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## The New Business Imperatives in the Environmental Regulation Area — Impact of Environmental Concerns on Business Transactions: Who Really Pays?

*Clive V. Allen\**

**D**uring this conference we have heard speakers explain in some detail the environmental laws of Canada and the United States, and we have heard other speakers outline key environmental issues for the 1990s and beyond. We have listened to discussions, often in more than one session, of specific environmental problems, including the clean-up of contaminated properties, to name but one.

We now turn to what I consider to be one of the most critical questions of all. What impact do environmental laws have on business transactions and, specifically, as the conference program asks, “who really pays” the costs of complying with such laws?

As will shortly become clear, I am of the view that, more and more often, the party required to pay is the party with the “deep pocket”, and not necessarily the party who is or was at fault. Such a practice can unfairly penalize profitable businesses having sound and progressive environmental programs, as well as businesses seeking funds to undertake remedial projects and lenders willing to advance such funds. If not checked, the practice eventually may have a chilling effect on the flow of capital to businesses located in jurisdictions that have incorporated the practice into their environmental laws.

Before turning to the topic before us, let me make three comments. I have been asked to present a Canadian perspective. I propose to do so, but at the same time I must point out that my comments are not necessarily limited to Canada. Although the corporation with which I am associated is Canadian in origin, it has substantial operations throughout the world, and I expect my comments will have the same scope.

Second, the topic for discussion is exceedingly broad, and in the limited time available to me I cannot do justice to each and every relevant aspect. I must of necessity refer only to certain issues and, for the purpose of illustrating my points, propose to focus primarily on laws related to the clean-up of contaminated properties.

Finally, I propose to conclude my remarks with a number of recommendations which, if implemented, may assist in making the application

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of environmental regulation more equitable and ensure that clean-up costs are borne by actual polluters and not by innocent parties.

### THE POLLUTER PAYS PRINCIPLE

In the early 1970s, members of the Organization for Economic Cooperation and Development endorsed the principle of "polluter pays", which requires that businesses bear the costs of any environmental damage they may cause. Until recently, the environmental laws of most jurisdictions were firmly based on this principle.

It is worth noting that the *polluter pays* principle has been frequently criticized.<sup>1</sup> It is said, among other things, to be elastic and open to interpretation. For instance, does it permit the retroactive imposition of liability?

While such criticisms may be justified, in my view the principle is nonetheless significant, because it makes it clear that a party that has neither caused nor contributed to environmental damage — by actually carrying on a polluting activity or by improperly allowing it to continue — should not be liable to clean-up the damage. To do otherwise would be manifestly unfair and would provide an unfair competitive advantage to the polluter.

As recently as July 1989, a consultant, in a report to the Province of Ontario summarizing the regulation of industrial toxic and hazardous emissions in Ontario and various Canadian, United States and other jurisdictions, concluded that all jurisdictions surveyed were operating on the *polluter pays* principle.<sup>2</sup>

While this conclusion might have been at the time correct in the case of toxic and hazardous emissions, the principle has been replaced, at least in some jurisdictions with respect to the clean-up of contaminated properties, by a new principle that the party with the deep pocket should remain forever liable, even in circumstances where that party has neither caused nor contributed to environmental damage.

### THE DEEP POCKET PRINCIPLE

This new principle can best be illustrated by referring to recent amendments to the Environmental Protection Act<sup>3</sup> of the Province of Ontario.

In June 1990, the Act was quietly amended to provide the Ministry of the Environment with the power to issue a control order or a stop order to the person who previously owned, was in occupation of, or had

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<sup>1</sup> See, e.g., Kyle McSarrow, *International Trade and the Environment: Building a Framework for Conflict Resolution*, 21 ENVTL. L. REP. 10589, 10593 (1991).

<sup>2</sup> HICKLING MANAGEMENT CONSULTANTS LTD., *THE REGULATION OF INDUSTRIAL TOXIC AND HAZARDOUS EMISSIONS IN ONTARIO AS COMPARED WITH SELECTED JURISDICTIONS* (1989).

<sup>3</sup> R.S.O. ch. E-19 (1990) (Ont.).

charge, management or control of a “source of contaminant”.<sup>4</sup> Prior to the amendment, only the person owning, occupying, operating, managing or controlling the source of contaminant could be subject to such orders.

A second amendment to the Act granted the Ministry the power to issue a written order against a person who previously owned, managed or controlled an undertaking or property, requiring the person to take various measures to prevent or minimize damage to the environment should a contaminant be discharged from the undertaking or from the property.<sup>5</sup> Before the amendment, the order could be issued only to the current owner or the person in management or control of the undertaking or property.

Leaving aside the issue of the constitutional validity of the amendments, and the question of how a party that no longer has any association with a source of contaminant or an undertaking or property can be expected to comply with Ministry orders, the amendments make certain parties — the deep pockets — liable for any and all clean-up costs, even though those parties may not have caused environmental damage or may have contributed only insignificantly to the problem.

There has been little case law interpreting these and similar provisions so the actual application of the legislation is unknown.<sup>6</sup>

#### LENDER AND BORROWER CONCERNS

The *deep pocket* principle, and the problem of liability for cleaning up contaminated properties, is obviously of considerable concern to both lenders and borrowers. In November 1991, the Canadian Bankers Association released a well-reasoned paper on the subject of “Sustainable Capital: The Effect of Environmental Liability In Canada On Borrowers, Lenders, and Investors”. While directed primarily to borrowers and lenders, the concerns and proposals outlined in the paper are sufficiently fundamental to be relevant to businesses generally.

The paper begins by listing four typical situations in which lenders and borrowers can be seriously affected by the *deep pocket* principle. These four situations are:

- (a) a small business is unable to borrow because it owns property that is considered to be environmentally risky;
- (b) a business is unable to absorb the costs of complying with a government order to clean-up its property without putting itself into a position of insolvency;
- (c) a lender declines to provide financial assistance to a troubled bor-

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<sup>4</sup> *Id.* at §§ 7(1), 8(1).

<sup>5</sup> *Id.* at § 18(1).

<sup>6</sup> The most recent reported decision, *CN Railway Co. v. Ontario (EPA Director)*, 3 O.R.3d 609 (Div. Ct. 1991), *aff'd*, 7 O.R.3d 97 (C.A. 1992), did not consider the June 1990 amendments to the Environmental Protection Act.

rower in a loan work-out situation for fear of attracting environmental liability to itself;

- (d) employees interested in investing in a faltering industrial plant in order to save their jobs are informed that their investment would be worthless because of the environmental liability they would be assuming if they bought the plant.<sup>7</sup>

The paper then reviews three aspects of the problem of environmental liability. These aspects — the broad scope of liability, the uncertain responsibility for clean-up, and the severity of the impact on an innocent party or one who has contributed only insignificantly to a problem — have been dealt with in my previous comments explaining the *polluter pays* and *deep pocket* principles.

After discussing the principle of sustainable development and the need for a principle of sustainable capital, and reviewing United States superfund legislation and its provisions granting lenders some protection from environmental liability, the paper offers the following conclusion:

The problem of environmental liability in Canada ultimately reduces to a simple question - who should pay for environmental cleanup? The CBA is of the view that the polluter should pay. In the event the polluter cannot pay, then the liability should be treated as a social cost.

The fundamental problem with environmental liability policy in Canada is that the broad and uncertain scope of potential liability departs from the polluter pay principle. In so doing, it weakens polluter accountability. To address the problem, the CBA proposes an approach to environmental liability that places responsibility and liability clearly on actual polluters.

These polluters should not, however, be impaired in their ability to access capital markets to finance the cost of the cleanup. Parties associated with these polluters (e.g. lenders, subsequent purchasers of the polluter's contaminated property and trustees) should not be tainted with the polluter's liability where the party has made a reasonable effort to determine that the polluter is in compliance with environmental laws.<sup>8</sup>

I tend to agree with this conclusion and consider it to be relevant to jurisdictions other than Canada.

#### THE NORTHERN TELECOM EXPERIENCE

I wish now to provide four examples of Northern Telecom's involvement in the clean-up of contaminated properties in various jurisdictions in order to illustrate some of the points I have previously made and to show generally how laws related to the clean-up of contaminated properties are being implemented by regulatory authorities.

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<sup>7</sup> CANADIAN BANKERS ASSOCIATION, *SUSTAINABLE CAPITAL: THE EFFECT OF ENVIRONMENTAL LIABILITY IN CANADA ON BORROWERS, LENDERS, AND INVESTORS* 1 (1991).

<sup>8</sup> *Id.* at 9.

### Example I

The first example illustrates, I believe, quite clearly the costs involved in cleaning up site contamination and the difficulty businesses encounter in attempting to determine the extent of their clean-up obligations or, in other words, “how clean is clean”.

Several years ago, Northern Telecom agreed to purchase a facility and property from a large corporation. During the course of our due diligence investigations, we discovered that groundwater on site had been contaminated by the vendor. In order to close the transaction, the vendor agreed to clean up the contamination, regardless of the cost or the time required to do so.

The problem was discovered almost three years ago, but a groundwater treatment facility constructed by the prior owner is just now being commissioned. By the time it is operating, the system will have cost the prior owner well in excess of \$1,000,000, and perhaps as much as \$2,000,000. The system will be expensive to operate and will probably still be operating well into the twenty-first century, long after I have retired from Northern Telecom.

Although we were not directly involved in discussions with the regulatory authority, it appeared to us, and to our external environmental consultant, that the regulator recognized that the prior owner was willing to live up to its responsibility to clean-up the site, and also had a deep pocket. The regulator thus insisted that any groundwater treatment system meet very strict operating standards.

As a result, the system being commissioned on our property is a “Cadillac”, whereas given the nature of the problem, a “Volkswagen” might have been just as acceptable from technical and environmental perspectives. The regulator, however, will be able to point to the system as an example of the type to be constructed by others when treating instances of contaminated groundwater, even though simpler, less costly systems may be just as effective in many circumstances.

During its discussions with the prior owner, the regulator has been seemingly reluctant or unable to discuss one crucial issue: the standards for deeming the site clean. The prior owner is in an unenviable position. It is impossible for it to know “how clean is clean”, how long it will be on site, and what amount of money it will ultimately be required to spend on remedial activities. These uncertainties should not be imposed on any business.

If the *deep pocket* principle were to apply to this example, Northern Telecom, as the new owner of the property, would be potentially liable for cleaning-up the contaminated groundwater, even though it is completely innocent of any wrongdoing.

Furthermore, if the transaction was to take place in 1992, and in a jurisdiction embracing the *deep pocket* principle, we would consider very carefully whether the acquisition was absolutely essential to our business

plans. Even if it were, if the vendor was small or in financial difficulty, environmental issues might dictate that we not proceed further.

### *Example II*

The second example is the converse of the first. A few years ago, Northern Telecom sold a facility and, as part of the transaction, the purchaser, a small, newly-formed corporation, assumed certain environmental liabilities. The purchase price, negotiated by experienced businessmen on both sides, took into account that Northern Telecom would have no further liability for such matters and that the purchaser would continue with certain relatively minor remedial activities.

If the *deep pocket* principle were to apply, Northern Telecom would have a potential liability for cleaning-up any contamination it may have caused, as well as any and all contamination that may be caused in the future by the purchaser or subsequent purchasers. Should a problem arise requiring remedy, I can assure you that I know exactly who the regulator would approach.

### *Example III*

The third example is intended to show the type of delay businesses, particularly those believed by regulators to have deep pockets, frequently encounter when seeking approval to carry out remedial projects.

Soil and groundwater contamination was discovered in the mid 1980s at one of our facilities. Remedial action was clearly required, especially as the plume of contaminated groundwater extended off-site towards a residential neighborhood.

Our outside consultant prepared a suitable remedial plan which was submitted in a timely fashion to the regulator for approval. No clean-up work could be undertaken until such approval was received.

Regrettably, we had to wait, for no apparent reason as far as we could see, well over a year for the approval. In that time, the contamination moved further off-site with a resultant increase in the costs and time required for clean-up. This was not a serious problem for a company our size, but was the environment protected as quickly as it might otherwise have been? I suggest not.

### *Example IV*

I turn now to the last example. This example does not deal directly with the clean-up of contaminated properties, but illustrates the manner in which one regulatory authority dealt with businesses it perceived as having deep pockets.

Several years ago, Northern Telecom retained a company to transport hazardous waste to a disposal facility. Northern Telecom had an agreement in place with the company requiring it to properly handle all waste. During routine investigations, Northern Telecom had not discov-

ered anything wrong with the operations of the company, which had been licensed by all applicable regulatory authorities.

Following a tip from a disgruntled employee, the regulator determined that the company was stockpiling waste in warehouses and not shipping it to disposal facilities on a timely basis. There were rumors at the time that the regulator had not adequately investigated similar earlier tips.

Notwithstanding the potential criticism that could be levelled at the regulator, or perhaps because of it, the companies whose wastes were stored in warehouses — the deep pockets — were asked rather bluntly to reclaim and dispose of the wastes. Although not under a legal obligation to do so, Northern Telecom, like most if not all of the other companies, paid a second time to have their wastes properly handled. I wonder how much more difficult this regulator would have been to deal with if the law had in fact been on its side.

### CONCLUSIONS

I mentioned at the beginning of my remarks that I would provide a number of recommendations for making the application of environmental regulation more equitable and for ensuring that clean-up costs are borne by actual polluters, not by innocent parties. I have three recommendations:

1. Liability for cleaning up environmental damage must be imposed only on the actual polluter and not on an innocent party. If the polluter cannot pay, or cannot be found, and the current owner of the business or property is innocent of any wrongdoing, liability for clean-up must be the responsibility of society as a whole.
2. As a corollary to my first recommendation, a party should not be considered a polluter and subject to environmental regulation merely because environmental standards have changed. If a party has in the past fully complied with all applicable environmental laws, and has no further connection with the business or property, it should not retroactively become subject to clean-up obligations.
3. A party's obligation to clean-up environmental damage must be in proportion to the damage that party has caused.

In closing, I would like to offer one personal observation. If the recommendations are not implemented, and should the *deep pocket* principle be allowed to become the norm, profitable, environmentally-sound businesses will be unfairly disadvantaged as polluters are given an unfair competitive advantage, and financial institutions and investors will become hesitant to lend to borrowers having even seemingly insignificant environmental problems. Should this happen, economic growth may very well be stymied.

