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# Acquiring Problem Properties

*Managing  
Environmental Risk*

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MANAGING ENVIRONMENTAL RISK IN  
MAJOR ACQUISITIONS AND  
DIVESTITURES OF OIL AND GAS  
PROPERTIES.

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MANAGING ENVIRONMENTAL RISK IN MAJOR ACQUISITIONS  
AND DIVESTITURES OF OIL AND GAS PROPERTIES

This paper examines legal issues relating to the allocation of risk for environmental liabilities between vendors and purchasers engaged in major divestitures or acquisitions of conventional oil and gas properties. In particular, the paper deals with the structuring of a sale and purchase agreement to take into account environmental risks, and ongoing liabilities of vendors and purchasers of environmentally sensitive oil and gas assets.

I. INTRODUCTION

Generally, the sale agreement will specifically allocate the risk of environmental problems between vendor and purchaser by means of general or environmentally specific representations, warranties and indemnities. This paper discusses vendor disclosure obligations, the drafting of warranty and indemnity clauses to deal with environmental problems, and the due diligence and environmental audit procedures which a prudent prospective purchaser may implement prior to closing a transaction to identify and assess environmental risks.

Common law rules relating to contract and tort are also relevant to the allocation of environmental risks between the parties to a sale agreement. Causes of action that could arise in a dispute over environmental liabilities include breach of an

express or implied term, failure of consideration, misrepresentation including failure to disclose material facts, and error in substantialibus. The current Canadian legal position is that caveat emptor applies to the sale of land. A Canadian court will not imply a warranty of fitness for use and vendors will not be liable for defects except in cases of non-disclosure of known but latent dangerous defects, or in situations of active non-disclosure of problems known to be material to the prospective purchaser.

In limited circumstances, a successor in title to a polluted property may have a cause of action against a remote vendor/pollutor under the common law tort concepts of nuisance, trespass, negligence, and the strict liability rule in Rylands v. Fletcher [1868], 3 L.R.H.L. 330; aff'g (1866) 1 L.R. Gx. 265. Our analysis of the applicability of tort law focuses primarily on theories of nuisance and strict liability because they have historically been the causes of action most relevant to environmental issues. In general, a remote vendor of land will not be held liable to successor owners of the very land transferred except in cases involving the "escape" of dangerous pollutants.

Finally, the express provisions of environmental statutes may regulate the transfer of environmentally sensitive assets and impose statutory liabilities on current or past owners or users who have generated, deposited, stored, spilled or disposed of pollutants or contaminants. In the United States, such statutory provisions are becoming common. In Alberta, the Oil and Gas Conservation Act R.S.A.. 1980, C.0-5, authorizes the Energy Resources Conservation Board (the "ERCB") to regulate the transfer of well sites and the Land Surface Conservation & Reclamation Act, R.S.A. 1980, C.L-3, arguably imposes clean-up obligations on former owners of oil and gas sites.

II. REPRESENTATIONS, WARRANTIES, INDEMNITIES AND PURCHASER'S DUE DILIGENCE

This portion of the paper outlines methods of structuring a sale of environmentally sensitive oil and gas assets to protect the vendor or the purchaser, as the case may be, from environmental liabilities. In particular, we focus on disclosure, due diligence and risk allocation issues which arise in the drafting of a sale and purchase agreement pertaining to oil and gas properties and associated assets such as wells, batteries, gas plants, gathering systems and storage facilities.

A. Disclosure

Where a vendor is aware of environmental concerns associated with a property or other asset about to be conveyed to a purchaser, the vendor should disclose fully the nature and extent of the problem to the prospective purchaser. If the purchaser, based on the vendor's disclosures, is willing to accept the environmental risk (i.e., the purchase is in effect on an "as is" basis), the vendor should include an express acknowledgment and a broad indemnity clause in the formal documentation. The following is an example:

The purchaser acknowledges that the Property has been used as a plant for the manufacture and storage of refined oil products and that such use may have resulted in the existence or leakage of toxic, hazardous, dangerous or potentially dangerous substances into the soil or the structures located on the Property. The vendor makes no representations or warranties whatsoever regarding the fitness of the Property for any particular use or regarding the presence or absence on the Property or any surrounding or neighbouring lands of or the leakage or emission from or onto the Property of any toxic, hazardous, dangerous, or

potentially dangerous substance or condition, including, without limitation any asbestos, gasoline or heavy metals.

B. Due Diligence

A prudent and diligent purchaser will generally insist on the right to some form of environmental inspection or audit of the properties prior to closing and will contract for the necessary rights of access.

1. Drafting Considerations

An example of a clause providing for an environmental audit by the purchaser is as follows:

Prior to the Closing, the vendor shall have provided the purchaser with access, during reasonable business hours and on reasonable prior notice, to the properties for the purpose of conducting an environmental assessment of the properties and all permits related thereto, provided that such assessment is conducted after prior arrangement with the vendor and in a manner which will not interfere with the vendor's operations. Such environmental assessment shall be at the purchaser's sole expense.

In the event that the environmental assessment conducted by the purchaser indicates the existence of previous and/or on-going release of hazardous substances at or under the site ("Adverse Environmental Conditions"), then: (i) if the parties agree upon the nature and extent of the remediation of the Adverse Environmental Conditions, the vendor may elect to commence, and subsequently continue, remediation measures in which event the Closing shall take place, with such remediation to be completed as promptly as practicable after the Closing; or (ii) if the parties hereto are unable to agree upon the nature and extent of such remedial measures or if the vendor elects

not to commence agreed-upon remediation actions, the purchaser may (A) terminate this Agreement without liability to the vendor, or (B) consummate the transactions contemplated by this Agreement and accept the Properties with knowledge of such conditions.

In some instances the purchaser will expressly seek a right to make soil, groundwater and other environmental tests or the contract may provide that the parties will commission the appropriate professional expert to conduct an environmental audit. In addition to physical inspection of the property, the cautious purchaser may also want to have the vendor agree to answer an environmental questionnaire detailing its operations and past and present use of hazardous substances as well as to conduct interviews with current and former employees and adjacent landowners.

## 2. Environmental Audits

Where the parties agree to an environmental audit, the sale agreement must specify who selects the auditor and who pays the cost, the time frame in which the audit must be completed, the standards the auditor is to use in determining whether remedial work is required (eg. legislative requirements or industry guidelines) and the extent of access that the auditor will have for inspections and physical testing. The extent of the auditor's access to the vendor's records, employees and government officials is often a point of serious negotiation.

Environmental audits for facilities should include some or all of the following:

- (i) visual inspection of the inside and outside of the facility;

- (ii) review of the chain of title and governmental records to determine prior owners and their use of the facility;
- (iii) review of processes where hazardous substances may have been employed;
- (iv) examination of governmental and vendor records of the facility's operations;
- (v) interviews with past and present operators of the facility;
- (vi) analysis of soil samples;
- (vii) investigation of underground tanks; and
- (viii) ground water and air sampling.

Where the purchaser has a right of inspection, the vendor should limit the purchaser's rights of access to ensure that the purchaser's inspection does not interfere with the vendor's operations and should require that properties be restored to their pre-existing state after testing.

The purchaser will generally want full access to all permits, licenses and all environmental studies, and the purchaser may also want to discuss the vendor's compliance with environmental standards of the relevant statutory authorities. An example of the type of clause a purchaser may request is the following:

The vendor hereby authorizes and directs all agencies, departments or other relevant authorities to release any and all information in their possession respecting the Properties

to the purchaser, and further hereby authorizes each of them to carry out inspections of the Properties upon the request of the purchaser. The vendor agrees to execute any specific authorization pursuant to this paragraph.

In some circumstances, the vendor may be concerned that such enquiries may draw the attention of government authorities to problems which may otherwise have gone unnoticed. The vendor may either prohibit the enquiries or may require that the purchaser pre-clear proposed enquiries with the vendor.

3. Confidentiality and the Privilege Defence

Clearly, the information generated by an environmental audit can be damaging to a vendor in the event that the sale does not proceed to closing and, therefore, all efforts should be made to maintain its confidentiality. The sale agreement should impose specific confidentiality obligations on the purchaser, and the parties should be aware that, in the event of subsequent prosecutions or litigation, the environmental audit will probably be a discoverable document.

It has been suggested that the rules of solicitor/client or litigation privilege can be used to erect a privilege defence in respect of environmental audits conducted in the context of purchase and sale transactions, provided the environmental auditors are retained by the solicitor of one of the parties rather than directly by the vendor or purchaser.

In our view, this procedure would not assure the success of a claim that the audit reports are privileged. For a third party to be protected by solicitor/client privilege, the environmental consultant must be regarded as the agent of either the company or the company's solicitors. For example, in

circumstances where a company retained an independent accountant to advise the company's lawyer on a tax matter, the court held that the accountant was acting as the representative or agent of the company and therefore the communications between the accountant and lawyer were privileged. [Susan Hosiery Ltd. v. Minister of National Revenue, [1969] 2 Ex. C.R. 27].

Third parties which are not agents will be protected by litigation privilege only if they are retained directly by a lawyer for the purpose of litigation. In this circumstance, communications or documents will be privileged only if their dominant purpose relates to civil or criminal litigation then existing or contemplated [Nova v. Guelph Eng. Co., [1984] 3. W.W.R. 314 (Alta. C.A.)]. In this regard, it is probable that a court would reject an argument to the effect that litigation is contemplated whenever an oil and gas property is sold.

Finally, disclosure of the environmental audit to a third party such as a prospective purchaser (where the audit is conducted by the vendor) destroys any privilege which may have otherwise existed.

#### C. Public Searches

A prudent prospective purchaser should carry out standard, as well as environmentally specific, searches prior to closing.

##### 1. Standard Pre-Closing Searches

The standard set of pre-closing searches may reveal potential environmental concerns. For example, action searches conducted at the court houses of the relevant jurisdictions may

disclose third party claims for environmental damage. Similarly, searches of title to environmentally sensitive facilities at the Land Titles Office may reveal lis pendens in respect of the same. The freehold title searches may also reveal agreements entered into by the Department of the Environment pursuant to section 7 of the Land Surface Conservation and Reclamation Act restricting the use of the lands. If a governmental agency has conducted clean-up activities necessitated by the vendor's operations and not recovered its costs, a writ of execution may be filed at the appropriate Sheriff's Office.

## 2. Specific Environmental Searches

There are a number of additional searches at public offices available in Alberta to obtain information relating to environmental matters. These searches will give the prospective purchaser an indication of whether the vendor is subject to any outstanding obligations under provincial environmental legislation and highlight potential environmental problems relating to the lands and facilities involved in the sale.

### (a) Reclamation Certificates

If the purchaser believes that the land has at any time been subject to reclamation obligations under the Land Surface Conservation and Reclamation Act, a search can be done to ensure that such obligations have been satisfied. The Land Surface Conservation and Reclamation Council (the "Council") will indicate whether or not the land is subject to a reclamation obligation, and will provide a copy of the Reclamation Certificate if one has been issued. If there are outstanding reclamation obligations, the search response will indicate that a Reclamation Certificate has not been issued because of outstanding reclamation deficiencies. The particulars of these deficiencies may be

obtained with the permission of the owner or operator. The Council deals with all freehold lands and the same information can be obtained from Alberta Energy in respect of Crown lands.

**(b) Alberta Environment Searches**

Searches may also be conducted at Alberta Environment, which will issue a letter summarizing environmental enforcement procedures where infractions have resulted in the department taking steps to compel compliance. The search request must include the location of the property and the names of the owners dating back to 1971, the year that Alberta Environment first began keeping such records.

The Alberta Environment search will disclose whether any stop or control order has been issued against the owner or operator of the land under the Clean Water Act, R.S.A. 1980, c.C-13 the Clean Air Act R.S.A. 1980, c.C-12, or the Hazardous Chemicals Act, R.S.A. 1980, c.H-3. If there has been any such order, the search response will indicate the date, the company against which it was issued, the land involved and the nature of the order. If the search discloses violations or orders, the purchaser will have to follow-up with the present or past owner to determine how the order or violation was dealt with and whether there are any outstanding concerns.

**(c) Standards and Approvals Searches**

Finally, the Director of Standards and Approvals in Alberta maintains a record of licensed facilities and violations of the licenses, particularly those under the Clean Water Act and the Clean Air Act. A search with the Director will disclose whether particular facilities are licensed under the relevant statute and whether there have been specific violations of the terms and conditions of the licence. Supplemental searches can be

obtained on stack emissions data, water discharge data and ambient monitoring information.

A copy of all information supplied to the person requesting it will be forwarded to the company that operates the facility, although the searcher's name will be kept confidential.

D. Remedies

The purchase and sale agreement should specify the purchaser's remedy in the event that the due diligence process reveals environmental problems. The suitability of any particular remedy will depend, in part, upon the precision with which the environmental liability can be assessed and quantified. Depending upon the circumstances, for example, an agreement may provide that the purchaser has an option to elect between two remedies, or to elect that one remedy shall apply to liabilities of a certain type or below a certain monetary threshold and a different remedy shall apply to liabilities of a different type or in excess of the established monetary threshold. The following list of possible remedies is suggested by Dean R. Massey in "Due Diligence in Modern Mining Deals: How to Protect your Client from Buying a Pig in a Poke", 33 Rocky Mt. Min. L. Inst. 2-1 (1987).

1. Termination/Rescission

If a satisfactory environmental audit is made a condition precedent to closing the transaction, the purchaser will have the right to refuse to complete the purchase if the audit discloses unforeseen environmental liability. Theoretically, upon execution of the purchase and sale agreement, the purchaser obtains an equitable interest in the subject property. If the transaction is not completed, the equitable interest reverts to the vendor.

For those of the view that ownership of any interest in a property with environmental problems is to be assiduously guarded against, the remedy of rescission ab initio may be preferable to termination. If regulatory agencies start to zealously search out and pursue owners and former owners (as reported in some American jurisdictions), a preference for rescission over termination may develop.

Also, care must be taken not to waive a condition precedent and a right to rescission by taking possession of the property.

2. Remedy or Reduce Price

If the extent and cost of the environmental liability associated with the property can be precisely quantified, it may be satisfactory to provide that the vendor will either remedy the problem to the purchaser's satisfaction prior to closing or reduce the purchase price by the cost of the remedial work required. Unless this remedy is used in conjunction with another remedy (eg. indemnity), the purchaser assumes the risk that the environmental problem is greater than the parties believed at the time of closing.

An example of a vendor's covenant to perform remedial work is as follows:

The vendor shall proceed, at its cost, to perform, or cause to be performed, the Remedial Work. To the extent the Remedial Work must be performed after the closing, the purchaser shall grant the vendor and its contractors and consultants access to the property without cost in order to perform such work. The purchaser may from time to time provide the vendor with proposed schedules of development of the Property, and the vendor shall use reasonable

efforts to perform the Remedial Work so as not to interfere with such schedules.

3. Exclusion of Problem Property

If the transaction encompasses several properties and the environmental problem is identified as associated with a specific property, it may be possible to exclude the contentious property from the transaction, reduce the purchase price accordingly and proceed with the sale.

4. Contingency Fund

A reserve fund for the benefit of the purchaser may be established by the vendor to be drawn against by the purchaser in the event that a potential liability realizes. The reserve may be an actual trust or escrow account or it may be in the form of a letter of credit or other security instrument. This mechanism is suitable if the purchaser is only concerned with incurring environmental liability within a finite period of time.

5. Payment from Income

If the purchase price is either to be paid in installments or to include an earnout component, or the transaction is structured such that the vendor retains an interest in the property (eg. an overriding royalty), the agreement may provide that damages suffered by the purchaser as a result of the specified environmental problem will be set off against the installments, profits or income, as the case may be, otherwise owed to the vendor.

6. Risk Allocation/Indemnity

Every agreement should either expressly or impliedly allocate risks between the parties. The parties may agree not only on who will bear what risk but also on the quantity of the risk to be borne by the party and the terms of the indemnity from the other party for any liability in excess of that party's allocation. As with all indemnities, the effectiveness of this remedy is dependent upon the continued existence and solvency of the party providing the indemnity.

7. Insurance

Current comprehensive general liability insurance excludes most forms of environmental damage; however, older forms of policies do not contain the same extensive exclusions and may continue to provide coverage for incidents which occurred during the term of the policy notwithstanding that the injury was discovered after the term expired.

As a part of the due diligence process, a prospective purchaser should review the insurance policies of the vendor. If there is a possibility that any of the old policies may apply to future claims, the purchaser should ensure that access to the policies is preserved and that a procedure is implemented whereby the purchaser can avail itself of the coverage extended by the vendor's old policy.

As a practical matter, this is usually achieved by covenants from the vendor to pursue any claims against its insurers and to serve timely notices under such insurance policies combined with an indemnity from the vendor for any losses or damages suffered by the purchaser as a result of occurrences which arose prior to the effective date of the sale. The indemnity is

important because, without it, after the sale the vendor may have no insurable interest and therefore may not suffer any insurable loss.

E. Representations and Warranties

Oil and gas purchase and sale agreements typically contain heavily negotiated representations and warranties such as the standard representation that the vendor has acquired all necessary licenses, permits and other authorizations and has operated the properties in accordance with good oilfield practices and in full compliance with all statutes, regulations, rules, orders and directives of all governmental agencies, departments and other authorities.

1. The Existing Alberta Statutory Framework

Given the nature of the existing Alberta statutory framework of environmental regulation, a vendor should be extremely cautious in giving broad performance representations and should endeavor to negotiate a limitation in the scope of such representations.

In particular, under Alberta's current enforcement philosophy, the terms and conditions in operating licenses often include performance standards or emission limits which are regarded by both the regulatory authority and the licensee more as performance objectives than as strict standards. In this circumstance, the licensee may be technically in breach of the licence provisions even though the applicable regulatory authority is not requiring strict performance of the licence requirements. Often, breaches of environmental standards are not enforced until

a specific complaint is received. Fines are sufficiently small and infrequent that they are sometimes treated as a cost of doing business.

Consequently, at any point in time, a vendor may be responsible for minor violations or contraventions of a number of environmental statutes. It is often not possible for a vendor conducting extensive operations in the province to give the broad representation of compliance, particularly where there may be third party operators on many of the properties.

## 2. Negotiating Representations and Warranties

From a vendor's perspective, there are many methods of limiting the scope of representations and warranties. For example, a vendor who is not the operator of sale properties should limit his representation to only those material matters within its actual knowledge. Also, a vendor may insist that representations as to the performance of all obligations under leases relate to the petroleum and natural gas leases only and do not extend to surface leases.

### (a) Compliance with Laws

The "no default under" or "no violation of laws" representations should have a substantial compliance or materiality limitation and should relate to the petroleum and natural gas rights only. By these means the vendor escapes warranting that there has been no violation of laws relating to surface or general environmental laws. The astute purchaser, on the other hand, will demand express environmental representations on plants and facilities.

Similarly, in the "interim compliance with laws" provision (i.e., the representation that during the period between entering into the purchase and sale agreement and the closing of the transaction contemplated by the purchase and sale agreement the vendor has complied with all applicable laws), there should be a materiality limitation and a limitation to petroleum and natural gas rights.

**(b) Validity of Licenses**

Representations relating to the obtainment and status of all permits or licenses should be limited to material licenses. From the vendor's point of view, it is preferable to merely represent that it holds all licenses and not that they are in good standing or that there has been no default under them. If pressed, the vendor should make sure that the representation is limited by materiality and also ensure that the representation speaks only to licenses relating to the petroleum and natural gas rights and not to tangibles and surface rights.

**(c) Abandonment of Laws**

One of the more specific representations frequently requested by purchasers is that all wells have been abandoned and shut-in in accordance with good oil and gas field practices and in compliance with applicable laws. From the vendor's perspective, it is preferable not to give such a representation. Particularly where the vendor has not been the operator of the properties, the relevant information may not be within the vendor's knowledge. Again, if the vendor is forced to give this representation, it should try to limit it to either one standard or the other, that is, either in accordance with applicable laws or industry standards.

**(d) Specific Environmental Representations**

In general, a sophisticated purchaser in a good bargaining position will seek a wide range of environmental representations and warranties concerning the property, including the following:

- (i) possession of all required environmental permits;
- (ii) compliance with all environmental laws and permits;
- (iii) no notice of any violation of any law or permit has been received and there is no basis for assertion of any such violation;
- (iv) no lawsuit, claim or proceeding has been asserted or commenced and there is no basis for such assertion;
- (v) all required notices under applicable environmental laws have been filed, including notices relating to releases of hazardous substances;
- (vi) absence of any required material expenditure needed to comply with environmental laws;
- (vii) absence of any condition which, if known to governmental authorities, would give rise to a claim of violation of law or permits, or require a material expenditure to comply; and
- (viii) absence of toxic substances and underground storage tanks or a commitment to remedial action if such items create a problem.

**(e) Limiting Liability**

The vendor, for its part, will want to limit potential liability under these representations, and generally will attempt to do so by employing one or more of the following techniques:

- (i) including a time limit on the survival of representations and warranties;
- (ii) setting a floor on claims to avoid having to deal with less significant problems;
- (iii) limiting damages for all breaches of warranties or specified warranties to the purchase price or a specified portion thereof;
- (iv) limiting its liability to the cost of the actual remedial work needed to correct the environmental problem and expressly excluding responsibility for lost profits, decline in market value of the prospects, interruption of business operations and any other type of special, incidental, consequential or exemplary damages;
- (v) excluding liability for fines and penalties, legal and consulting costs and third party claims;
- (vi) limiting liability to contamination arising during its ownership of the property; and
- (vii) limiting its liability to problems of which it had knowledge at the time of the disposition.

Where the purchaser has conducted extensive due diligence investigations, the vendor may seek to reduce the extent of its representations on that account. The purchaser on the other hand will want the representations and warranties to continue unabated notwithstanding its investigations.

As indicated above, from the vendor's perspective the extent of liability for any breach of warranty should be limited by the amount paid for the particular asset affected such that if there is a breach of a representation relating to a tangible, and the portion of the purchase price allocated to the tangible is low as is typically the case, then the liability for the breach of the warranty would be capped by that low allocation.

### 3. Drafting Approaches

Generally, as a matter of drafting style it is better to rely on broadly drafted representations and warranties so as to avoid the implication which arises with respect to more narrowly drafted representations, i.e., that matters not expressly covered by the specific and narrow representations have been expressly and purposefully omitted. Accordingly, in usual circumstances the purchaser will attempt to force the vendor into giving broad representations. However, in some circumstances, the parties may prefer express and extensive customized environmental warranties.

A simple example of a customized representation which takes into account environmental considerations is as follows:

The Property contains no contaminant (as that term is defined in the Environmental Protection Act, R.S.O. 1980, c. 141, as amended) deposited, added, emitted or discharged by the vendor, its officers, directors, agents and

employees but not including its tenants during the period that the vendor has owned the Property.

A more complex example is as follows:

The vendor (i) has been and is in substantial compliance with all laws, regulations and orders relating to the environment. Further, the vendor has received no written notice of non-compliance, and does not know, or does not have reasonable grounds to know, of any facts which could give rise to a notice of non-compliance, with any such laws, regulations, or orders; (ii) has obtained all permits, licenses and approvals which are required for the operation of its business as presently being conducted and all such permits are valid and in full force and effect and no violations thereof have been experienced, noted, or recorded, and no proceeding is pending or, to the best of the vendor's knowledge after due inquiry and investigation, threatened to revoke or limit any of them; (iii) has not used any of its facilities, or permitted them to be used, to generate, manufacture, refine, treat, transport, store, handle, dispose, transfer, produce or process any contaminants, dangerous substances, pollutants, hazardous wastes or hazardous materials, except in substantial compliance with all laws, regulations, or orders; (iv) has never been convicted of an offense for non-compliance with any laws, regulations, or orders or been fined or otherwise sentenced or settled such prosecution short of conviction; (v) has never defaulted in reporting to the proper governmental authority on the happening of a substantial occurrence requiring it by law, regulation, or order to do so; (vi) has disclosed all such reporting to the purchaser and provided full details; and (vii) has not caused or permitted, and has no knowledge of, the Release of any hazardous substances on or off-site of its property or of any release from a facility owned or operated by third parties, but with respect to which the vendor is alleged to have liability. All wastes and other

materials and substances disposed of, treated or stored on or off-site of real property owned or occupied by the vendor, whether hazardous or non-hazardous, have been disposed of, treated and stored in substantial compliance with all laws, regulations, and orders. To the best of the vendor's knowledge after due inquiry and investigation, Schedule "A" identifies all of the locations where hazardous substances and any other environmental contaminants used in whole or in part by the vendor or resulting from the vendor's businesses have been or are being stored or disposed of.

F. Third Party Consent

Often in oil and gas transactions, properties are held pursuant to joint venture arrangements, and applicable contracts will require that a vendor of properties obtain the consent of its co-owners prior to consumating any proposed sale. Typically, such clauses will permit consent to be reasonably withheld.

This raises the issue of whether consent may be reasonably withheld in a circumstance where onerous reclamation obligations are associated with the subject properties and the co-venturers are concerned that a transfer to an irresponsible or impecunious entity may increase the potential liability of the other joint operators.

This situation is expressly dealt with under the proposed 1990 CAPL operating procedure by the inclusion of a deeming provision as follows:

It shall be reasonable for a party to withhold its consent to a disposition hereunder if it reasonably believes that the disposition would be likely to have a material adverse effect on its working interest, including, without limiting the generality of the foregoing, a reasonable belief that the proposed assignee

does not have the financial capability to meet prospective obligations arising out of this Operating Procedure.

Under forms of operating procedure currently in use, common law principles may be applicable. The traditional expression of the factors to be considered in determining whether consent has been reasonably withheld is set out in the leading landlord/tenant case of Houlder Brothers and Company Limited v. Gibbs, [1925] 1 Ch. 575 (C.A.). In that case it was stated that the landlord's objection must be connected with the personality of the intended assignee or with the probable use of the property. A landlord is therefore prevented from refusing consent on grounds which are personal to him and independent of the proposed relationship with the prospective assignee/lessee.

This test was expanded by Lord Denning in Bickel v. Duke of Westminster, [1976] 3 All E.R. 801 (C.A.). Lord Denning was of the view that no strict grounds could be dictated and that it was an exercise of the judgment of the landlord under the circumstances.

The more liberal view of Denning has been upheld by the Alberta Courts in two cases. The first is Coopers & Lybrand Limited v. William Schwartz Construction Co. Ltd. (1981), 31 A.R. 466 (Alta. Q.B.). In that case the court began by stating that the burden was upon the tenant to prove that the landlord unreasonably withheld its consent. The court then held that the landlord's objections may properly be based on whether the proposed assignee is objectionable for personal or financial reasons or that the proposed use of the premises is detrimental to the lessor. In addition, the landlord has the right to consider the effect of a tenant carrying on a trade on the subject premises in competition with the landlord's own business.

The second case is Sundance Investment Corporation Ltd. v. Richfield Properties Limited and Beaver Lumber Company Limited, [1983] 2 W.W.R. 493 (Alta. C.A.), which relied on Coopers & Lybrand. In Sundance the court held that the test to be applied is what a reasonable landlord would do in the circumstances. The court stated that it was not unreasonable for the landlord to be concerned when its own financial interest would be adversely affected.

Assuming that the above principles are applicable in the context of dispositions of interests in oil and gas properties, a withholding of consent on the basis that the proposed assignee lacks financial capabilities would probably not be interpreted as an unreasonable withholding of consent.

#### G. Adjustment and Indemnity Clauses

Indemnification and adjustment provisions are useful where there are potentially large environmental risks and liabilities to allocate among the vendor and purchaser. The recipient of the indemnity should ensure that the indemnification specifically extends to both direct damages and indirect damages, that is, third party claims.

##### 1. Clean-up Covenants

A concerned purchaser will want to negotiate a covenant making the vendor liable after closing for the clean-up of environmental problems and indemnifying the purchaser from any loss occasioned by such problems. The indemnity may be general, indemnifying the buyer, its officers, directors and employees, from any claims, liabilities, damages, losses or expenses arising out of the breach by the vendor of any representation or warranty.

A typical clause providing for post-closing remedial work and indemnity is as follows:

After the closing, the vendor covenants at its sole cost and expense, to remove or take remedial action with regard to any materials released to the environment at, on or near the property prior to the closing for which any removal or remedial action is required pursuant to law, regulation, order or governmental action, provided that (i) no such removal or remedial action shall be taken except after reasonable advance written notice to the purchaser; (ii) any such removal or remedial action shall be undertaken in a manner so as to minimize any impact on the business conducted at the Property, and (iii) the vendor shall indemnify the purchaser for any action taken by the vendor under this section. The vendor shall at all times retain any and all liabilities arising from the handling, treatment, storage, transportation or disposal of environmental contaminants by the vendor or by any of the vendor's contractors in accordance herewith. The vendor shall indemnify and save harmless the purchaser from and against any and all (i) liabilities, losses, claims, damages (including, without limitation, lost profits, consequential damages, interest penalties, fines and monetary sanctions), and costs (hereinafter "Loss"), and (ii) lawyers', on a solicitor and his own client basis, and accountants' fees and expenses, court costs and all other out-of-pocket expenses (the "Expense") incurred or suffered by the purchaser by reason of, resulting from, in connection with, or arising in any manner whatsoever out of the breach of any warranty or covenant or the inaccuracy of any representation of the vendor contained in this section.

## 2. Drafting Indemnities

Indemnity clauses tend to be given narrow construction by the courts. It is therefore very important to draft indemnity

clauses to maximize their effectiveness. The following is a list of matters to consider in drafting indemnities:

- (i) There are two types of liability which can be covered by indemnity clauses: indemnification for indirect losses (i.e., claims against the indemnified party brought by third parties) and indemnification for direct losses which the indemnified party suffers as a result of actions of the indemnifying party. Indemnity clauses should be drafted carefully to ensure that both direct and indirect losses are covered. Unless direct liability is expressly referenced, an indemnity may be found to relate only to third party liability (see, for example, Mobil Oil Canada Ltd. v. Beta Well Service Ltd., [1974] 3 W.W.R. 273).
  
- (ii) The indemnity clause should expressly name specific costs for which the indemnified party wishes to be reimbursed (e.g., consultant's services, witness fees). Unless legal costs are stated to be payable on a solicitor-client basis (i.e., the actual billed amount for legal services), they will be awarded on a party-party basis (i.e., pursuant to a schedule contained in the Rules of Court which is generally much less than the actual billed amount). If the indemnity is specifically tailored to address environmental issues, the buyer will want to have the indemnity include the costs of environmental consultants and engineers, witness fees and legal fees.
  
- (iii) A vendor may negotiate the period of time for which it may be liable under the indemnity to the purchaser, and the extent of indemnification may be limited to

the amount of the purchase price attributed to the relevant asset. The extent of indemnification may also be limited by a general form of limitation. For example, it may be limited to losses in respect of petroleum and natural gas rights based on the premise that it was only these rights which were attributed significant value. A vendor may also try and limit the indemnification to damages which have actually accrued prior to the effective time. This is an attempt to cut off liability for contingent liabilities; that is, liabilities that have not accrued prior to the effective time.

- (iv) A purchaser may have difficulty collecting on an indemnification for those problems of which it had knowledge prior to closing. Ideally, a vendor should stipulate that it will not assume any liability for indemnification in circumstances where the purchaser had knowledge prior to closing of the subject matter giving rise to the liability.
- (v) Unless specifically named, losses caused by certain events may not be recoverable. Unless the indemnity explicitly covers losses arising from the fundamental breach of the contract containing the indemnity (a breach which goes to the root of the contract) the indemnity may not extend to such loss.
- (vi) From the perspective of the indemnifier, the indemnity should include provisions requiring the party relying on the indemnity to notify it promptly of any claim or damage suffered and to provide the indemnifier with an opportunity to defend any action and participate in any negotiations relating to the subject matter of the indemnity.

- (vii) Notwithstanding any successful efforts by the vendor to limit its indemnity, its third party liability may not be limited to the negotiated amounts. Applicable environmental statutes, for example, may impose liability on the vendor as a former owner or creator of pollution. Also, third party contractual and tortious liabilities may extend the vendor's obligations in respect of the sold assets.
  
- (viii) Where the purchaser has reason to be concerned about the vendor's ongoing financial viability, in addition to the standard indemnity it may also be prudent to require some form of security to ensure that the vendor will be financially able to fulfill its obligations (eg., a holdback of part of the purchase price until clean-up is completed, escrow arrangements, letters of credit, performance bonds or third party guarantees). Naturally, from the vendor's perspective, limiting any such requirements is desirable.
  
- (ix) The transferability of environmental warranties to successive purchasers should be expressly addressed. The vendor will endeavor to have the agreement provide that the representations and warranties are personal to the parties, and that they provide no rights or remedies to third parties. The purchaser, for its part, will seek the right to assign the warranties to subsequent purchasers.

III. COMMON LAW PRINCIPLES APPLICABLE TO THE CONTRACTUAL RELATIONSHIP

A. Introduction

Under basic principles of Canadian contract law, a vendor of polluted property need not disclose the defect unless it is within the vendor's knowledge and it is dangerous to the purchaser. Liability can also accrue to the vendor in cases of active non-disclosure of material defects known by the vendor to conflict with a purchaser's purposes.

The onus is on the purchaser to conduct a reasonable inspection of the property and to protect itself by means of express or collateral warranties. In limited circumstances, a purchaser may also succeed in an action against a vendor of polluted property by establishing failure of consideration, error in substantialibus or misrepresentation.

B. The Doctrine of Caveat Emptor

Generally, in the absence of misrepresentation or mistake, a vendor is responsible for the environmental quality of property being sold by him only to the extent to which he expressly agrees to be responsible. Professor Bora Laskin, in "Defects of Title and Quality, Caveat Emptor and the Vendor's Duty of Disclosure" (1960), L.S.U.C., Special Lectures, p.389 at pp.403-404 described the general principle of caveat emptor as follows:

Does the vendor have any duty of disclosure in matters of quality and fitness which do not constitute defects of title? Here we deal with the classical notion of caveat emptor as applied to the physical amenities and condition

of the property unrelated to any outstanding claims of third parties or public authorities such as would impinge on the title. Absent fraud, mistake or misrepresentation, a purchaser takes existing property as he finds it, whether it be dilapidated, bug-infested or otherwise uninhabitable or deficient in expected amenities, unless he protects himself by contract terms.

If the vendor and purchaser deal at arm's length, each with an equal means of knowledge concerning the property which is the subject of the sale, the purchaser must take a property as he finds it and will be afforded only those protections for which he specifically contracts. Under the doctrine of caveat emptor, the seller is not under a duty to disclose defects which the buyer could determine by reasonable inspection and the seller does not impliedly warrant either that the land is free from any defects of quality or condition or that the land is suitable for any particular purpose.

This principle has been reaffirmed by the Supreme Court of Canada as recently as 1979 in the case of Fraser-Reid v. Droumtsekas (1979), [1980] 1 S.C.R. 720, 9 R.P.R. 21, where Justice Dickson stated as follows [S.C.R. at 723]:

Although the common law doctrine of caveat emptor has long since ceased to play any significant part in the sale of goods, it has lost little of its pristine force in the sale of land . . . [N]otwithstanding new methods of house merchandising and, in general, increased concern for consumer protection, caveat emptor remains a force to be reckoned with by the credulous or indolent purchaser of housing property. Lacking express warranties, he may be in difficulty because there is no implied warranty of fitness for human habitation upon the purchase of a house already completed at the time of sale. The rationale stems from the *laissez-faire*

attitudes of the eighteenth and nineteenth centuries and the notion that a purchaser must fend for himself, seeking protection by express warranty or by independent examination of the premises. If he fails to do either, he is without remedy either at law or in equity, in the absence of fraud or fundamental difference between that which was bargained for and that obtained.

The judicial rationale for the rule of caveat emptor has been the need for finality and certainty in business affairs, the opportunity for the purchaser to protect itself by express warranty, and the argument that the prospective buyer knows best to what use he intends to put the purchased property and therefore should provide his own investigation as to its fitness for that purpose [Redican v. Nesbitt (1923), [1924] 1 D.L.R. 536 (S.C.C.)].

C. The Duty to Disclose Pollution Which is Dangerous

1. Introduction

One of the generally recognized exceptions to the rule of caveat emptor is the liability for failure to disclose latent, dangerous conditions known to the vendor. A latent defect is one which is not readily apparent to a purchaser conducting a reasonably careful, ordinary inspection. A vendor is generally not under a duty to disclose a latent, but not dangerous, condition.

2. Judicial Origins of the Duty to Disclose Dangerous Latent Defects

There are a number of Canadian cases standing for the proposition that a vendor of polluted property who knows of the

existence of hazardous waste will be held liable for breach of a duty to warn in circumstances where the vendor fails to disclose the fact to a purchaser who would not otherwise be able to discover its presence by reasonable inspection. They are discussed at length by Terry R. Davis in a recent (1989) discussion paper published by the Canadian Institute of Resources Law, Faculty of Law, University of Calgary, entitled "Successor Liability for Environmental Damage".

The affirmative duty to warn of latent dangerous defects derives from the decision of the Supreme Court of Canada in Rivtow Marine Ltd. v. Washington Iron Works (1973), [1974] S.C.R. 1189, 40 D.L.R. (3d) 530, [1973] 6 W.W.R. 692 (S.C.C.). On the basis of the reasoning of Justice Ritchie in that case, the source of the liability is in the nature of a product liability rule that imposes liability for dangerous defects "based on the fact that the vendor of the article who knew it to be defective was guilty of fraud or deceit and for this reason liable to anyone who suffered as a result of an injury. . ." [D.L.R. at 538]. Liability attaches because of the foreseeable harm that could occur from a breach of the duty to warn of a dangerous defect.

In Rivtow Marine, both the manufacturer and the distributor were aware of the crane's seriously defective design. The crane was withdrawn from operation during the plaintiff's busiest time of year shortly after a similar crane collapsed, killing its operator. The failure to warn of the defect so that repairs could have been made at a convenient time was held to be negligent. The manufacturer and distributor, knowing the nature of the plaintiff's business and its dependence upon the defendants for advice, were jointly liable for the avoidable economic loss attributable to their failure to warn, although not for the cost of repairing the defect.

Justice Ritchie cited Justice Laskin's comments in Lambert et al v. Lastoplex Chemicals Co. Ltd. et al (1971), 25 D.L.R. (3d) 121, [1972] S.C.R. 569, as follows [D.L.R. at 543-44]:

Where manufactured products are put on the market for ultimate purchase and use by the general public and carry danger, ...although put to the use for which they are intended, the manufacturer, knowing of their hazardous nature, has a duty to specify the attendant dangers, which it must be taken to appreciate in a detail not known to the ordinary consumer or user. A general warning, as for example, that the product is inflammable, will not suffice where the likelihood of fire may be increased according to the surroundings, in which it may reasonably be expected that the product will be used. The required explicitness of the warning will, of course, vary with the danger likely to be encountered in the ordinary use of the product.

Alternatively, as Davis points out (at p.5), another justification for imposing liability for non-disclosure of hazardous latent defects may be the existence of deceitful inducement in the non-disclosure of a latent defect; i.e., the making of a false representation with the intention that it be relied upon while knowing that harm could befall the purchaser. [See Langridge v. Levy (1837), 2 M. & W. 519, 150 E.R. 863.]

Rivtow Marine was adopted and applied to the sale of land in C.R.F. Holdings Ltd. v. Fundy Chemical International Ltd. (1982), 19 C.C.L.T. 263, [1982] 2 W.W.R. 385, 33 B.C.L.R. 290 (B.C.C.A.); leave to appeal to Supreme Court of Canada refused (1982), 42 N.R. 358 (S.C.C.) (sub nom. Smerchanski v. C.R.F. Holdings Ltd.). In that case, a purchaser bought land containing radioactive slag material from a vendor, who represented that the slag made "excellent fill", but failed to mention that it was radioactive and could only be stored under license from the Atomic

Energy Control Board. The British Columbia Court of Appeal held the vendor liable in deceit, fraudulent misrepresentation and for breach of a duty to warn the purchaser of the inherently dangerous nature of the waste. As authority for this position, Justice Anderson relied on Rivtow Marine as applicable to the sale of polluted land. He extended the rule as enunciated by Justice Ritchie as follows [W.W.R. at 422]:

The vendor of land on which situate an inherently dangerous substance is guilty of fraud if he sells such land to a purchaser without warning the purchaser that, if the dangerous substance is not used or disposed of in a specified manner or in the manner prescribed by statute the purchaser and/or strangers to the contract may suffer a serious risk of injury.

Anderson continued [W.W.R. at 423]:

There would seem to be no good reason why the law relating to the sale of dangerous chattels should not be applied to the sale of land, where it is reasonably foreseeable that the dangerous substance, situate on the land in question, may be used or disposed of in a manner causing a risk of injury to health.

Damages awarded were the difference between the price paid for the land and the actual value, plus an amount for consequential loss (the contingency that clean-up might be impossible).

In McGrath v. McLean (1979), 95 D.L.R. (3d) 144, 22 O.R. 784, 27 Chitty's L.J. 58 (Ont. C.A.), where a massive landslide from adjacent lands forced a purchaser to vacate purchased lands, the Ontario Court of Appeal rejected the purchaser's contention that the vendor's knowledge regarding minor landslides constituted

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knowledge of a latent defect rendering the purchased premises unsafe for human habitation. There was no evidence that the vendor was aware of the potential for such a devastating landslide as occurred here. Justice Dubin, nevertheless, made the following useful observation [D.L.R. at 151-52]:

I am prepared to assume that, in an appropriate case, a vendor may be liable to a purchaser with respect to premises which are not new if he knows of a latent defect which renders the premises unfit for habitation. But . . . in such a case it is incumbent upon the purchaser to establish that the latent defect was known to the vendor, or that the circumstances were such that it could be said that the vendor was guilty of concealment or a reckless disregard of the truth or falsity of any representation made by him . . .

Similarly, I am prepared to assume that there is a duty on the vendor to disclose a latent defect which renders the premises dangerous in themselves, or that the circumstances are such as to disclose the likelihood of such danger, e.g., the premises being sold being subject to radioactivity.

Dubin continued [D.L.R. at 153]:

Where the action sounds in fraud or misrepresentation, the defence of caveat emptor would be of no avail, nor would the purchasers' success be precluded by what was said in Redican v. Nesbitt.

Sevidal v. Chopra (1987), 41 C.C.L.T. 179, 2 C.E.L.R. (N.S.) 173 (Ont. H.C.), a residential property case, extended the CRF Holdings test to include potential as well as actual danger. The failure of the duty to warn is now actionable in deceit, where the latent dangerous defect, actual or potential, is within the knowledge of the vendor. Silence is fraudulent. Justice Oyen stated [C.C.L.T. at 206]:

They [the vendors] knew about the potentially dangerous latent defect prior to the signing of the agreement. The fact that at the time the agreement was signed the latent defect was only known to be on property in the immediate area and not on the property itself, provides no excuse for non-disclosure. The Chopras were guilty of concealment of facts so detrimental to the Sevidals that it amounted to a fraud upon them, and therefore, the Chopras are liable in deceit.

The Sevidal case involved the purchase of a home in a subdivision which was located on the former site of a wartime radium recovery plant. Prior to signing the agreement of purchase and sale, the vendors were aware that radioactive material had been found in the area, although not on their particular premises, but failed to disclose this fact to the purchasers. In addition, prior to closing the vendors were advised by an official of the Atomic Energy Control Board that radioactivity had been discovered in their backyard. Again the vendors did not disclose this fact to the purchasers.

The court held that, although the radioactive material did not pose an immediate health risk, the amount was sufficient to be of potential risk and hazard and therefore a potential danger to the purchasers. As such, and being a latent defect, the vendors were under an obligation to disclose the existence of the radioactive material in the area prior to entering into the agreement, and in the circumstances of that case, were also under a duty to disclose the change of circumstances to the purchasers prior to closing. As a result of their failure to disclose, "the [vendors] were guilty of concealment of facts so detrimental to the [purchasers] that it amounted to a fraud upon them, and, therefore, the [vendors] are liable in deceit".

Clearly, as a result of these cases, the law in Canada is that the failure of a vendor of polluted property to disclose a known potential or actual danger in the nature of latent defect is a form of fraud where the defect is material. Vendors will not, however, be held liable where they have no knowledge of the latent defect or where the defect is minor in nature.

In Heighington v. Ontario (1987), 2 C.E.L.R. (N.S.) 93, affirmed (1989), 4 C.E.L.R. (N.S.) 65 (C.A.), Justice Holland held that the Ontario Housing Corporation could not be held liable for a latent defect (radioactive contamination) of which it had no knowledge where there was no express warranty. The Court cited the general rule as expressed in 42 Hals. (4th ed.), p. 49, para. 54 for the proposition that there is no implied warranty of fitness for the purpose in a sale of land [2 C.E.L.R. at 109]:

Prima facie the rule 'caveat emptor' applies also to latent defects of quality or other matters (not being defects of title) which affect the value of the property sold, to the vendor, even if he is aware of any such matters, is under no general obligation to disclose them. There is no implied warranty that land agreed to be sold is of any particular quality or suitable for any particular purpose.

In the case of Caleb v. Potts (1986), 2 A.C.W.S. (3d) 2, affd. 7 A.C.W.S. (3d) 107 (Ont. C.A.), however, the court held that the presence of methane gas in the water well serving the vendor's home, which was vented from the well into a tank in the basement, was a minor latent defect of quality, since it did not render the house dangerous or uninhabitable. As such, there was no duty on the vendor to inform the purchasers as to the function of the tank.

3. The Purchaser's Perspective: The Nature of Reasonable Investigations

The non-disclosure of latent dangerous defects is actionable only where the defect would not be readily apparent to a purchaser conducting a reasonably careful, ordinary inspection. To our knowledge, the extent of such reasonable inspection has never been clearly defined by a Canadian court in the context of environmental due diligence by the purchaser of properties.

Current and proposed legislation in the United States, however, provides some guidance as to the requisite extent of reasonable environmental due diligence investigations. For example, the U.S. Superfund Amendment and Reauthorization Act ("SARA"), Pub. L. 99-499, 100 Stat 1613 (1986), which enacted the so-called "innocent landowner defense" to environmental actions under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. 9601 et seq., provides that owners or operators of polluted property will not be held liable for the clean-up of prior contamination if they can prove that, at the time of acquiring the property or taking possession, they undertook a reasonable investigation and had no reason to believe that the property was contaminated.

SARA provides little guidance as to what constitutes "reasonable investigation" but does direct the courts to take into account any specialized knowledge or experience on the part of the owner, the relationship of the purchase price to the value of the property if contaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property and the ability to detect such contamination by appropriate inspection [SARA Sec. 101(35)(B), 42 U.S.C. 9601(35)(B)]. See

also, Richard G. Leland, "Environmental Audit Should Become Part of Merger Checklist", National Law Journal, February 5, 1990 pgs. s10-s13.

Legislation has recently been introduced in Congress which would more expressly define the type and extent of investigation required to establish the "innocent landowner defense". Under the proposed Innocent Landowner Defense Amendment of 1989, H.R. 2787, 101st Cong., 1st Sess., a reasonable environmental audit necessary to assert the "innocent landowner defense" must include at least the following:

- (i) a review of recorded chain of title documents;
- (ii) a review of aerial photographs available from state and local governments that may reflect prior uses of the property;
- (iii) a determination of whether there are any existing environmental clean-up liens against the property that have arisen under federal, state or local statutes;
- (iv) a review of reasonably obtainable federal, state and local records of sites or facilities when there have been, and are likely to be, further releases of hazardous substances, including reports and environmental records concerning landfills, underground storage tanks and activities that are likely to cause or contribute to the release of hazardous substances; and
- (v) a visual site inspection of the real property, its improvements and adjacent real property.

D. Active Non-Disclosure of Material Defects

In some cases, Canadian courts have held vendors liable for express, albeit innocent, misdescriptions which have induced a purchaser to buy property apparently suitable for its purpose when, in fact, a latent defect rendered the property materially less than suitable. To our knowledge, all such cases have involved some element of active non-disclosure of a material defect by the vendor, verging on a fraudulent suppression of the truth.

The rule on which these cases is based was first set out in Flight v. Booth (1834), 1 Bing (N.C.) 370, 131 E.R. 1160 as follows:

[W]here the misdescription, although not proceeding from fraud, is in a material and substantial point, so far affecting the subject-matter of the contract that it may reasonably be supposed that, but for such misdescription, the purchaser might never have entered into the contract at all, in such case the contract is avoided altogether. . . Under such a state of facts, the purchaser may be considered as not having purchased the thing which was really the subject of the sale . . .

Further, 42 Hals. (4th ed.), p. 51, para. 56, states that:

[I]t may be the duty of the vendor to disclose matters which are known to himself, but which the purchaser has no means of discovering, such as a defect which will render the property useless to the purchaser for the purpose for which, to the vendor's knowledge, he wishes to acquire it.

Jung v. Ip (1988), 47 R.P.R. 113 (Ont. D.C.), is a case in point. The vendors were held liable for fraudulent misrepresentation for failing to disclose the severe damage caused

by a termite infestation of the property sold to the purchasers. In fact, the vendors did not on any occasion speak to the purchasers who made direct inquiry concerning termites of the agents of the vendor. However, when the plaintiff asked about replacement flooring, the vendors indicated that it was the repair of water damage, when the damage had actually been caused by termites. In the case, Gotlib D.C.J. stated [R.P.R. at 123]:

It is clear, based on transcripts of examination for discovery of Mr. Ip, that the vendors were aware of the termite infestation. It is equally clear that because [the prior owner] had not mentioned the termite infestation to Mr. & Mrs. Ip when they purchased the property in 1982, they were of the view that they need not pass that information on to any purchaser from them. In that, of course, they were wrong in law. Ignorance of the law is not excuse. A latent defect must be disclosed by a vendor who is aware of its existence... Even if the vendors themselves had committed no wrong, they would be vicariously liable for the wrongs of the two agents. Nor are the vendors saved by the doctrine of caveat emptor, in which does not apply where there is error in substantialibus, nor does it apply where the transaction has been brought about by the fraud of the vendor.

After referring to the decision in the Sevidal case, Gotlib continued:

It is now clear that the law of Ontario is such that vendors are required to disclose latent defects of which they are aware. Silence about a known major latent defect is the equivalent of an intention to deceive.

In another termite infestation case, Hoy v. Lozanovski (1987), 43 R.P.R. 296 (Ont. Dist. Ct.), the purchaser made the purchase conditional upon a satisfactory independent inspection report. Upon receipt of the satisfactory report the sale was

completed; subsequently, the purchaser discovered the extensive damage caused by termites. The action was dismissed because the purchaser relied on the inspection report rather than any representation the vendor may or may not have made. The court stated [R.P.R. at 301]:

[The purchaser] cannot be said to have relied on the vendor's silence even if the vendor had been fully aware of the material latent defect. Where the purchaser chooses not to rely on the vendor and requests inspections, including professional inspectors, then reliance for completion of the deal is shifted to the inspector whom the purchaser has chosen. The purchaser has relied on the inspector's report, not the vendor's silence, to formulate his decision whether or not to complete the deal. In such a case the responsibility of the vendor is released and assumed by the purchaser or transferred to his agent, the home inspector...In this case, the plaintiff has failed to show fraud on the part of defendants as there was no reliance on the defendants' silence. If, however, the vendor has made representations to the purchaser or the purchaser's inspectors that were fraudulent, then the responsibility for disclosing the latent defect would remain with the vendor.

In a case where misdescription was not found, Sorensen v. Kaye Holdings Ltd. (1979), [1979] 6 W.W.R. 193, 14 B.C.L.R. 204 (B.C.C.A.), leave to appeal to the S.C.C. refused, 31 N.R. 445n (S.C.C.), the vendor of a resort property failed to disclose that it had been convicted of violating health regulations in the operation of a swimming pool located on the resort property and simply advised the purchaser that the Board of Health might require a permit. Subsequent to closing, the Board of Health refused to issue a permit, thereby putting the purchaser to the expense of substantial renovations. The court refused to order rescission on the grounds that the vendor had not expressly misdescribed the property.

Sorenson has been distinguished, however, in significant Canadian cases. In Sevidal v. Chopra supra, the court noted that the defect was not patent or dangerous, and was discoverable by contacting the appropriate authorities. Anderson J.A. in C.R.F. Holdings citation distinguished Sorenson on several grounds [W.W.R. at 419 and 420]: "[T]he plaintiffs in Sorenson were well aware of the relevant facts at all material times; there was no evidence that any positive assertion amounting to a misrepresentation had been made; the plaintiffs were put on inquiry (they were told that the Board of Health might require a permit to operate the pool); and . . . on the facts, that there was no intent to deceive."

The absence of duty to warrant fitness for the purpose is to be distinguished from actively inducing a purchaser to enter a contract on the basis of the failure to disclose a material defect on the part of the vendor. In the former, the courts have refused to impose on the vendor obligations where there is no intent to deceive; in the latter, the purchaser cannot be bound by a contract in which it did not receive that for which it bargained.

G. H. Treitel, in An Outline of the Law of Contract (London: Butterworths, 1984) at 96, had this to say:

[I]f one of the parties undertakes that it has [some important] quality, he is normally liable if the subject matter in fact lacks the quality, and the other is in that event normally not bound to perform. The difficult cases are those in which both parties simply assume that the thing has a certain quality which is in fact lacking. Many mistakes of this kind are obviously not fundamental . . . In these cases it can be said either that the mistake is not important enough to affect the validity of the contract, or that it related to a matter in respect of which the party prejudiced by the mistake could have been

expected to protect himself, by expressly stipulating that the quality must exist. (author's emphasis)

E. Conclusion

The principal of caveat emptor requires that the purchaser exercise due diligence to discover all patent and latent defects of the property. The vendor is not required to disclose non-dangerous defects provided it does not mislead. However, if a dangerous defect is within the actual or constructive knowledge of the vendor and there is a foreseeable risk of serious injury to the purchaser, the vendor has a duty to warn the purchaser, and that warning must be sufficiently explicit in the circumstances of ordinary or expected use of the property.

Where the latent defect is not dangerous, the vendor does not imply a warranty of fitness for the purpose for which the property was bought. The purchaser must obtain express warranties for this purpose. The vendor will only be liable for defects in cases of active non-disclosure of defects known to be material to the prospective purchaser.

IV. POTENTIAL TORTIOUS LIABILITIES OF PRIOR OWNERS TO CURRENT OWNERS OF POLLUTED LANDS

A. Introduction

During the course of its occupancy, the operator of an oil and gas property may, through its drilling or production activities, pollute the property owned in common by itself and its co-venturers. Subsequently, ownership of all or portions of the property may change hands through transfer on one or more

occasions. At some point, a situation arises where the original pollution results in the land being unsuitable for the purposes intended by a subsequent purchaser (e.g., farming or recreational use).

What is the likelihood of the subsequent purchaser successfully pursuing an action in private nuisance, strict liability or negligence against the original vendor? In what circumstances will a polluter of land, who subsequently sells the property, be held liable under tort principles to successors in title purchasing or leasing that particular property from the party who purchased it from the vendor/ polluter or a successor to such party?

Further, does it make any difference whether the original vendor sold the property at an appropriately discounted price reflecting the reduced usefulness of the land as a result of the pollution, that the agreement may have been an 'as is' contract or that the second purchaser may have assumed liability for environmental risks in its agreement with the intervening owner?

The answer to these questions depends on the extent to which the law applicable to torts of nuisance, trespass, strict liability and negligence can sustain a cause of action by the present successor in title against a remote predecessor in title.

**B. The Elements of Private Nuisance**

Nuisance is a tort arising out of competing land uses and grounded in the reciprocal duties of neighbouring occupiers of land. An essential element of an actionable private nuisance is the unreasonable interference with an occupier's use and enjoyment of his land arising from conflicting or incompatible uses of