

Environmental Issues

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Environmental Considerations in Commercial Real Estate Transactions

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1. Introduction

When the words ‘environmental issue’ and ‘real estate’ are used in the same sentence, most lawyers flinch. We are all aware of situations in which a vendor or purchaser was unpleasantly surprised by a detrimental environmental discovery post-closing, or a previously identified issue has turned out to be more significant than anticipated. On the other hand, proper due diligence and intelligent document drafting can lead to the discovery and management of potential liability for known or unknown environmental concerns. Moreover, under the right, informed circumstances, these types of real estate transactions can become successful ventures through the remediation, rejuvenation, and redevelopment of contaminated sites.

This paper will discuss the basic environmental law principles that apply in commercial real estate transactions. It will also refer to the identification, allocation and management of environmental risks that arise in such transactions. Lastly, we will touch on financial considerations in commercial real estate transactions involving contaminated lands.

2. The Basics: Environmental Law Principles in the Commercial Real Estate Context

(a) Caveat Emptor

The common law principle caveat emptor – “let the buyer beware” – is one of the most fundamental principles in law, and is especially so in the context of commercial real estate transactions. Caveat emptor provides that in a sale transaction, a purchaser has a duty to inspect and judge a product for imperfections, and further, that the purchaser assumes the risk that the product may be defective or unsuitable.

This protection for vendors of goods has eroded over time due to consumer protection legislation and the willingness of courts to imply warranties of fitness and suitability, to the point where it could be argued that caveat venditor – “let the seller beware” – has become the norm. However, when it comes to the sale of land, Canadian courts continue to hold purchasers to their deals, leaving them to protect themselves through contractual covenants.

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While caveat emptor does not shield sellers who engage in fraud or bad faith by making false or misleading representations, the principle does impart an obligation on purchasers to undertake due diligence to uncover obvious imperfections before concluding a purchase and to negotiate appropriate representations and warranties to cover such risks.

Legally, these imperfections have been characterized as either 'patent defects' or 'latent defects'.

(b) Patent Defects

A patent defect is an apparent flaw that should be readily discoverable by an ordinary inspection – a crack, water damage, or a leaking above-ground tank, for example. These are the types of defects that a purchaser should be aware of and therefore assumes the risk of. If a purchaser fails to observe any patent defects on inspection, the rule of caveat emptor applies. This means that a defect, which might not be observable on a casual inspection, may be patent if it would have been discoverable through a reasonable inspection by a qualified person (e.g. an environmental consultant).

A vendor is under no obligation to disclose a patent defect that is visible or discoverable through a reasonable inspection.

(c) Latent Defects

A latent defect is a defect of quality not readily apparent to an ordinary purchaser during the course of an ordinary inspection – for example, mould, asbestos, or a leaking underground storage tank. A latent defect may be known to the vendor and actively hidden from the purchaser (fraudulent misrepresentation) or unknown to the vendor (mistake).

While a vendor has no general duty to disclose latent defects, and in certain instances a vendor may be unaware of a latent defect, courts have imparted an obligation on vendors to disclose material latent defects which they are aware of.

In *McGrath v MacLean* (1979), 95 DLR (3d) 144, the Ontario Court of Appeal held that the onus is on the purchaser to establish that the vendor had knowledge of the latent defect, giving rise to a claim for fraudulent misrepresentation. At paragraph 151, Justice Dubin stated:

“...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