Why a Good Contract Isn't Enough to Avoid Liability for Environmental Contamination

Control Data (CD), a company that manufactures computer punch cards, leased a plant in Ontario. The lease required CD to comply with all environmental laws. Ten years later, CD sold the business to Axidata. As part of the deal, Axidata agreed to take over the lease, including the environmental obligations. Seven years after that, Axidata discovered that the property was contaminated with toluene, a solvent used to clean printing presses. Most of the contamination occurred during CD's tenancy but had since spread to neighbouring properties. Axidata paid over $3 million to remediate and sued CD to recover its costs. The Ontario Superior Court found CD responsible for 90% of the cleanup costs [*Monarch Construction Ltd. v. Axidata Inc.*, 2007 CanLII 6579 (ON SC)].

The Problem

Like contamination itself, liability for contamination may endure for decades after it's inflicted. Stated differently, companies that contaminate land may remain responsible for their pollution long after they sever all ties with the land'even if the company only occupied the property as a tenant. This is true even if the agreement in which the company assigned, that is, transferred the lease to a new tenant purports to end the company's responsibility for the

property's environmental condition. These were the hard lessons learned by CD in the *Monarch* case.

Legal Analysis

The right of businesses and individuals to sell their interests in real estate to a buyer and move on is essential to a free market economy. But it also conflicts with a key principle of Canadian environmental law: 'polluter pays.' That principle holds that costs of cleaning up polluted property should be borne by the party(ies) that created the mess, even after they've transferred all interests in the property. 'Polluter pays' overrides free transfer of real property. Thus, polluters can be saddled with environmental liabilities not only for the lands they currently occupy but also for those they've owned or leased in the past. As the *Monarch* case demonstrates, this liability can last for decades.

The False Solution

I know that you and your fellow officers and directors appreciate these risks. I also know that when the company sells a piece of land or assigns a lease, our lawyers go through the documents carefully and insert language to limit the company's potential exposure to environmental liability. The point of this memo is to caution you against letting these contractual provisions lull you into a false sense of security.

Consider what happened in the *Monarch* case. When Axidata bought CD's printing business, it agreed to assume all of CD's liabilities under the lease, including the responsibility to comply with environmental regulations. Presumably, our company would include similar terms in any agreement we entered into.

It would take CD two decades to discover that the clause transferring responsibility to Axidata hadn't gotten it off

the hook. Like any buyer would when assuming a seller's obligations under a lease, Axidata had insisted that CD represent and warrant in the sales agreement that it, CD, was in compliance with all terms of the lease on the date the sale closed. CD also agreed to 'indemnify,' that is, pay Axidata for any losses it incurred as a result of CD's failure to live up to its obligations under the agreement.

As it turned out, CD's representation and warranty was false; the company wasn't in compliance with environmental regulations at the time of the sale. After a lengthy legal battle, the Ontario court determined that CD was responsible for most of the contamination (and 90% of the cleanup costs):

- CD dumped of 90% of the toluene that caused the contamination;
- The tank in which CD stored the toluene leaked because it wasn't designed to hold flammable liquids;
- CD failed to equip the tank with a spill alarm or pump it regularly; and
- CD didn't instruct employees on proper use of the tank.

The Real Solution

Liability for contaminated property is a complicated issue for which there's no simple solution. As the *Monarch* case plainly shows, contractual clauses that purport to end a company's environmental liabilities may offer little protection if contamination is later found on the property'especially if the company caused the contamination. In the world of 'polluter pays,' even the most ingenious of contracts may not fully insulate a company.

The only reliable way to avoid responsibility for remediation is not to commit contamination in the first place. Ultimately, then, it is not the lawyers but the environmental management system that represents the company's first line of defence against environmental liability for contaminated property.