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Contamination is Risky Business For Restructuring Companies and their Directors and Officers

by Varoujan Arman
Originally published in *Blaneys on Business* (March 2014)

Varoujan Arman is a member of Blaney McMurtry's Architectural, Construction and Engineering Services (ACES) Practice Group. He has experience in construction law, including construction liens and deficiency claims, and insurance defence litigation, including occupier's liability and professional negligence claims against architects, contractors, engineers and lawyers.

Varoujan may be reached directly at 416-596-2884 or varman@blaney.com.

This article has been adapted for Blaneys on Business from material published originally in Blaneys on Building.

Two Ontario Court of Appeal decisions released in October 2013, and a settlement of an appeal of a Ministry of the Environment (MOE) order, have set off alarm bells for owners, past owners and would-be buyers of contaminated properties, including their directors and officers.

The court decisions, one concerning Nortel Networks, Inc. and the other concerning Northstar Aerospace, Inc., demonstrate that companies that own contaminated property and that are contemplating restructuring should take a very careful look at whether an insolvency proceeding is the best approach in the circumstances.

The decisions also make it clear that prospective buyers, such as builders, developers and landlords, must be very careful to determine clearly how they can limit their exposure to the liability that may flow from such transactions, especially when the seller is in the midst of insolvency proceedings.

Finally, the lesson that flows from the settlement of an appeal of an MOE order is that current and potential directors and officers of corporations that own, have owned or are thinking about buying a contaminated site should seek legal advice on any personal risks that might be inherent in such ownership.

Background to *Nortel*

In *Nortel*, the company, which was insolvent, was undergoing restructuring under the *Companies' Creditors Arrangement Act* (*CCAA*). Under the terms of the court order granting Nortel protection from its creditors, the company was granted relief from cleanup obligations imposed by the MOE. The lower court found that the MOE order was tantamount to a financial obligation of Nortel because compliance with it would have required Nortel to spend money that would then have escaped the reach of creditors. As a result, the claim was stayed (i.e. put on pause) during the insolvency, just like any creditor's claim. The MOE appealed this, and succeeded, as explained below.

When Clean-Up Orders Will Trump, and When They Won't

In coming to its *Nortel* decision, the Court of Appeal referred to the Supreme Court of Canada decision in *AbitibiBowater*. In this case, remediation orders *were* found to be subject to the insolvency process. The circumstances, however, were unique. The province would perform the remediation work itself and only *then* seek reimbursement. As a result, the MOE *became* a creditor, and so its claim was stayed.

In *Nortel*, the Court of Appeal distinguished *AbitibiBowater*. The court found that it was *not* clear that the MOE's sole option in Nortel's specific situation was to perform the remediation itself and only then seek reimbursement. Accordingly, the MOE orders in *Nortel* were not found to constitute orders to pay and therefore were not subject to the stay imposed by the insolvency proceeding. By virtue of Nortel being obliged

to comply with the MOE's orders during the restructuring process, the ministry was effectively granted priority over creditors.

At the same time that it released its decision in *Nortel*, the Court of Appeal also released its decision in *Northstar*. In this case, the *CCAA* court had initially reached the same conclusion as in *Nortel* -- that the MOE's claim was a financial obligation, just like all other monetary claims of creditors, and therefore should be stayed. Unlike in *Nortel*, however, the Court of Appeal upheld the decision staying the MOE's claim against Northstar because the MOE had *already* begun remediation efforts following Northstar's bankruptcy. The central factor appeared to be the point in time at which the clean-up order had crystalized into a financial obligation of either the corporation or the taxpayer.

Impact on Owners of Land; On Prospective and Former Owners, and On Restructuring Corporations

Prospective buyers of potentially contaminated sites, such as builders, developers and landlords, will want to consider the impact of cases like *Nortel* and *Northstar*, particularly where property is to be purchased from a vendor undergoing insolvency proceedings. The impacts can be significant, so the ability to limit or reduce exposure to possible liability should be considered carefully.

In addition, for struggling corporations which may be contemplating restructuring, the *Nortel* and *Northstar* decisions may have a significant impact on the conduct of insolvency proceedings. In some situations, there may be strategic reasons why a *CCAA* proceeding will no longer be the preferred approach. It is therefore important for a corporation considering restructuring to seek legal advice at an early stage to assess the various options.

Personal Liability of Directors and Officers

Contaminated land transactions obviously contain risks for individual or corporate buyers and sellers. But these risks can also attract personal liability. In another recent case, *Baker v. Director (MOE)*, directors and officers of a corporation, including some whose appointment post-dated the contamination and who appeared to have no specific role or responsibility in relation to environmental matters, were named *personally* in a $15 million MOE remediation order.

These directors/officers appealed to the Environmental Review Tribunal. Shortly before the appeal was to be heard, an out-of-court settlement was reached, which included payment by eight of the directors and officers of $4.75 million to the MOE. This was in addition to the payment of legal fees plus interim remediation costs, which they were compelled to pay, even while the appeal was pending.

It is important to underline that because of the settlement, no determination was made regarding the liability of these directors and officers. Accordingly, prospective and current directors and officers of corporations that own, owned or are considering the purchase of a contaminated site would be well advised to obtain legal counsel to give careful consideration to any potential risks, such as those raised by the *Baker* settlement.

For more information and for legal inquiries regarding bankruptcy and insolvency please contact Lou Brzezinski at 416.593.2952 or John Polyzogopoulos at 416.593.2953, and for legal inquiries regarding environmental issues please contact Janet Bobechko at 416.596.2877 or Ralph Cuervo-Lorens at 416.593.2990. ■