



Environmental Protection Law in Ontario

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## Doing Business in Ontario: An Overview of Environmental Protection Law

### HOW TO COMPLY WITH ONTARIO'S LAWS & REGULATIONS

This guide provides a brief overview of the main elements of environmental protection law in Ontario. Its main objective is to identify the principal structural elements of the law and provide companies doing business in Ontario, or planning to do business in Ontario, with a basic understanding of the laws that might apply to their operations.

In the five chapters that follow, we examine topics that illuminate distinct and important features of environmental protection law in Ontario.

- **The first chapter** provides an overview of the division of responsibilities for environmental protection amongst the federal, provincial and municipal governments.
- **The second chapter** examines Ontario's key environmental protection statute—the *Environmental Protection Act* ("EPA").
- **The third chapter** deals with the so-called "brownfields" provisions of the EPA. These provisions illustrate, among other things, the use of a variety of regulatory modes to facilitate the protection of the environment.
- **The fourth chapter** highlights the circumstances in which courts or regulators may pierce the corporate veil, an issue of particular importance for US companies with subsidiaries in Ontario.
- **The fifth chapter** reviews the law on the defence of due diligence, and the related use of environmental management systems to achieve and maintain compliance.
- **The final chapter** includes a listing of the principal statutes related to environmental protection matters.

Our intention, in providing this overview of environmental protection laws in Ontario, is to facilitate business planning for companies intending to do business in Ontario, in part by allowing those companies to compare the basic structural elements of Ontario's environmental protection laws with environmental protection laws in the United States. This may, in turn, make it easier for US companies to adapt their existing compliance mechanisms for use in Ontario.

# Constitutional Framework

**Under Canada's constitution**, responsibility for the protection of the environment is divided between the federal and provincial governments. As we discuss briefly below, the federal government has an important but relatively limited role. The most important powers in this area are exercised by the provinces, and, in the next chapter, we take a close look at Ontario and its key environmental protection statute—the EPA. Some attention must also be paid to the common law, as injunctions and civil claims for damages can be brought against parties based on actions with environmental consequences.

The third level of government, that of the municipalities, has a very limited role in the protection of the environment. Municipalities can, for example, pass by-laws prohibiting the use of pesticides within their jurisdiction and regulating discharges into sewage systems. Municipalities can, and often do, take environmental matters into consideration when making land-use planning decisions, including imposing a requirement that properties meet prescribed standards before development can proceed.

### THE FEDERAL GOVERNMENT

The role of the federal government in the protection of the environment is limited principally to the protection of the oceans and inland waterways, the protection of fisheries, and the control of the importing and exporting of hazardous products. The federal government also regulates the transportation of dangerous goods between provinces and between Canada and other countries.

There are five main federal statutes dealing with the protection of the environment. They are:

- The *Canada Shipping Act*, which deals principally with controlling the discharge of pollutants from shipping vessels;
- The *Fisheries Act*, which addresses the protection of fisheries habitats in both oceans and inland waterways;
- The *Transportation of Dangerous Goods Act*;
- The *Canadian Environmental Assessment Act*; and
- The *Canadian Environmental Protection Act, 1999* (“CEPA”).

The CEPA has particular significance for companies moving products between Canada and the United States. The CEPA contains provisions that control the importing and exporting of hazardous materials. Substances are classified as being on the Domestic Substances List, for which there are no import limits,

or on the Non-Domestic Substances List, for which there are import limits.

The CEPA contains a full range of investigative and enforcement powers, including the power to impose administrative orders. The CEPA also places an obligation on officers and directors to take all reasonable measures to ensure compliance with its provisions.

### THE PROVINCE OF ONTARIO

There are a number of Ontario statutes that, directly or indirectly, deal with the protection of the environment. For purposes of this discussion, we will focus on the most comprehensive of the statutes, the EPA. In Chapter 6 we list the other Ontario statutes which deal principally with the protection of the environment.

We note that there are obligations dealing with environmental compliance and disclosure that arise indirectly from other statutes. For example, the Ontario Securities Commission requires issuers under its jurisdiction to make disclosure with respect to the following matters:

- financial liabilities related to the environment;
- asset retirement obligations;
- financial and operational effects of environment protection requirements;
- environmental policies fundamental to operations; and
- environmental risks.

We also note that some statutes confer a jurisdiction on regulatory boards to address environmental matters, even though that is not their principal function. For example, the *Ontario Energy Board Act* authorizes the Ontario Energy Board to conduct assessments of the environmental impact of the construction of energy generation and transmission facilities.

Finally, this booklet deals with what might be described as the traditional models of environmental protection, those used to protect the environment from the more immediate impacts of, chiefly industrial, human activity. Newer models, those dealing with the longer-term protection of the environment, chiefly from the impact of greenhouse gases, focus on, for example, the promotion of alternate sources of energy. These models are not discussed in this booklet.

# The Ontario *Environmental Protection Act*

**The following are the main structural elements of the EPA:**

- (a) prohibitions;
- (b) licensing requirements;
- (c) the use of codes and standards;
- (d) enforcement mechanisms, including administrative orders and prosecutions;
- (e) investigative protocols;
- (f) fines and penalties;
- (g) officers' and directors' liability;
- (h) particular provisions dealing with spills, "brownfields" developments, and the handling of waste.

As noted at various points below, the provisions of the EPA must be read in conjunction with the regulations under that Act. In a number of instances, the EPA sets out broad requirements, the details of which are to be found in the regulations. An example are the provisions of the EPA dealing with the handling of waste. The EPA sets out the basic requirements, but it is in Ontario Regulation 347 that the detailed rules on how waste should be categorized and handled are found.

The basic prohibition in the EPA is that dealing with the discharge of a contaminant into the natural environment in an amount, concentration or level in excess of that prescribed by regulation.

The EPA defines a contaminant very broadly, to include any solid, liquid, gas, odour, heat, sound, vibration, and combination thereof, resulting directly or indirectly from human activities that cause an adverse effect.

One key building block of the regulatory system in Ontario is that the allowable concentrations of contaminants of most substances are prescribed by regulation. What concentrations are allowed is tied to land use. The allowable concentrations depend, for example, on whether the use is residential, institutional or commercial/industrial, or its proximity to an environmentally sensitive area. In the case of air emissions, the allowable concentrations depend on the closest receptor.

The EPA also contains provisions dealing with the spills of contaminants, which are defined as discharges into the natural environment that are abnormal in quality or quantity. There is

a duty imposed on a person having control of the contaminant that has spilled and every person who causes or permits a spill to notify the Ministry of the Environment ("MOE") and the affected municipality. In addition, there is a duty to take steps to prevent, eliminate and ameliorate the adverse effect of the spill and to restore the natural environment.

### EPA POWERS TO ISSUE ORDERS AND LICENSES

The EPA grants the MOE broad powers to issue a variety of administrative orders to deal with the discharge of contaminants causing adverse effect. Those powers include the following:

- (a) The power to issue control orders, orders which may limit or control the rate of the discharge of a contaminant into the natural environment or require that the discharge be stopped altogether. Control orders may also require the person to whom they are directed to study and report to the MOE on measures required to control the discharge of a contaminant in the future;
- (b) The power to issue stop orders. These orders may require the person to whom they are directed to immediately stop or cause the source of the contaminant to stop discharging it into the natural environment, either permanently or for a specific period of time. Stop orders may require a person to effectively cease the operation of the business;
- (c) The power to issue remedial orders which may require a person to take steps to clean up a contaminant and to restore the natural environment; and
- (d) The power to issue orders to take preventative measures.

An important feature of these administrative orders is the range of persons to whom they may be issued. They may be issued to the following:

- (a) An owner or previous owner of the source of the contaminant;
- (b) A person who is or was in occupation of the source of the contaminant;
- (c) A person who has or had the charge, management or control of the source of a contaminant.

The breadth of the potential objects of an administrative order has important implications for the structuring of commercial transactions for the purchase, sale or financing of land or business. These implications are discussed, below, in the context of

a review of the “brownfields” provisions of the EPA.<sup>1</sup> There are also implications for the shielding of US parents from the consequences of prosecutions against, and administrative orders imposed on, Ontario-based subsidiaries.<sup>2</sup>

In addition to its power to issue administrative orders, the EPA also creates a form of licensing system. A Certificate of Approval (“C of A”) is required to construct, alter, extend or replace a new plant, structure, equipment, apparatus, mechanism or thing that may discharge a contaminant into the natural environment. A C of A is also required to alter a process or rate of production that may result in the contaminant being discharged. If a C of A is required, there is a prohibition against operating without it.

The EPA, and the regulations under it, also contains detailed provisions dealing with the management of waste. A C of A is required to use, operate, establish, alter, enlarge or expand a waste management system or waste disposal site. A waste management system is broadly defined to include any facility or equipment used in, or operations carried out for, the collection, handling, transportation, storage, processing or disposal of waste. The regulations under the EPA also contain specific requirements for certain kinds of waste, for example, asbestos waste and PCB waste. One important feature of Ontario law is that, once waste has been properly transferred to an approved waste disposal facility, responsibility for the handling of the waste resides with the operator of that facility, and not with the person who generated the waste.

The EPA contains provisions dealing with the spills of contaminants. A spill is defined as a discharge into the natural environment that is abnormal in quality or quantity. There is a duty imposed on a person having control of the contaminant that has spilled and every person who causes or permits a spill to notify the MOE and the affected municipality. In addition, there is a duty to take steps to prevent, eliminate and ameliorate the adverse effect of the spill and to restore the natural environment.

The EPA allows appeals to a body called the Environmental Review Tribunal (“ERT”) in a number of circumstances, including those where a C of A has been refused or where an administrative order has been issued. As a general rule, the appeal does not act as a stay of the administrative order. The ERT may issue a stay, except where there is a danger to health or safety, or the risk of serious impairment to the environment, if certain tests are met.

Where a person refuses to comply with an order or will not

carry out the order competently, the MOE may itself do the work. The MOE may then order the person to whom the order was originally issued to pay for the work that the MOE does.

## EPA PROSECUTIONS

The EPA grants a broad array of powers of inspection and investigation to so-called provincial officers.

In addition to administrative orders, the MOE may prosecute for a breach of the EPA, including a breach of the terms of a C of A. The size of the fines imposed on conviction depends on the nature of the offence, and whether it is a first or subsequent offence. For serious offences a jail term may be imposed.

The EPA grants courts the discretion to impose, in addition to fines or jail terms, requirements for remediation and restitution, as well as the power to strip profits earned from the actions that breached the EPA.

The EPA contains a list of circumstances that a court may consider in determining the nature and size of a penalty imposed for a conviction. Those circumstances include, for example, whether the offence caused an adverse effect, whether the defendant committed the offence intentionally or recklessly and whether, after the commission of the offence, the defendant failed to cooperate with the MOE or other public authorities, failed to take prompt action to mitigate the effects of the event, and failed to take prompt action to reduce the risk of similar offences being committed in the future. This last circumstance is particularly relevant to the use of an environmental management system.

A recent amendment to the EPA allows the MOE to impose administrative monetary penalties. These are penalties for breaches of the EPA that do not depend on a conviction and which are typically applied for each day that the breach continues.

An important aspect of the administrative monetary penalties scheme is that the defence of due diligence, which is discussed in detail below, is not available where an administrative monetary penalty is imposed. However, the regulations under the EPA provide that a person is entitled to receive notice of an intention to impose an administrative monetary penalty, and is entitled to make submissions requesting that, for example, the amount of the administrative monetary penalty be reduced.

One significant feature of this regulation is that it allows the MOE to reduce the administrative monetary penalty if, at the

<sup>1</sup> See Chapter 3 for a more detailed examination of the “brownfields” provisions of the EPA.

<sup>2</sup> See Chapter 4 for a more detailed discussion of the law on piercing the corporate veil.

time of the contravention, a person had in place an environmental management system for the plant that was audited in the three years before the contravention, and if the audit confirmed that the environmental management system had met the specified standards. The contents of an environmental management system, and of the procedures used to audit its operation, are now codified.<sup>3</sup>

### **EPA DUTIES IMPOSED ON OFFICERS AND DIRECTORS**

The EPA imposes, on the officers and directors of a corporation, a duty to take all reasonable care to prevent the corporation from the following:

- (a) discharging or causing or permitting the discharge of a contaminant in contravention of the EPA, the regulations under it, or a C of A;
- (b) failing to notify the MOE of the discharge of the contaminant;
- (c) failing to do everything practicable to prevent, eliminate and ameliorate the adverse effect of a spill and to restore the natural environment;
- (d) hindering or obstructing any provincial officer in the performance of his or her duties under the EPA, or orally, in writing or electronically giving or submitting false or misleading information to the MOE;
- (e) failing to install, maintain, operate, replace or alter any equipment or other thing in contravention of a C of A; and
- (f) contravening any order made under the EPA.

A significant feature of the duty that is imposed on officers and directors is that, if they are charged with a breach of that duty, they bear the onus, at the trial of the offence, of proving that they carried out the duty. A breach of the duty imposed on an officer or director can lead to a fine, or, in particularly serious circumstances, a jail term.

As a practical matter, corporations doing business in Ontario should understand that it is the practice of the MOE, in most if not all cases, to issue administrative orders to, or to prosecute, the officers and directors of a corporation. It is the Ministry's position that issuing orders against officers and directors, or prosecuting them, is the most efficient way to ensure that a corporation complies with the EPA in the future.

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For most offences under the EPA, the defence of due diligence is available. To succeed in that defence, the defendant must establish either that the act which is the basis for the charge did not occur or that, if it did occur, the person charged took all reasonable care to prevent the commission of the offence. In the case of charges against officers and directors, the courts have ruled that, to succeed in the defence of due diligence, the following matters will be considered:

- (a) did the board of directors establish a system for the prevention of the event and was there supervision or inspection of the system;
- (b) did each director ensure that the corporate officers are instructed to set up a system sufficient to meet the industry practices of ensuring compliance with the environmental laws, that the officers report back periodically to the board on the operation of the system, and that the officers are instructed to report any substantial non-compliance to the board in a timely manner;
- (c) directors are responsible for reviewing the environmental compliance reports provided by the officers of the corporation and may be justified in placing reasonable reliance on reports provided to them by corporate officers or consultants, counsel or other informed parties;
- (d) directors should be satisfied that the officers are promptly addressing environmental concerns brought to their attention by the others;
- (e) directors should be aware of the applicable environmental laws and the standards of their industry; and
- (f) directors should immediately and personally react when they have notice that the system has failed.

<sup>3</sup> See Chapter 5 for a more detailed discussion of environmental management systems, and their relationship to the defence of due diligence.



Establishing the defence of due diligence requires, for all intents and purposes, that a corporation have an environmental management system. The elements of an environmental management system are now prescribed by the Canadian Standards Association in guidelines that have been adopted by the regulations under the EPA. The same regulations adopt the standards established by third parties for the auditing of environmental management systems.

One relatively new feature of the EPA is the attempt to bring a measure of certainty to commercial transactions involving the purchase, sale, and financing of contaminated land. The so-called “brownfields” provisions of the EPA establish a system under which, if a qualified third party certifies that any contamination on a property is below the applicable level of concentration, then a “Record of Site Condition” is issued which precludes the MOE from, for example, issuing administrative orders in respect of the property. It is now common practice, in all transactions involving the purchase, sale or financing of commercial and industrial property, that a Record of Site Condition is required.

## **THE COMMON LAW**

While much of the focus of environmental protection law is on the operation of statutes, like the EPA, it is important to remember that there are elements of the common law that deal with the protection of the environment.

For example, a person may seek civil damages against a party where that party’s actions on its land have contaminated the land. In addition, a person may seek an injunction to stop another person from carrying on an activity that is causing environmental harm to him or his property. While compliance measures, such as the use of an environmental management system, are important to prevent the imposition of orders or penalties under statutes like the EPA, they are also important in both avoiding the circumstances that might give rise to a civil claim for damages under the common law and to providing a defence if such a claim should arise. Having said that, however, recent decisions of the Supreme Court of Canada suggest that compliance with regulatory requirements may not be a sufficient defence to a claim of nuisance.

# Modes of Regulation: The Brownfields Provisions

**In the early stages of the development** of environmental protection law in Ontario, there were a number of regulatory modes used. The most basic of the approaches was a broadly-framed prohibition against the discharge of a contaminant that would have an adverse effect on the environment.

In the absence of established standards for allowable concentrations of, for example, commonly used chemicals, and in the presence of varying standards for what constituted an adverse effect, it was often difficult to determine when the prohibition had been breached. The prohibition was enforced by quasi-criminal prosecution, carrying with it, on conviction, the risk of substantial fines and damage to a company's reputation and goodwill.

A second mode was licencing. Processes that involved the use of contaminants, or which might result in the discharge of contaminants, required licences, called certificates of approval, for their operation.

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A third, and in many ways the most significant, regulatory approach was the use of administrative orders. These orders included, for example, ones under which the MOE could take control, in effect, of the operation of a business, or require the operation of a business to stop altogether.

Over time, the number and variety of administrative orders that could be imposed increased to include orders to take measures to clean up contamination, to restore the natural environment, and to pay administrative monetary penalties, the equivalent of fines for ongoing breaches of the law. Administrative orders were imposed by the MOE and, while an appeal process was available, that process was time-consuming and costly.

### ISSUE OF RESPONSIBILITY

One important feature of administrative orders was the broad reach of the parties on whom they could be imposed. The legislation allowed the orders to be imposed on owners, and

former owners, tenants, and former tenants, and persons who have or had the charge, management and control of the source of a pollutant. That broad reach meant that the responsibility for contamination could not be eliminated by the simple mechanism of selling or leasing contaminated property.

It also affected lenders, because of the risk that, if contaminated property were ever seized, the lender could be subject to one or more of the administrative orders. The imposition of an administrative order could also affect the ability of the borrower to service the debt, and might significantly reduce the value of the underlying security.

The commercial response to these regulatory measures took a variety of forms. For example, both lenders and purchasers often required a benchmark audit to establish the environmental condition of a property. The parties to a transaction could rely on the benchmark audit, in that they could sue the auditing firm if it turned out that the property was contaminated, or more contaminated, than the audit had disclosed.

The problem, however, was that there were no standards for what constituted an acceptable environmental audit, no standards for what constituted an acceptable auditing firm, and no requirements that the auditing firms be insured. Given these weaknesses, parties to a commercial transaction involving a contaminated, or potentially contaminated property, were forced to rely on common commercial mechanisms for allocating risk, including representations and warranties and indemnification provisions.

The value of such mechanisms was diminished by the absence of prescribed site condition standards—specifically, prescribed standards of allowable concentrations of contaminants. Given these deficiencies, and even with the use of environmental audits and indemnification provisions, the parties to commercial transactions involving contaminated, or potentially contaminated, property could never be certain that an administrative order would not be imposed on them.

### ALLOCATION OF RESPONSIBILITY—THE BROWNFIELDS PROVISIONS

In part in an attempt to address these various uncertainties, the provincial government introduced what are commonly referred to as the brownfields provisions of the EPA. What these provisions reflect is the use of a variety of techniques to achieve the goals of protecting the environment, encouraging the development of contaminated property, and, perhaps most



importantly, providing a measure of commercial certainty in transactions involving contaminated property.

The brownfields provisions are set out in parts XV.1 and XV.2 of the EPA, and in Regulation 153/04 under the EPA (the “Regulation”).

The main components of the brownfields provisions are the record of site condition (“RSC”), which is a formal record of the environmental condition of a property, and the Registry, where RSCs are filed and where the public can gain access to this information.

## REQUIREMENTS AND CONTENTS OF AN RSC

The EPA sets out the following requirements for an RSC:

- a. That it is prepared by a qualified person;
- b. That the qualified person certifies that either a phase I environmental site assessment (“ESA”) has been done and a phase II ESA is not required; or
- c. That the qualified person certifies that, if a phase II ESA has been done, the property meets the standards, that is the allowable concentrations of contaminants, applicable to the circumstances of the property and its proposed use;
- d. That if a contaminant is in a concentration exceeding the allowed levels, a risk assessment has been performed;
- e. That the MOE has accepted the risk assessment; and
- f. That the property meets the standards in the risk assessment.

Once the MOE has accepted the RSC, and it is filed on the Registry, the public not only knows that a RSC exists for a property, but has access to all of the information required to prepare the RSC.

In order to bring certainty to the content of a RSC, and to bring certainty to the system, the EPA and the Regulation define what constitutes the following:

1. A qualified person;
2. A phase I ESA;
3. A phase II ESA;
4. A risk assessment; and
5. The allowable concentrations of contaminants, which vary depending on the circumstances of the property, and on its proposed use.

By defining these terms, and establishing the requirements for them, the MOE has eliminated many of the uncertainties that had plagued the commercial transactions involving contaminated, or potentially contaminated, property.

Under the brownfields provisions, the MOE does not itself certify that a property meets any particular condition. All the MOE does is accept that the RSC, and the supporting assessments underlying it, have been prepared according to the standards established in the EPA and the Regulation. All of the risks remain privatized, principally allocated to the “qualified person”, and to that person’s insurance policy.

The EPA specifies the contents of a RSC. They include the following:

- a. a description of the property;
- b. the name of the person filing the RSC, and the names of any other owners of the property;
- c. the type of property use to which the property for which the RSC is filed is to be put;
- d. what standards prescribed by the Regulation were applied for the RSC;
- e. a description of any soil removals or other action taken to reduce the concentration of contaminants on, in or under the property;
- f. for each contaminant for which sampling or analysis has been performed, the maximum known concentrations of a contaminant on, in or under the property as of the certification date;
- g. a statement indicating whether a certificate of property use has been issued in respect of the property;
- h. a list of all reports relied on by qualified persons in making the certification; and
- i. such other certifications, information, and documents as they are prescribed by the Regulation.

A RSC is delivered to the MOE. The MOE either rejects it because it does not meet the requirements of the EPA and the Regulation, or it acknowledges that it has been filed in the Registry.

If a risk assessment is required, the MOE may issue a certificate of property use (“CPU”). That CPU may specify that certain action is to be taken in respect of the property, for example, eliminating a contaminant or monitoring it. A CPU may also specify restrictions on the use of a property, or on

the construction of any building on the property. A CPU can be subsequently revoked or amended. Finally, if the CPU contains a prohibition on the use of the property or on construction on it, no permits or licences, for example, building permits, can be issued that would be contrary to the limitations.

## PROTECTION OF A RSC

The RSC provisions provide a measure of protection against the imposition of administrative orders and greater certainty for vendors, purchasers, and lenders.

The consequences of the filing of a RSC on the Registry are the following:

1. Certain kinds of administrative orders cannot be issued in respect of the contaminants existing before the certification date. The relevant orders are control orders, stop orders, remedial orders, preventive measures orders, and orders to stop or correct contraventions; and
2. The administrative orders cannot be issued against the person who filed the RSC or a subsequent owner, against the person in occupation of the property or who was in occupation any time after the certification, or against the person who has or who had the charge, management or control of the property.

The significance of these consequences is that it provides protection against the imposition of administrative orders. This, in turn, provides a measure of certainty in commercial transactions. It provides protection for vendors and purchasers of contaminated property, and for tenants on the property.

There are exceptions to the protection provided by the brownfields provisions. The protection does not apply, for example, if the RSC contains false or misleading information, or if contaminants move to another property, or if the actual use of the property is different from that specified in the RSC.

The Regulation does the following:

1. It defines the different types of property use, for the purpose of determining what standard for allowable concentrations of contaminants will be used;
2. It sets out the requirements for what constitutes a “qualified person”, requirements that will vary depending on, for example, whether the qualified person is preparing a Phase II ESA, or a risk assessment;
3. It sets out the insurance requirements for a qualified person;
4. It defines what constitutes any change of use;

5. It specifies the contents of a RSC;
6. It sets out the required contents of Phase I and Phase II ESAs;
7. It sets out the standards for the allowable levels of concentration, which will vary depending on the soil conditions and the use to which the property will be put; and
8. It sets out the requirements for a risk assessment.

The MOE is in the process of updating the site condition standards for soil and groundwater. The expectation is that the updated standards will, for a number of contaminants, be more stringent than the existing standards. The more stringent standards may require more frequent use of a risk assessment. At the same time, the government is proposing to expedite the risk assessment process.

It is important to recognize that the brownfields provisions do not change the basic risk allocation underlying transactions involving contaminated, or potentially contaminated, property. The risk remains in private hands. The government does not certify the condition of the property. Rather, the qualified person does, backed by that person's insurance policy.

What the government does say is that the standards it has established for the assessment of the environmental condition of the property have been met. And, if those standards have been met, the government offers a measure of protection against the imposition of administrative orders.

Historically, Ontario's environmental protection laws relied heavily on licencing, on prohibitions, and on punishment for violations of those prohibitions. To that basic “tool kit” of regulatory mechanisms have been added, through the brownfields provisions, codes and standards. The use of these codes and standards has provided greater certainty in commercial transactions. The provision by the vendor of a RSC is now a *de minimus* requirement of all transactions involving property, regardless of whether that property is, or is suspected of being, contaminated. It is also a basic requirement of many municipalities for granting permission to develop or redevelop a property.

# Piercing the Corporate Veil in Ontario

**A question often asked** by US or other foreign corporations interested in setting up business in Canada through a subsidiary is: “What is the parent company’s, and officers’ and directors’ liability for environmental damages in Ontario?”

In answering this question, there are three areas to consider:

1. Civil liability;
2. Liability for administrative orders; and
3. Liability to prosecution.

## CIVIL LIABILITY

In Ontario it is difficult to pierce the corporate veil in a civil action and attach liability to a parent company or an officer or director of the parent company. The law of damages for environmental harm is the same as for any other civil action. So long as the Canadian company is not just the alter ego of the parent company or is not used as a front for fraud, there will be no liability on the parent company. In Ontario, corporations are separate, legal entities.

Likewise, it is difficult to pierce the corporate veil to make directors and officers liable for environmental harm caused by the corporation. The exception to this is a situation in which the officer or director is acting outside his or her capacity as an officer or director and has committed some independent wrong that is actionable independent of that person’s role as an officer or director of the corporation.

## LIABILITY FOR ADMINISTRATIVE ORDERS—CHARGE, MANAGEMENT OR CONTROL

The liability for administrative orders is perhaps the most important area for consideration when operating in Ontario. Where contamination of the natural environment has occurred or is threatened, administrative orders are often issued by the MOE. The orders can take several forms, including a stop order, control order, remedial order or preventive order. These orders can have significant liabilities attached to them since the remedial action plans required by orders can often cost in the millions of dollars.

Under the EPA and other statutes, control orders or stop orders can be issued to “a person who has, or had the charge, management or control of the source of contaminant”. It is important to note that the definition includes current and past people with the charge, management or control. The section

has been applied retroactively.

The MOE has used this wording to issue orders against a Canadian company operating in Ontario, the foreign parent company, the foreign grandparent company and on up the line. Orders have also been issued to the officers of the Canadian company and directors of the parent company. The MOE has taken the position that the various people and entities named in the order have the charge, management or control of the Canadian company that has caused the contamination.

Such orders issued to officers and directors of companies have been upheld on appeal with respect to a closely-held company where the company is the alter ego of the one or two people behind the company.

What about the large multi-national corporations carrying on business in Ontario through a Canadian subsidiary? There have been two instances where the MOE has issued orders to the Canadian company and foreign parent companies and directors. The first case occurred in the early 1990’s when the legislation permitting such orders had just been enacted. The order was issued to the Canadian company with a plant in Ontario, the immediate US parent and the US grandparent company and against the director common to both the Canadian company and the US parent.

The order involved a multi-million dollar, long-term remediation plan for buried waste and, most significantly, off-site ground water contamination. The order was appealed with the issue of whether such an order could be issued to parent companies and directors an important part of the appeal. However, the appeal was resolved without the issue ever having been determined by the Appeal Tribunal. The settlement involved the Ontario government contributing significant amounts of money to the remediation costs. In the result, the order remained against the US parent companies, although it was withdrawn against the director who, in the course of the appeal, retired. Consequently, there was no ruling on the authority of the MOE to issue such orders.

In 2005, the MOE again issued an order to a Canadian company, its US parent and to the officers and directors of the Canadian company, some of whom are US residents. In this case, the Canadian company was insolvent. The orders have been appealed, but the appeal has not yet been heard, since the parties have been discussing settlement. The case is likely to be settled without any determination as to whether or not the MOE has the authority to issue such orders to parent com-

panies and directors.

## FACTORS IN DETERMINING CHARGE, MANAGEMENT AND CONTROL

While there have been no appeal rulings on the authority of the MOE to issue orders to parent companies and directors and officers and what is required to show charge, management and control, evidence led in the first case, and the rulings involving smaller companies suggest the following are relevant:

1. What are the financial arrangements and controls between the parent company and Canadian company? Does the parent company have budgetary control to the extent that it must approve any expenditures for environmental matters?
2. How is the Ontario corporation operated? Is it a branch plant of the parent company or is it operated independently?
3. Does the responsibility for environmental decisions and other decisions rest with the Canadian employees or with the parent company's employees?
4. How much reliance is on employees of parent companies?
5. Is the manufacturing controlled by the Canadian company or parent company?
6. Is the determination of the manufacturing schedule and products to be manufactured in the hands of the parent company?
7. Who controls the board of directors? Although there are requirements for a minimum number of Canadian directors, the question arises as to whether those directors are purely figure heads or whether they actually have control of the company.

There are probably many more criteria that can determine if the parent company has the charge, management or control of the operation causing the contamination. It is clear that the more involved a parent company is in the operations of the Canadian subsidiary, the more likely the test will be met.

Directors and officers can likewise be named in orders on the basis that the officers and directors have the charge, management or control of the company that is the source of the contaminant. The same considerations set out above apply, although it is likely that the Canadian officers and directors more easily meet the test for charge, management and control. In the second case referred to above, the directors of the Canadian company have been named in the order, including the lawyers who were on the board to meet the Canadian

residency requirements for boards of directors.

Another overriding principle to be considered in assessing whether or not parent companies and officers and directors will be liable to an order is the view that it is not fair that taxpayers are left with the bill. Where there is that potential, the MOE will look much further for the "deep pockets".

A question arises as to whether such an order can be enforced against a parent company or an officer and director not resident in Canada. Ultimately, the answer depends on the laws of the country in which the parent or directors and officers have assets. The question of enforceability normally arises where there is default in compliance with the orders. This of course is the reason for naming the parent company and directors and officers in the first place. It is an offence, under various statutes, to fail to comply with an order. Offences will be dealt with separately below.

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## Directors and officers can likewise be named to orders on the basis that the officers and directors have the charge, management or control of the company that is the source of the contaminant.

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More importantly, in the context of enforceability of orders, where there is default under the order, the MOE can do the work and send the bill to the parties named in the order. In such circumstances, the right to appeal the bill received is very limited. Experience tells us that governments do the work at a far greater cost than the private sector. If the bill is not paid, it can be filed with the Superior Court of Justice in Ontario and enforced as if it were an order of the court. The question then becomes whether or not the order of the Superior Court of Ontario can be enforced under the reciprocal enforcement of judgment provisions of the country or state in which the parent company or officers and directors have assets.

In Ontario, judgments obtained in the US courts in similar circumstances have been enforced in the courts of Ontario.

The discussion so far has been with respect to orders that can be issued to a person having the charge, management or control. Other orders can be issued against those who "permit" the

discharge of a containment. The word “permit” may be more limited than the words “charge, management and control”, but it may be an academic discussion since most orders are issued under several sections, some of which include the ability to issue an order to those who have charge, management or control.

since liability may be imposed on the parent company, officers and directors.

## LIABILITY TO PROSECUTION

While the Canadian *Criminal Code* (federal jurisdiction, not provincial) does have offences related to the environment, the vast majority of offences are prosecuted under provincial legislation.

There are no provisions specifically making those with the charge, management or control subject to prosecution. However, where an order has been issued to a parent company or an officer and director and is not complied with, it is an offence for which prosecution is available. In addition, those who “permit” discharges of contaminant can be prosecuted. Employees, including directors and officers of a Canadian company are often prosecuted on the basis that they have “permitted” the prohibited activity. It is an open question whether a parent company will be prosecuted for “permitting” the Canadian subsidiary to carry out the prohibited activities.

There is a specific offence for officers and directors. The section specifically provides that every officer or director of a corporation has a duty to take all reasonable care to prevent the corporation from carrying on listed activities, including discharging, causing or permitting the discharge of a contaminant, failing to advise the Ministry of the discharge of a contaminant and contravening an order. In defending charges, the director or officer has the onus of proving that he or she carried out the duty imposed.

There are a couple of important points to keep in mind with respect to environmental offences. Since they are not *Criminal Code* offences but provincial offences, they are not governed by extradition laws. Finally, it is up to the local law of the place where a person resides or has assets whether or not a fine imposed in Ontario for breach of environmental laws will be enforced. Typically, it will not.

## EXPOSURE TO RISK IS REAL

There is a significant exposure to parent companies, directors and officers to liability for environmental harm in Ontario. When doing business in Ontario and elsewhere in Canada, parent companies and officers and directors need to take care that a Canadian company does not cause harm to the environment,



# The Defence of Due Diligence and Environmental Management Systems

**For persons charged with an offence** under environmental protection legislation in Ontario, the defence available is that of due diligence. The defence was first articulated in a 1978 decision of the Supreme Court of Canada, in the case of *The Queen v. Sault Ste. Marie*. In that case, the court identified three categories of offences. Those categories were the following:

1. offences in which *mens rea*, consisting of some positive state of mind, such as intent, knowledge, or recklessness, must be proved by the prosecution, either as an inference from the nature of the act committed, or by additional evidence;
2. offences in which there is no necessity for the prosecution to prove the existence of *mens rea*; the doing of the prohibited act *prima facie* imports the offence, leaving it open to the accused to avoid liability by proving that he took all reasonable care. This involves consideration of what a reasonable man would have done in the circumstances. The defence will be available if the accused reasonably believed in a mistaken set of facts which, if true, would render the act or omission innocent, or if he took all reasonable steps to avoid the particular event. These offences may be properly called offences of strict liability; and
3. offences of absolute liability where it is not open to the accused to exculpate himself by showing that he was free of fault.

*The Queen v. Sault Ste. Marie*, [1978] 2 S.C.R. 1299 at 1325 and 1326 [*Sault Ste. Marie*]

The Supreme Court of Canada did not discuss, in any detail, what proving the defence of due diligence would require. It did observe, however, that, depending on the circumstances, the accused would have to establish that it “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”. (*Sault Ste. Marie*, *ibid.* at 1331.) While the burden on the prosecution is to prove the commission of the prohibited act beyond a reasonable doubt, the defendant need only prove the defence of due diligence on a balance of probabilities.

## CRITERIA FOR DUE DILIGENCE

What constitutes due diligence will vary depending on the circumstances of each case. However, the courts, following *Sault*

*Ste. Marie*, have established certain criteria for the defence. Those criteria are discussed below.

The defence of due diligence is important, not just for companies facing charges under environmental protection legislation, but for their officers and directors. As noted earlier, there are provisions in provincial and federal environmental protection legislation that impose duties on officers and directors to take all reasonable care—words that echo the language used by the Supreme Court of Canada in describing the defence of due diligence in preventing the corporation from breaching an environmental protection law.

The components of the defence of due diligence closely track the components of environmental management systems. The adoption of an environmental management system is one way in which corporations can formalize their efforts to establish due diligence.

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## Simply put, Regulation 222/07 codifies the importance of the use of an environmental management system.

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The significance of environmental management systems is now reflected in their use in Ontario Regulation 222/07 made under the EPA (“Regulation 222/07”). Section 17 of that Regulation authorizes the MOE to reduce the “gravity component” of an administrative monetary penalty if the person facing the penalty had in place an environmental management system that meets certain requirements and that has been audited within three years of the contravention. That Regulation describes an environmental management system as one that meets the standards established by the Canadian Standards Association.

Simply put, Regulation 222/07 codifies the importance of the use of an environmental management system.

In what follows, we will discuss, first, the content of the defence of due diligence and, second, the content of an environmental management system.



## DEFENCE OF DUE DILIGENCE

As noted above, the nature of the due diligence defence was first articulated in *Sault Ste. Marie*. There are two components to the defence. One is that the defendant operated under a reasonable mistake of fact. The second is that the defendant took all reasonable care to avoid the occurrence of the event.

In discussing what constituted reasonable measures to avoid the occurrence of the event, the Supreme Court of Canada made reference to:

- (1) the existence of a system to prevent pollution; and
- (2) the taking of reasonable steps to ensure the effective operation of the system.

In the decisions following *Sault Ste. Marie*, the courts have repeatedly referred to those two components of the defence and have identified a number of factors to be assessed in determining whether the defendant has taken all reasonable steps in the circumstances. These factors include:

1. The nature and gravity of the adverse effect;
2. The foreseeability of the effect;
3. The availability of alternate solutions;
4. The defendant's legislative or regulatory compliance;
5. Industry standards—what are the practices of the industry, what do comparable enterprises do to ensure compliance, and how does the defendant's conduct, or system, compare;
6. Efforts made to address the problem, including over what period of time, and the promptness of the response;
7. Matters beyond the control of the accused;
8. Preventative systems in place, and steps to ensure effective operation of the systems; and
9. Economic considerations—a defendant cannot rely on harsh economic impact to avoid compliance with the regulated regime in which it operates, however, the cost of taking steps to prevent violations is a factor to be considered, and balanced with the other factors, in determining the standard of care.

Reasonable care and due diligence do not mean superhuman efforts. They mean a high standard of awareness, and decisive, prompt and continuing action. A balancing of all factors must be undertaken.

With respect to the liability of officers and directors for environmental offences, the courts have considered a number of factors that demonstrate due diligence, as follows:

1. The board of directors should establish a system for the prevention of the event, with ongoing supervision or inspection of the system;
2. Each director should ensure that the corporate officers are instructed to set up a system sufficient to meet the industry practices of ensuring compliance with environmental laws, with the officers reporting back periodically to the board on the operation of the system and reporting any substantial non-compliance to the board in a timely manner;
3. Directors are responsible for reviewing the environmental compliance reports provided by the officers of the corporation;
4. Directors should be satisfied that the officers are promptly addressing environmental concerns brought to their attention by others;
5. Directors should be aware of the applicable environmental laws and the standards of their industry; and
6. Directors should immediately personally react when they have noticed that the system has failed.

In listing the factors that will be considered by the MOE in deciding whether to reduce the amount of a proposed administrative monetary penalty, Regulation 222/07 uses language that exactly tracks that used by the courts in describing the components of the defence of due diligence. For example, Regulation 222/07 indicates that, in seeking a reduction in a proposed administrative monetary penalty, the regulated person must establish that he or she took one or more of the following steps to prevent the contravention:

1. Analysed in writing the likelihood of the contravention to occur and the potential impacts if it occurred;
2. Developed strategies to prevent the contravention based on that analysis, and documented the implementation of the strategies;
3. Established monitoring and maintenance programs for structure, equipment and mechanisms at the plant for the purpose of preventing the contravention;
4. Constructed or installed containment structures for the purpose of preventing the contravention;

5. Installed and maintained an alarm system or other notification system to alert operators of the plant when the contravention is imminent, and documented procedures for operating the system;
6. Altered or redesigned industrial processes used at the plant for the purpose of preventing the contravention, or installed equipment for that purpose;
7. Trained personnel in the construction, installation, or maintenance of any relevant structures, equipment or mechanisms, and in the implementation of any other measures relating to preventing the occurrence.

Not only do these kinds of measures track the language used by the courts to describe the components of the defence of due diligence, they also mirror the components of an environmental management system, as approved by the Canadian Standards Association.

## ENVIRONMENTAL MANAGEMENT SYSTEMS

As noted above, the components of the due diligence defence lend themselves to the establishment of an environmental management system. In addition, Ontario law provides that the presence of an environmental management system is a factor in deciding whether to reduce a proposed administrative monetary penalty.

What constitutes a valid environmental management system has now been codified in a document entitled “Environmental Management Systems—Requirements With Guidance for Use”, designated as CAN/CAS-ISO 14001-04, published by the Canadian Standards Association. To have the effect contemplated by Regulation 222/07, the system must have been certified as meeting that standard by an environmental management systems registrar accredited by either the Standards Council of Canada or by an accreditation body outside of Canada that is a signatory to the International Accreditation Forum—Multilateral Recognition Arrangement.

The basic elements of an environmental management system can be summarized as follows:

1. The starting point is some expressed policy about environmental protection, for example, a policy of complying with all applicable environmental protection laws. That policy might be expressed more expansively, such as continuous improvement with a view to reducing, and ultimately eliminating, all adverse impacts on the environment from the activities of the corporation;
2. The identification of all aspects of the business that might adversely affect the environment, or give rise to a breach of

an environmental protection law. Those aspects might include, for example, a description of the chemicals handled by the corporation, the manufacturing processes used, the means by which contaminants are stored and transported, and the processes used to handle waste;

3. Comprehensive identification of all applicable environmental protection laws and policies;
4. The setting of measurable objectives and targets, consistent with the environmental policy;
5. A description of the management structures governing the operation of the system, with the respective roles and responsibilities and the relevant personnel described;
6. A description of how all aspects of the business that might adversely affect the environment would be operated in order to ensure compliance with the applicable environmental protection laws;
7. A description of how the company personnel are trained, and, as required, retrained in the operation of the environmental management system;
8. A description of the emergency response mechanisms in place to deal with incidents involving a potential adverse effect on the environment or a breach of environmental protection laws;
9. A description of how all aspects of the policy are communicated, both internally and to relevant external parties;
10. A description of the criteria used to measure the performance of the system, for example, a record of compliance with the applicable regulatory requirements;
11. A description of the system used to periodically monitor the operation of the system, including, if possible, some provision for internal and external audits of the system;
12. The next component, which is tied to both the emergency response mechanism and the performance criteria, would be a description of any retraining or discipline that may be required as a result of the failure in the operation of the system; and
13. A means for periodic, typically quarterly, reports to the officers and directors of the corporation on the operation of the system, together with more frequent reports, as required, describing any breaches of the system, and the response to those breaches.

All of these components must be set out in writing.

In order for the environmental management system to have the effect, as set out in Regulation 222/07, of reducing a proposed administrative monetary penalty, it must be audited according to a code of practice that conforms with a document entitled “Guidelines for quality and or environmental management systems auditing”, designated as CSA/ISO 190011:2003, published by the Canadian Standards Association.

In addition, the person doing the auditing must have been certified by an auditing certification body that has been accredited by the Standards Council of Canada, including the Canadian Environmental Certification Approvals Board or a body outside of Canada that is a signatory to the International Accreditation Forum—Multilateral Recognition Arrangement.

Finally, at the time of the audit, the environmental management system has to have been verified as meeting the requirements set out in certain codes established by the Canadian Chemical Producers Association.

Regardless of whether an environmental management system is used to reduce administrative monetary penalties as specified in Regulation 222/07, such a system is now an essential part of ensuring compliance with environmental protection laws for a company doing business in Ontario.

In addition, it is an essential component in successfully establishing the defence of due diligence. A corollary of that is that it is an essential tool in mitigating the risk imposed by environmental protection laws for officers and directors.

# Ontario Statutes

**The following is a list of Ontario statutes, in addition to the *Environmental Protection Act*, dealing principally with the protection of the environment:**

1. *The Environmental Assessment Act*

This Act requires that major undertakings, whether public or private, be assessed to determine their impact on the environment.

2. *The Environmental Bill of Rights, 1993*

This Act creates an Environmental Registry, and requires that notice of “proposals” be posted on it. The proposals include changes in Regulations, and requests for Certificates of Approval or changes in Certificates of Approval. The Act permits the public to comment on the proposals and creates a limited right to challenge the proposals.

3. *The Clean Water Act, 2006*

*The Nutrient Management Act, 2002*

*The Safe Drinking Water Act, 2002*

These three Acts arise out of an incident in which a municipal drinking water system was contaminated through a combination of agricultural run-off and poor training and management by municipal officials. The Acts, read together, are an attempt to prevent a recurrence of that kind of incident, through a combination of measures.

*The Clean Water Act, 2006*, is intended to protect sources of drinking water. It requires designated areas, principally municipalities, to prepare source protection plans, which are measures to identify and protect local drinking water sources.

*The Nutrient Management Act, 2002*, regulates the use of materials, chiefly associated with large scale or intensive agricultural and livestock operations, which may adversely affect the environment.

*The Safe Drinking Water Act, 2002*, regulates drinking water systems. It establishes standards for those who own and operate a drinking water system, in most cases, municipal governments. It imposes requirements on those who operate the systems and on those who test the systems.

4. *The Ontario Water Resources Act*

This Act is intended to protect surface and groundwater from adverse impacts caused by contaminants. The provisions of the Act are, in most respects, identical to those in the EPA.

The Act also contains provisions dealing with the taking of water for other than municipal and agricultural uses.

5. *The Pesticides Act*

This Act regulates the use of pesticides.

6. *The Technical Standards and Safety Act, 2000*

This Act regulates, among other things, fuel storage tanks, both aboveground and underground. Its provisions do not deal directly with the protection of the environment, except in one respect. The regulations under the Act require that, where aboveground or underground storage systems are removed permanently, an assessment must be completed delineating the full extent of any petroleum product that has escaped to the environment.

7. *The Occupational Health and Safety Act*

This Act contains provisions which deal with the handling of hazardous materials in the workplace, for example, asbestos. It also mandates the Workplace Hazardous Materials Information System (“WHMIS”) and the requirements for material safety data sheets (“MSDS”).

8. *The Dangerous Goods Transportation Act*

This Act mirrors the federal act, and imports the provisions of the federal act into Ontario for purposes of the transportation of goods by provincially-regulated transportation entities.

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