not be liable. Of course, this then puts the cost of clean-up on another party, such as the victim, or taxpayers. Whether this allocation of costs is the optimal solution is a topic for another presentation.

The key point to recognize is that the due diligence defence is available. It is one of the most important precautions that a business can undertake, and it should not be ignored when conducting operations.

2. Specific Due Diligence Defences

Due diligence defences are common in environmental law. Some are specifically included in the legislation, such as s. 13 of The Environmental Management and Protection Act. This permits one to avoid liability in a civil suit if all reasonable care was taken. Note that the EMPA does not extend the due diligence defence, at least specifically, to ministerial orders.

The magical phrase of "taking all reasonable steps" does not have to be mentioned for due diligence to work. Many offences have been found to be "strict liability", and therefore subject to a due diligence defence, even though there is no specific wording to that effect. This finding is usually up to the judge in each case, and again will be dependent on his or her concept of fairness in the circumstances.

3. How To Practice Due Diligence

Management Plan and Checklists

Now that we know that due diligence is essential to helping avoid liability, how is it accomplished? The most important ingredient is something called an environmental management system, or EMS.

An EMS is a road-map of how the business conducts operations to avoid undesirable environmental impact. It is usually more than a simple policy statement or manual. At its most complete, an EMS provides an ongoing system or checklist to prevent contamination from occurring.

An EMS must apply to the total business. This does not mean that upper management will be doing the same things as those on the shop floor. It does mean, however, that every person in the company must be responsible for his or her own areas of responsibility, and those collective areas must be enough to be considered "all reasonable care".

Which brings up the next point -- how does one know that an EMS is sufficient? The flippant, but accurate, answer is "You don't". This is where the real art comes about in constructing a due diligence program. It must be comprehensive enough to shield the party from as much liability as possible, while still keeping it within reason from a cost and administrative point of view.

Still, once the program has been implemented, you will never have a guarantee it will prevent all liability from attaching to your business. It will only be tested after you have been accused of some wrong, and it will then be up to the judge or other decision maker to decide if it was adequate.

Documentation is extremely important in a case like this, because of the tendency to use 20/20 hindsight in environmental cases. Remember that 25 years ago no one dreamed that operations would have to be conducted in the manner that they are done today. Will a court 25 years in the future take a similarly jaded look at the EMS that you invoked today?

Ongoing Monitoring

It is not enough to set up an EMS. The most important aspect is ongoing monitoring of compliance. In addition, the EMS will need to evolve to cover changing situations and weaknesses in the original plan.

This is usually done through what are called ongoing compliance audits. On a regular basis, the system and the business should be reassessed. There may have been changes in the business or the business environment that require changes. Experience may have shown particular elements of the EMS are inadequate, or can be improved. These changes have to be implemented in order to maintain whatever protection the EMS can provide. Remember that your entire goal is to be seen as doing all that can be reasonably done to prevent contamination. The law is quite clear that a "reasonable person" will conduct periodic audits. Because the initial setup of the system can be so time consuming, it is human nature to get things underway, and then forget about the EMS for a while. Try to resist this inertia.

Compliance

Nothing can destroy due diligence quicker than committing an environmental offence. While guilt will not automatically destroy the best laid plans, it is an extreme hurdle that will have to be overcome.

Therefore, the EMS must, at a minimum, provide for a standard higher than that required by the prevailing laws. It is not an argument to say that compliance would have inconvenient, or too expensive. You should aim for nothing less than perfect conformity with statutes and the common law.

Other

There are many other points that should be included in your due diligence checklist:

- Know and understand the laws
- Have at least one person responsible for all aspects of the plan. Do not, however, spread out responsibility so that persons think others are handling things.
- Identify material, or "red flag" events, that need immediate attention.
- Work with authorities to the greatest extent possible. Besides assisting due diligence, this

can help develop a relationship that can come in handy later.

4. Audits

Reasons to Audit

The area of audits is one of the key weapons to prevent environmental liability. Rather than looking at financial statements, as you would in an accounting or income tax audit, an environmental audit investigates the state of contamination in a certain set of circumstances.

Although we have talked about compliance audits already, the best known type of environmental audit is for land. There are many reasons to do such an audit:

- It can confirm the existence or absence of contamination on the property. This may be important to an owner that is not planning to sell the land, but has a suspicion or a report that pollution may exist;
- An audit can provide protection for a potential buyer or lender. Presently, the law is still generally "buyer beware" when purchasing land, unless appropriate safeguards are taken. An audit of the land is unquestionably one of the best ways for the potential purchaser to decrease the risk;
- Closely related to the above, an audit can help sale prospects. Anyone selling land these days quickly learns that purchasers are quite sophisticated about potential liability, and they will invariably require some type of audit to be done before the deal closes. A savvy vendor can conduct its own audit for reference beforehand. Not only can this eliminate some of the concerns the purchaser will have, and perhaps allow the deal to close more readily, it may also reduce some of the releases and warranties that the purchaser might otherwise require.

For these reasons, any landowner can now count on needing at least a passing familiarity with environmental audits.

Types of Audits

There are no firm guidelines in place for audits. This can be disadvantageous, since you may need more guidance to determine what is available, and what should be done in your particular case. More often, however, the lack of guidelines is a strength. You have great flexibility to tailor an audit to your exact requirements.

Environmental consultants and engineers usually talk in terms of Phase 1, Phase 2 and Phase 3 audits. These are useful as a rough guide, but keep in mind that there may be differences in people's definitions, and therefore activities that to one firm are included in Phase 1 may fall into Phase 2 or 3 with another company.

A Phase 1 audit is the simplest form of investigation. Visual inspections of the property will be done, looking for danger signs like dumping pits, landfills, dead vegetation, and underground tanks, among other things. Interviews may be conducted with present and former occupants and employees. Searches will be done at the Land Titles Office to determine former owners, and provide some clue as to former property usage. Additional agencies will be searched, including Saskatchewan Environment, municipal records, and others. Aerial photographs taken over time can often provide valuable clues. The process is much like that of a detective, to determine whether there is a probability that contamination occurred.

In some cases, the Phase I audit can end matters. If it can be shown that the land has been farmed for the past 100 years, there is less of a chance of any industrial pollution, and it may not be worth investigating further (one cannot discount, however, the possibility of farm chemicals being dumped or stored).

In some cases, the investigation will need to go beyond Phase I. Perhaps there was evidence of a spill, or a suspicious activity. Maybe underground tanks have been identified, but no one knows what they were used for, or if they are leaking. These situations call for a Phase 2 audit. A Phase 2 search involves actual testing of the property, rather than relying on existing registries and evidence. Therefore, a Phase 2 can give much more accurate results, and is limited only by how detailed one wants to get.

Typically, Phase 2 will involve drilling boreholes and testing the resulting soil and water samples. The Phase I audit should have identified certain "danger spots", so this can be used to narrow down the area where holes will be drilled. As well, the initial investigation will likely have provided a clue toward what contaminants might be present. It is far simpler and cheaper to look for particular pollutants (for example, hydrocarbons originating in gasoline), than to look for all types of contaminants.

If the Phase 2 audit detects levels of pollution that need to be cleaned up, the situation usually proceeds to Phase 3. It is a bit of a misnomer to refer to Phase 3 as an "audit", since this is where you enter the realm of remediation. Steps will be taken to correct the problem, and these can vary according to the contamination involved. The most usual forms of remediation in service station situations (the most common type of pollution problem that we are presently seeing in Saskatchewan) are soil removal and vapor/liquid recovery. We have all seen the former; the property is literally dug out, and the soil removed and hauled away. The main problem with this approach today is that it is difficult to find a place to accept the soil. Saskatchewan Environment has strict controls on where the soil can be placed. There are no incineration devices suitable for soil in Saskatchewan. Accordingly, the soil might be spread out on "farms", where bacteria and microbes are used to literally digest the waste.

Vapor and liquid recovery is just as common, and we all have probably seen the devices without realizing what they were. Small boxes may be placed on former (and current) service station sites. These contain blowers that sit on top of boreholes. The air is literally sucked out of the hole, run through a filter device, and released. In appropriate cases, ground water may be filtered using a similar process.

Obviously, the distinct phases of an audit comprise vastly different costs. A Phase I is the cheapest, and can be done for as little as \$1,500. As with anything else, you get what you pay for. Some can do audits for less, but there may not be enough investigation done to make the process worthwhile.

A Phase 2 audit varies more widely according to the work that has to be done. It would be difficult to have one done for less than \$3,000. The cost varies directly according to the number of drill sites and tests needed. Large properties can easily run into 5 figures.

A Phase 3 "audit" is much more expensive, because of the remediation component. Again, it is difficult to generalize but soil removal and/or vapor recovery of even an average city lot can easily run between \$50,000.00 and \$100,000.00.

B. RESPONDING TO SPILLS

We have tended to talk a lot about pre-existing pollution (since that is the most common problem), but the original spill has to occur sometime. If you are unlucky enough to be the person in charge of controlling the pollutant, or perhaps the owner of the property upon which the spill occurred, you will be glad that you had at least a passing knowledge of what to do.

I. Statutory Obligations

Unless you are in a dangerous or heavily regulated industry (like nuclear power, for example), there are not a lot of statutory requirements that need to be followed when a spill occurs. They are, however, very important to follow. If you do not, you run the risk of fines, or even a jail sentence.

EMPA & Regulations

Strangely enough, the major environmental statute in Saskatchewan does not include a specific duty to report spills. The closest that the EMPA comes is s. 9, which requires the owner of a pollutant, the person having control of a pollutant, any person on whose property a pollutant is located or any other person who has knowledge relating to the pollutant to "furnish and maintain" any information that Saskatchewan Environment may require. Therefore, you must usually comply with a request to furnish information, but you do not have a positive duty to offer it, at least under the EMPA.

Some of the regulations passed under the authority of the EMPA put more of an onus on persons, albeit in an indirect manner. Under The Hazardous Substances Regulations, most storage permits are granted subject to the applicant providing a copy of an emergency response contingency plan. This plan will probably set out a procedure to follow if a spill occurs, and it must be followed in such an event.

Spill Control Regulations

These regulations, as their name implies, are the first place one should look if a discharge has taken place. Unlike the EMPA, there is a positive duty on persons to report spills. The person having control of the pollutant (as defined in the EMPA) must report the spill as soon as possible to Saskatchewan Environment and Resource Management, the owner of a property on which the spill takes place, and the owner of the pollutant. In addition, members of police forces, and employees of municipalities who have knowledge of a spill shall report to SERM (unless they have reason to believe a report has already been made).

The initial report to SERM is made by phone, and should include the location and time of the spill, the type and quantity of pollutant spilled, details of action taken or proposed, and a description of the spill's location and immediately surrounding area. Within 7 days, a more detailed written report must be made, including the above information, as well as the names of person notified, and the known causes and effects.

Besides the reporting, the person having control of the pollutant and the owner of the pollutant have to take all reasonable action to prevent further discharges, and minimize the spill's effects.

It is highly recommended that any business that may handle dangerous substances obtain a copy of these Regulations, and be familiar with them. The consequences of an inadequate response can range from civil liability to fines and possibility a jail sentence.

Transportation of Dangerous Goods Regulations

These Regulations are highly technical, and lengthy, so it would be impossible to properly cover them in a brief space. Instead, I would recommend that you become familiar with the requirements if you are a transporter, shipper or receiver of hazardous substances. These requirements cover everything from containers to signage required on transports.

2. Non-Statutory

Besides the statutory obligations, the main other thing to be worried about is the due diligence requirement discussed earlier. Your EMS should have a spill response component built into it. If so, make sure that everyone in the business knows what to do immediately.

As always, be prepared to adjust the process if it is reasonable. Do not blindly follow a procedure if it does not make sense in the circumstances (even if it is built into the EMS). Of course, your ongoing compliance audits should have anticipated these problems beforehand.

C. HOW TO BUY AND SELL LAND

We have mentioned throughout this paper that land is the most common contamination problem, and likely the area where you will come into contact with the law. If you do not understand these rules when you buy and sell land, you can be exposed to much more liability than you have to be.

There are obviously different considerations for the potential vendor and purchaser. The seller wants to detach itself as cleanly as possible. In other words, once the deal has closed, the seller wants to be able to walk away with the money and without future worries as to liability (I am assuming that we are not involved in a case where a vendor knows about pollution, but actively and fraudulently attempts to conceal it). The buyer, on the other hand, has less knowledge about the property and previous uses. It hopes that everything is OK, but wants some recourse in the future if that does not turn out to be the case. The only way that these oftentimes conflicting interests can be reconciled is through negotiation.

I. The Seller

To achieve its goals, a seller is going to have to follow these guidelines:

- Avoid indemnities. For hundreds of years, the closing of a real estate deal (and many other types of sale transactions) has been treated as a special event. The main features of closing are that the purchaser takes the property "as is", and generally gives up the right to sue the Vendor after that date. This rule of caveat emptor, or "buyer beware", has worked in the seller's favor for environmental claims, because those liabilities are usually not discovered until well after the fact.

To combat this, knowledgeable purchasers usually ask for indemnities or warranties that survive closing. These amount to guarantees by the vendor on certain issues. The downside for the seller is that it can never really be considered to be free of a potential claim regarding the property (unless the indemnities are time limited).

- Consider an audit as a marketing aid. Unless a buyer is extremely unsophisticated, he or she will insist on some type of an audit to be done before closing the deal. This audit may be a formal or informal investigation.

The cost of an audit is often borne by the purchaser. Nonetheless, it can be a tactical

advantage for the vendor to have an audit done itself before the property is even offered for sale. This allows the vendor to perform the audit according to its own specifications and with its own trusted consultant, rather than relying on another party. It can also be a powerful negotiating tool - "Why should I have to give you an indemnity when I provided you, free of charge, with a clean environmental audit?"

- Be up-front. This will not be a morality lecture, so I won't remind you to be truthful and honest when selling land. Admittedly, it can be sorely tempting to hide certain facts, especially when such "details" could cause the entire deal to collapse. One reason to avoid this temptation is because of the need to foreclose liability in the future. The law of Vendor and Purchaser is not an exact science. There are certain rules that guide judges, to be sure, but a great deal is left to their discretion and characterization of facts. There are many cases where a failure to disclose a relevant fact, even without being actively hidden, has caused a court to hold a vendor liable. If you are not fully disclosing all the facts to a buyer, consider whether you want to accept the risk that you may never be totally clear of your obligations.
- Obtain a release from the purchaser. No matter what the law might imply, there is no substitute for a properly drawn contract. If you want a particular result out of the transaction, put it into the written agreement. It can be dangerous to assume that you will be automatically released just because the money has changed hands.

2. The Buyer

In order to further its interests, a purchaser should be looking at the following:

- Assume rule is "buyer beware". As was mentioned under the Seller's interests, the common law has essentially put the risk in land deals on a purchaser. This adds some certainty to the law, but this can be small comfort to a purchaser that has been stuck with a bad deal.

There are ways to avoid the rule of caveat emptor; for example, the sale agreement/contract that is used can specifically reallocate the risk in whatever way the parties see fit. It is usually rare that a vendor will agree to this, or it will be severely watered down.

Unless the contract is drawn exactly the way the purchaser wants, it should proceed under the assumption that caveat emptor continues to apply. This means that the buyer has to take the responsibility for completely investigating the property, and making sure that no unwanted liabilities are accepted. This usually means an audit.

- Audit. The best way of avoiding the buyer beware rule is to remove the "beware" part. A complete audit of the property can be the best way of uncovering hidden liabilities. Only then can the purchaser make an informed choice, and perhaps adjust the price offered.

On occasion, the vendor may have done its own audit, and will offer this as proof of the state of the land. Be suspicious of this offer. If the audit has not been done by a reputable consulting or engineering firm, or if the investigation was cursory at best, give it little weight. Remember that one of the reasons for having an audit done by your own consultant is so you have someone to blame if a problem is missed. By relying on the vendor's consultant, you may not have a similar right of indemnity.

- Obtain indemnities and avoid releases. The opposite applies here as discussed above under

Vendor's interests. To alleviate the buyer beware rule, indemnities or warranties that survive closing can provide invaluable protection. Unfortunately, vendors are well aware of the high exposure they face in such a case, and will fight you tooth and nail. The best you might be able to get is a limited indemnity (for example, one that survives for a year or two after closing). This is better than nothing, since at least you will have a period of time to examine the property firsthand.

- A few vendors will ask for releases. This is a term of the contract in which you specifically give up a partial or total right sue the vendor for liability, including environmental liability. Why would they need this, given the rule of buyer beware? Those vendors correctly recognize that there are exceptions to the rule, and they want to eliminate any chance that you will be able to come after them after closing. I always advise clients to avoid these releases, unless they are absolutely sure that there cannot be a problem in the future. Otherwise, consider yourself taking on all the risk.

II. CONCLUSION

By now, you should have realized that prevention of environmental liability is not something that can be treated as a graft to your existing business. You have to look at an entire package, something that becomes intertwined with everyday operations.

In fact, prevention is something you will want to practice, if for no other reason than to save money. It is now clear that there is a much higher probability of facing liability. Thus, there is no longer room to gamble that you will not be caught. It is cheaper to prevent pollution from the start. Those businesses that recognize this will enjoy a financial advantage through the coming years.

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