

LANDLORD AND TENANT ENVIRONMENTAL LIABILITY



When leasing commercial property in Ontario one of the most significant risks faced by both landlords and tenants relates to potential liability for environmental contamination of the property. This risk derives from environmental law in Ontario as it pertains to owners of property and those having charge, management and control of property. The risk may be minimized by conducting due diligence and carefully negotiating the provisions in the lease relating to environmental matters.

The Environmental Protection Act

In Ontario, the *Environmental Protection Act* (the “EPA”), imposes liability on the “person responsible” for the source of the contaminant. This potential liability applies to the owner of the property, and/or the tenant, as the person having charge, management or control of the leased property when the environmental contamination is discovered. The EPA is a public policy statute that imposes what is known as strict liability. This means that the “person responsible” has a positive obligation to prevent the contamination regardless of fault. As a result, liability may arise even if the landlord or tenant did not cause the environmental contamination.

Minimizing The Risk – Landlord’s Perspective

From a landlord’s perspective, to minimize the risk of liability for a tenant’s environmental contamination of a property, the following steps should be followed. First and foremost, it is extremely important for the landlord to ascertain if, due to the nature of the tenant’s operation, hazardous substances will be handled at the leased premises. Such due diligence should include research of the tenant’s business, obtaining references from previous landlords, and requiring the tenant to complete a questionnaire related to environmental matters.

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Next, a prudent landlord will establish the “base line” environmental condition of the property at the commencement of the lease and will environmentally assess the property at lease-end. This means that prior to a tenant taking possession of a leased property, and just before lease-end, the landlord should obtain environmental assessments from a qualified environmental engineering firm. The results of such assessments, together with the nature of the tenant’s operation at the leased premises (*i.e.* whether the tenant handles any hazardous substances), will invariably assist in establishing liability for any environmental contamination. Also, many landlords include provisions in their commercial leases that grant them access to the leased premises throughout the term to conduct inspections and environmental audits and to require the tenant to undertake, at the tenant’s sole cost, such remediation as is revealed by the inspection or audit. Unless otherwise negotiated by the tenant, most commercial leases will state that the cost of such environmental audits will be paid directly by the tenant or will be included in the operating costs charged to the tenant in a net lease.

The lease provisions should also include covenants from the tenant to comply with all applicable environmental laws, to conduct its business in a manner that prevents the release of any hazardous substance, and to carry out any required environmental remediation at the sole cost and expense of the tenant. In addition, the lease should state that the breach of any such covenants will

provide the landlord the right to terminate the lease together with an action in damages.

The lease should also include a provision whereby the tenant agrees to indemnify the landlord (and its officers, directors, employees, successors and assigns) from all environmental damages and claims due to any act or omission by the tenant or by those for whom the tenant is responsible at law. In support of such an indemnity, a landlord should obtain security from the tenant in the form of a cash deposit or letter of credit. As an alternative, the landlord may require the tenant to obtain environmental liability insurance in a stated amount with the landlord named as additional insured.

Minimizing The Risk – Tenant’s Perspective

For the tenant, minimizing the risk of environmental liability for contamination caused by others starts with its own due diligence. Like the landlord, the tenant should establish the “base line” environmental condition of the property as close as possible to the commencement date of the lease. In the offer to lease, the tenant should require the landlord to produce copies of all up-to-date environmental reports related to the property in the landlord’s possession or control. If no up-to-date environmental report exists, the tenant should require the landlord to obtain a report, at the landlord’s cost, or the tenant should negotiate for the right to conduct its own due diligence by way of an environmental assessment from a qualified environmental engineering firm. Whether the tenant is successful with either requirement depends on the relative bargaining power between the parties.

In the lease, the tenant should include a representation and warranty from the landlord that, as at the commencement date of the lease, the property is not contaminated and complies with all applica-

ble environmental laws. In addition, the tenant should try to include an indemnity whereby the landlord agrees to indemnify the tenant (and its officers, directors, employees, successors and assigns) from all environmental damages and claims due to any act or omission by the landlord or by those for whom the landlord is responsible at law.

Tenants should note that most commercial leases include a provision whereby the tenant indemnifies the landlord for all environmental liability regardless of cause. From a tenant’s perspective, this provision should be vigorously resisted and, instead, the tenant should try to include in the lease an acknowledgement that the tenant is not responsible for any environmental contamination caused by or resulting from third party activities, whether or not occurring during the term of the lease.

The financial consequences for environmental liability can be severe, so landlords and tenants must be careful about the risks and ensure that environmental issues are adequately addressed in the lease.

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