

**MANAGING ENVIRONMENTAL
RESPONSIBILITIES WITHIN
CURRENT CORPORATE
GOVERNANCE STANDARDS**

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NOTE TO READER: This paper is intended to introduce some of the concepts related to managing environmental liabilities and is not intended to be read as legal advice. The members of the Edwards, Kenny & Bray LLP Environmental Practice Group would be pleased to discuss particular fact situations with you.

MANAGING ENVIRONMENTAL RESPONSIBILITIES WITHIN CURRENT CORPORATE GOVERNANCE STANDARDS

What do today's new expectations for corporate governance mean for environmental management? It means that the interest at the corporate board level in environmental due diligence that began a dozen years ago with *Bata Industries*¹ has taken on fresh urgency.

SOURCES OF ENVIRONMENTAL RESPONSIBILITIES FOR DIRECTORS

Today, the obligations of corporate directors with respect to the environment arise from multiple (and often overlapping) sources. As a matter of general corporate law, a company's directors owe the company a general duty of care. General principles of corporate governance require a director to act diligently in supervising and managing the corporation's affairs² to create "a 'better' corporation".³

The environmental regulatory regime imposes a separate parallel duty on directors to undertake a high level of diligence in the supervision and management of a corporation's environmental affairs. In particular, environmental compliance dictates that a company exercise due diligence in order to avoid incidents that may harm the environment. Directors are not required to personally design a due diligence system or to personally implement the system. As a matter of general corporate law and in fulfilment of environmental due diligence obligations, directors must act prudently and on "a reasonably informed basis".⁴ What that means is that directors must apply their own informed business judgment in ensuring that an appropriate due diligence system is in place.

¹ *R. v. Bata Industries Ltd.*, (1992), 7 C.E.L.R. (N.S.) 245 (Ont. Ct. (Prov. Div)), var'd (1993), 11 C.E.L.R. (N.S.) 288 (Ont. Ct. (Gen. Div)) var'd (1995), 18 C.E.L.R. (N.S.) 11 (Ont. C.A.) ("*Bata*"). *Bata*, it will be recalled, was the 1992 Ontario prosecution where two of the directors of a corporation were convicted and fined as a result of their failure to ensure that adequate care was taken to avoid an environmental incident.

² *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68 ("*Peoples*") at para. 32

³ *Peoples*, *supra* note 2, at para. 67

⁴ *Peoples*, *supra* note 2, at para. 47

Financial markets also impose high expectations for accurate disclosure of all liabilities, including environmental liabilities, of public companies. The public expect a high standard of care in the undertaking of environmental stewardship responsibilities. It is the director's role to ensure that a corporation meets those expectations.

The Supreme Court of Canada has not been subtle in expressing the importance the Court places on the protection of the environment. Last year, the Court said this:⁵

The question of compensation for environmental damage is of great importance. As the Court observed in Canada (Procureure générale) c. Hydro-Québec, [1997] 3 S.C.R. 213 (S.C.C.), at para. 85, legal measures to protect the environment “relate to a public purpose of superordinate importance”. In Friends of the Oldman River Society v. Canada (Minister of Transport), [1992] 1 S.C.R. 3 (S.C.C.), the Court declared at p. 16 that “[t]he protection of the environment has become one of the major challenges of our time”. In R. v. Canadian Pacific Ltd., [1995] 2 S.C.R. 1031 (S.C.C.), “stewardship of the natural environment” was described as a fundamental value (para. 55; italics in original). Still more recently, in 114957 Canada Ltée (Spray-Tech, Société d’arrosage) v. Hudson (Ville), [2001] 2 S.C.R. 241, 2001 SCC 40 (S.C.C.), the Court reiterated at para. 1:

... our common future, that of every Canadian community, depends on a healthy environment This Court has recognized that “[e]veryone is aware that individually and collectively, we are responsible for preserving the natural environment ... environmental protection [has] emerged as a fundamental value in Canadian Society” ...

The twentieth century tension between maximizing profits from production while safeguarding the environment from the consequences of production has now developed into a requirement for directors to protect both the environment and profitability from the consequences of inadequate environmental management. Indeed, the modern realities of corporate social responsibility have moved towards the convergence of the best interests of a corporation and the best interests of the wider community. The 1950's sound bite “what's good for General Motors is good for the rest of America” has transformed into “what's good for the community is good for the corporation”.⁶ Put another way, minimizing impacts on the environment not only benefits the wider community but also benefits the corporation by significantly reducing the possibility of commission of an environmental offence and significantly reducing environmental clean-up costs.

⁵ *British Columbia v. Canadian Forest Products Ltd.* (2004), 8 C.E.L.R. (3d) 1 at 15 (S.C.C.)

⁶ The challenge, however, is ensuring that “what's good for the community” is determined on an informed and rational basis.

MANAGING ENVIRONMENTAL RESPONSIBILITIES

Managing environmental responsibilities is not dissimilar to other management strategies: neither over-react nor under-react, and clearly identify goals. The two principal environmental management goals are ensuring that nothing that your company does breaches environmental laws or harms the environment, and ensuring that environmental liabilities are, to the extent possible, minimized. Due diligence is at the centre of a process aimed at achieving those goals. Due diligence is crucial in avoiding environmental non-compliance and avoiding environmental liabilities as well as in mitigating those liabilities, if they arise. Moreover, the process of instituting a due diligence system aimed at maintaining a high standard of environmental stewardship responds not only to environmental regulatory requirements but also to the general duty of care imposed on directors

Due diligence is directed to attempting to foresee what can “go wrong” and to establishing systems to eliminate or reduce the risk of those things going wrong. If flawed due diligence results in environmental impact, public confidence in a company’s governance structures will be adversely affected. Flawed due diligence may also lead to an environmental prosecution and to remediation or clean-up costs which can be significant: the balance of this paper will address those two issues in more detail.

ENVIRONMENTAL OFFENCES AND THE REGULATORY STANDARD

Due diligence, in the environmental law context, means the exercise of all reasonable care to avoid environmental non-compliance. Due diligence is generally a defence to Canadian environmental offences. Even if not sufficient to support a defence, due diligence may convince regulators not to proceed with a charge and will be relevant to the amount of the fine if a charge and conviction occurs.

Canadian courts have developed an approach to the exercise of reasonable care in the environmental context. An example can be found in a British Columbia case involving an oil spill in Tahsis Inlet by a fuel barge that was unloading fuel.⁷ The oil spill led to charges under

⁷ *R. v. Gulf of Georgia Towing Company Ltd.* (1979), 10 B.C.L.R. 135 (B.C.C.A.) at 136

the federal *Fisheries Act* and, eventually, the case made its way up to the British Columbia Court of Appeal. The Court of Appeal, in dismissing the appeal, quoted from the trial judge who had found that:

It is not a defence on the part of the respondent to say that the fault lies with the employee who failed to exercise reasonable care notwithstanding the imposition by the company directors of rigid safety regulations and training programs.

The Court of Appeal concluded by saying this:⁸

For fuel barges, if one does nothing but hire careful people, train them carefully and tell them not to leave valves open, inevitably a valve will be left open. I am sure they have not hired infallible people. There will inevitably then be a spill. It seems to me that the consequences are so serious that something will have to be devised by the company if it is to be protected here to prevent spills when employees are not as careful as they are told to be.

At about the same time as the BC case, the Supreme Court of Canada decided a case involving the City of Sault Ste. Marie.⁹ The City had contracted with an outside contractor for the disposal of all of the City's refuse. The outside contractor placed the refuse in a landfill near a creek that ran into a river. Pollution from the landfill made its way into the creek and then to the river. The contractor and the City were charged and convicted under an Ontario statute. The Supreme Court found that in order to establish due diligence a corporation must show that it had exercised all reasonable care by establishing a proper system to prevent commission of the offence and that it had taken all reasonable steps to ensure the effective operation of the system.

A recent formulation of due diligence by an Appellate Court is that of the Ontario Court of Appeal in the 2003 *Petro-Canada* case.¹⁰ The Court, referring to the Supreme Court of Canada in *Sault Ste. Marie*, said this:

While, in the end, Dickson J. [in Sault Ste. Marie] ordered a new trial, he did describe briefly how the defence of reasonable care might operate in the context of the charge in that case. At p. 377, he made clear that the question would be whether the accused had negated its wilful involvement in the act charged and "... whether the accused exercised all reasonable care by establishing a proper system to prevent commission of the offence and by taking reasonable steps to ensure the effective operation of the system." The focus of the defence is the discharge and the steps taken to prevent it.

⁸ *ibid.* at 137

⁹ *R. v. City of Sault Ste. Marie* (1978), 85 D.L.R. (3d) 161 (S.C.C.)

¹⁰ *R. v. Petro-Canada* (2003), 63 O.R. (3d) (Ont. C.A.) at para. 15

Despite best efforts towards compliance, occasionally, incidents of non-compliance will occur. Environmental management also requires thinking through in advance a company's policy approach to environmental prosecutions. In the context of 21st century corporate values, including today's focus on social responsibility, it is appropriate to pause and re-think approaches to environmental investigations and prosecutions. What type of prosecutions does the company wish to defend? Will the approach be to vigorously defend all prosecutions where it is perceived that regulators are unjustifiably over-reacting to a relatively minor infraction? Or will it be the general policy to "accept the medicine" and move forward? While many environmental statutes provide for fines of up to a million dollars per day, it continues to be the case that the majority of fines actually imposed are for one hundred thousand dollars or less. A table of offence penalties from a selection of Canadian statutes related to environmental compliance is set out on the following page.

POTENTIAL STATUTORY LIABILITIES AND PENALTIES UNDER COMMON ENVIRONMENTAL LEGISLATION (OCTOBER 2005)

STATUTE	OFFENCE PENALTY							CIVIL LIABILITY
	Statutory Offence	Offence Penalty	Continuing Offence is Separate Offence	Potential Additional Creative Sentencing	Potential Additional Monetary Benefits Penalty	Director and Officer Liability	Statutory Due Diligence Defence	Potential Statutory Civil Liability to Individual and/or Crown
Canadian Environmental Protection Act, 1999	<i>inter alia</i> , contravene a provision of the Act or regulations, an obligation or prohibition therein, or an order made thereunder	up to \$300,000 and/or 6 months' imprisonment for summary convictions; up to \$1,000,000 and/or 3 years' imprisonment for indictable offences; up to 5 years' imprisonment where the contravention is intentional or reckless and results in environmental damage or risk of harm to persons and, where death or bodily harm to person results, possible prosecution for criminal negligence under the <i>Criminal Code</i>	✓	✓	✓	✓	✓	environmental protection action; cause of action to prevent or compensate loss; Crown action to recover costs for remedying damage from offence
Fisheries Act	unauthorized discharge of deleterious substance, or unauthorized works harmful to fish habitat	for summary conviction, up to \$300,000 for first offence, and up to \$300,000 and/or up to 6 months' imprisonment for subsequent offences; for indictable offences, up to \$1,000,000 for first offence, and up to \$1,000,000 and/or up to three years' imprisonment for subsequent offences	✓	✓	✓	✓	✓	cause of action for fishers for recovery of income loss; Crown action to recover costs for remedying damage from offence
Species at Risk Act	<i>inter alia</i> , harm or possess listed species, or damage their residence or destroy their critical habitat	for summary conviction, up to \$300,000 for first offence of corporation; for indictable offences, up to \$1,000,000 for first offence of corporation. For subsequent offences, all fines may be doubled. Also, fines are cumulative; fines may be imposed for each animal or plant involved in an offence.	✓	✓	✓	✓	✓	as creative sentencing, Court may order payment to Crown for recovery of costs to remedy or prevent damage from offence
Navigable Waters Protection Act	<i>inter alia</i> , deposit materials that may interfere with navigation in navigable waters, or disobey order to remove unauthorized works	up to \$5,000 on summary conviction						Crown action to recover costs of removing unauthorized works
Migratory Birds Convention Act	<i>inter alia</i> , unauthorized deposit of substance harmful to migratory birds	for summary conviction on first offence, up to \$100,000 for vessels over 5,000 tonnes, or up to \$300,000 and/or up to 6 months' imprisonment for person or vessel; for indictable offences on first offence, up to \$1,000,000 for vessels over 5,000 tonne, or up to \$1,000,000 and/or up to 3 years' imprisonment for persons or vessels. For subsequent offence, all fines may be doubled.	✓	✓	✓	✓	✓	as creative sentencing, Court may order payment to Crown for recovery of costs to remedy or prevent damage from offence; cause of action for compensation for property loss caused by offence
Transportation of Dangerous Goods Act, 1992	fail to comply with provision of Act, i.e. requirements re transport, handle or contain dangerous goods	for summary conviction, up to \$50,000 for first offence and up to \$100,000 for subsequent offence; for indictable offence, up to 2 years' imprisonment	✓	✓ up to \$1,000,000 per offence		✓	✓	as creative sentencing, Court may order payment to any person for remedial action or damage relating to offence
Canada Shipping Act, 1985	<i>inter alia</i> , discharge pollutant in contravention of regulation under s. 656	for summary conviction, up to \$250,000 and/or up to 6 months' imprisonment for an individual, and up to \$250,000 for a corporation; for indictable offences, up to \$1,000,000 and/or up to three years' imprisonment for an individual, and up to \$1,000,000 for a corporation	✓				due diligence may impact fine amt.	
Criminal Code of Canada	<i>inter alia</i> , negligently or knowingly failing to take reasonable steps to prevent bodily harm arising from employment-related work or tasks	varies for summary conviction up to \$100,000 varies for indictable offence up to an unlimited amount				✓		
Transportation of Dangerous Goods Act (BC)	handle or transport goods in contravention of permit or prescribed safety requirements for containers, packaging, road and rail vehicles	up to \$50,000 and/or up to 2 years' imprisonment for first offence; up to \$100,000 and/or up to 2 years' imprisonment for subsequent offence				✓	✓	
Environmental Management Act (BC)	<i>inter alia</i> , introduce waste into environment as to cause pollution in contravention of Act, regulation, permit, or approval	up to \$1,000,000 and/or up to 6 months' imprisonment; up to \$3,000,000 and/or up to 3 years imprisonment for <i>intentional</i> damage to the environmental or risk to person	✓	✓	✓	✓		Crown action to recover costs of responding to, <i>inter alia</i> , spills and environmental emergencies
Environmental Assessment Act (BC)	<i>inter alia</i> , fail to undertake environmental assessment when required under Act	up to \$100,000 for first offence of a corporation; up to \$100,000 and/or 6 months' imprisonment for first offence of an individual; up to \$200,000 for subsequent offence of a corporation; up to \$200,000 and/or 1 year imprisonment for subsequent offence of a corporation		✓		✓		Court may order person convicted to pay compensation or make restitution

ASSESSING YOUR DUE DILIGENCE SYSTEM

A starting point in assessing an operational due diligence system is to ask this question: if a regulator (including an enforcement officer) understood your undertaking as well as you do, what environmental concerns might that regulator have? In working through the due diligence process, particular attention should be paid to the following questions:

- Are the failsafe aspects of the environmental system adequate? That may mean reviewing the electronics of the system and associated alarm mechanisms.
- Is the maintenance schedule for the environmental protection system sufficient and is it being implemented?
- Is the level of training sufficient? Is the manual sufficient, is it being updated and do people read and understand the manual?
- Are staffing levels and levels of expertise sufficient?
- Are there any concerns with respect to the structural integrity of the environmental protection system?
- Finally, does the system work?

Layered over these six concerns is a monitoring and reporting regime whereby senior management, and, ultimately, the directors, ensure that standards are continuing to be met.

DON'T BUY MORE THAN YOU HAVE BARGAINED FOR

An important issue in environmental management relates to clean-up costs of contaminated sites. Clean-up costs and diminishment in property values often are unexpected, unplanned for and, to a degree, uncontrollable. The instinct to share the misery can be almost irresistible. Due diligence is important in avoiding liability for clean-up costs as well as in managing and quantifying those liabilities if they do occur. As to the former, ensure that systems are in place

on acquisitions so that you don't buy more than you bargained for. If you discover that you do have a contaminated lands issue, assess the environmental liability, consider whether and to what extent you want to redress the situation, and what approaches to take in this respect.

Disputes with respect to contaminated lands ordinarily take shape in one or more of the following forms:

- disputes between vendors and purchasers over who should be responsible for clean-up;
- disputes between landlords and tenants;
- disputes between government and potentially responsible persons over allocation of liability;
- disputes between government and potentially responsible persons over standards of remediation;
- cost recovery and/or indemnity actions between or among potentially responsible persons;
- disputes between adjoining landowners over "travelling" or "migrating" contamination;
- disputes between insurers and insureds over coverage for environmental events; and
- recently, disputes between government and those responsible for injuring the environment under the new natural resource damages cause of action.

Cost recovery actions and remediation orders [both under the *Environmental Management Act* (the "EMA"), which replaced the *Waste Management Act* last summer¹¹] are the two principal liability mechanisms contained in the contaminated lands regime in British Columbia.

Under section 48 of the EMA, a regulatory official (specifically, a director) carrying out functions under the EMA has a discretion (but not a duty) to order remediation of a contaminated site. The person or persons so ordered again must be "responsible persons" within the definitions contained in the EMA. The group of responsible persons centres on past and present owners and

¹¹ The EMA came into force on July 8, 2004, replacing both the *Waste Management Act* and the *Environment Management Act*. Significantly, the long-rumoured changes to the contaminated sites responsibility regime do not appear in the new legislation, so for now, the wide liability net remains.

operators (as defined in the EMA) of contaminated sites. To the extent that parent corporations control or have controlled operations at the site, those parent corporations can also be responsible persons even absent direct ownership or direct operation at the contaminated site. The *EMA* also specifically excludes certain persons from responsibility.

Liability under a remediation order is joint and several (the EMA now uses the term “separate”) so that all responsible persons, whatever the level of culpability, equally share the burden of carrying out obligations under an order. Allocation of responsibility is left for cost recovery. If more than one person is named on a remediation order, there is, however, no ready process to decide who should undertake the obligations.

The statutory cost recovery action [under section 47(5) of the EMA] allows any person who incurs costs in remediating a contaminated site to recover those costs, to the extent that such are reasonably incurred, in an action in the British Columbia Supreme Court against one or more persons who fall under the statutory definition of “responsible person”. Under the present state of the law, costs must be incurred before those costs can be recovered.

The concept of “polluter pay” remains an underlying principle of the regulatory regime. The “polluter pay” principle, however, does not necessarily mean that sole responsibility falls upon the person who deposited the contamination. As referred to above, the EMA sets out those persons who are or can be responsible persons and it is those persons who must pay for clean-up; and, it is in that context that the EMA gives meaning to the polluter pay principle.

The B.C. Court of Appeal in *Seabright*¹² made some general comments about the contaminated sites regulatory regime under what is now the EMA:

I understand the burden the policy underlying the contaminated sites statutory regime imposes on those who fall within the statutory definition of a “responsible person” and understand why those among them who have not benefited from what is now considered polluting conduct will consider themselves unfairly burdened

... All the tools given to the manager, like the new cause of action created by s. 27(4), are designed to serve one fundamental object, the cleanup of polluted sites at the expense of those who benefited from polluting them.

¹² No. 158 *Seabright Holdings Ltd. v. Imperial Oil Ltd.*, 2003 BCCA 57 at para. 31 to 33

No statutory scheme is perfect. Previous owners or operators may consider the Legislature has cast the balance too much in favour of current owners of contaminated sites. Present owners, especially those who cannot afford to remediate, and neighbours to what have come to be known as “brownfields,” may consider the statutory scheme insufficiently harsh on those who have polluted, that more remediation should be ordered at the polluters’ expense, with less concern for their economic interests and more concern for speedy cleanup. In their effort to promote the public interest, legislators do the best they can to balance the interests of those affected by the enactments against a background of what is economically feasible by way of administration.

Madam Justice Huddart wrote the decision in both the *Seabright* appeal and the companion *Workshop*¹³ appeal. At paragraph 41 in *Workshop*, the Court said this:

Fundamental to the new scheme were three principles: absolute liability, retroactivity, and joint and several liability, all in aid of the underlying governmental policy of “polluter-pay” ...

At paragraph 46, this was said by the Court:

The concepts of absolute and joint and several liability facilitate actions against alleged polluters, make recovery of damages from multiple defendants more likely, and remove the burden of proving causation or fault-based conduct.

As a practical matter, contaminated land issues dictate that your company should be careful of what it leaves behind, be careful of what it buys, and be careful of how it sells. Remediation strategies, of course, also involve understanding and managing remediation projects carefully. A hands-on approach with your consultant, and with your lawyer, will save you money. You should understand the reason for recommended remediation and litigation approaches. You should also consider including protective acquisition and divestiture protocols within your due diligence system. Don’t assume an environmental indemnity from a buyer of your lands (or, indeed, from a seller with respect to lands you are buying) is, necessarily, the end of the story. An indemnity is only as good as the resources behind it and is not binding on others, including, for the most part, government. Don’t assume that liability falls only on polluters, and be aware that you can take on environmental liabilities by amalgamating with another corporation.

¹³ *Workshop Holdings v. CAE Machinery Ltd.*, 2003 BCCA 56

CONCLUSION

Due diligence means exercising all reasonable care. Specific suggestions have been referred to earlier. In a nutshell, however, it comes to this: be alert and think through what can go wrong, and ensure that systems are in place to respond to what can go wrong. This approach applies both to avoiding regulatory non-compliance and to avoiding and managing environmental liabilities. The difference between the two is that there is little room for consciously accepting risk when it comes to regulatory compliance. Business decisions related to environmental liabilities may factor in the acceptance of some risk (although not on the issue of disclosure).

While it is the responsibility of the directors to govern prudently in applying informed judgments, it is the job of senior management and environmental managers to provide the information base and analyses – to set the table – so that the board can effectively meet current standards and expectations for governance.