



RealEstateBrief

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In this issue, Leslie A. Wittlin, a partner in our Banking and Restructuring Group, reviews the impact upon a landlord of a bankruptcy or insolvency of a tenant and suggests how landlords can structure commercial leases to improve their position.

Paula Lombardi reviews how the proposed amendments to the *Environmental Protection Act* and the *Ontario Water Resources Act* (known as Bill 133) will impact directors and officers of corporations and provides some guidance on what directors and officers can do to try and limit the potential liability.

Taking Security for Obligations of the Tenant Under Commercial Leases

Introduction

Generally speaking, commercial landlords have two so-called self-help remedies in the event that a tenant defaults in payment of rent due under a commercial lease, namely distress over the tenant’s property and termination of the lease. These two remedies cannot be utilized concurrently. Distress over the tenant’s property cannot be exercised once the lease has been terminated. While distress does give the landlord the ability to seize and sell the tenant’s personal property, until the full distress process is completed by the landlord, it is automatically relieved by a voluntary assignment in bankruptcy or by an involuntary bankruptcy occurring as a result of the issuance of a bankruptcy order following the return of a petition in bankruptcy issued and served by a creditor. However, landlords should be aware that there is another way to obtain rights over a tenant’s property which can be enforced in the event of bankruptcy.

Effect of Bankruptcy and Insolvency

The lease may only be terminated for non-payment of rent before a bankruptcy occurs. In Ontario, after bankruptcy, the trustee in bankruptcy has an unqualified right to occupy the leased premises on payment of occupation rent for up to 90 days following the date of bankruptcy. Occupation rent is calculated and payable on a per diem basis in accordance with the terms of the lease. The trustee in bankruptcy must disclaim, affirm or assign the lease on or before 90 days following the date of bankruptcy. To affirm or assign the lease, the trustee must pay all arrears of rent outstanding under the lease and otherwise bring the tenant’s obligations into good standing.

In most insolvencies (including bankruptcies) of tenants, the landlord seldom recovers its arrears arising from the insolvency. The landlord in a bankruptcy may submit and prove a claim as a preferred creditor for three months arrears of rent and three months accelerated rent if so provided for under the lease, but will otherwise rank as an ordinary unsecured creditor in the bankruptcy estate. Many commercial landlords find their positions quite

frustrating, especially in proceedings under the *Companies Creditors Arrangement Act* (the “CCRA”) where their leases are often jettisoned or modified with what they consider to be insufficient compensation. This, of course, is usually a function of market conditions affecting the desirability of their premises.

Obtaining Security on Tenant's Property

Some inventive commercial landlords have required full or partial guarantees and indemnities from related parties as a term of certain leases. Such guarantees and indemnities are a function of market conditions, availability and value thereof.

Very few landlords, however, require security agreements from tenants under which the performance of all of their covenants under the lease are secured by a continuing charge over all of their property, assets and undertaking. It is a relatively simple task to either incorporate sufficient charging language in the lease itself, or to take a separate security agreement, and in both cases perfect the security given by the tenant by registration of a proper financing statement under the *Personal Property Security Act* (the “PPSA”). In taking such security, the landlord must usually agree to postpone its charge over the property, assets and undertaking of the tenant to that of the banker or other financier of the tenant to enable the tenant's business to continue to be financed.

Such priority acknowledgment language can be built into the language of the lease itself, but most secured lenders will want a complete written priority acknowledgment from a landlord holding security by way of a charge over the property, assets and undertaking of the tenant to secure the tenant's obligations to the landlord under the lease.

Advantages of Obtaining Security

While the landlord must be vigilant about preserving the perfection of its security agreement by keeping its registration

up to date in all respects, there are a few very tangible advantages to be gained by obtaining such security from the tenant where possible.

First, the landlord's position is now elevated to that of a secured creditor. This may or may not have value in the event of an insolvency (including the bankruptcy) of the tenant. It will depend on the value of the equity remaining in the secured property, assets and undertaking of the tenant after the prior charge thereon has been paid in full. However, the effect of acquiring such security, even if it ranks behind that of the bank or other financier for the business of the tenant, is to broaden

the remedies available to the landlord considerably, as the landlord now has all the remedies of a secured creditor under the PPSA in addition to its conventional remedies.

Second, the rights of secured creditors are outside the purview of the *Bankruptcy and Insolvency Act* (the “BIA”) for the most part. The remedies of a secured creditor are not stayed by a bankruptcy. (However, the stay of proceedings contained in protection orders under the CCAA will prohibit the exercise of all remedies, even those of a secured creditor.)

Third, when other prior secured creditors are taking steps to enforce their security, as a subsequent security holder, the landlord will then be entitled to notice of enforcement procedures being taken. This information can be of strategic importance to the

landlord. Without being a secured creditor, the landlord would not be entitled to such notice.

Finally, in this latter respect, taking the simple step of securing itself over the tenants property, assets and undertaking puts the commercial landlord in a much better position to know what is going on with the tenant, and therefore allows the commercial landlord to better protect its position. For example, if the tenant is going to change banks, the new bank will insist on a priority acknowledgment from the tenant. The advantages can be subtle, but they are very real.

Very few landlords require security agreements from tenants under which the performance of all of their covenants under the lease are secured by a continuing charge over all of their property, assets and undertaking. It is a relatively simple task to either incorporate sufficient charging language in the lease itself, or to take a separate security agreement.

Conclusion

If any commercial landlords would like to pursue this avenue further, we can be of assistance. For example, we could easily prepare a simple form of security agreement that would constitute a term of the standard form commercial lease of the landlord. Alternatively, we could provide a general security agreement tailored to the landlord's interests. In either case, a financing statement would have to be registered against the tenant under the PPSA upon execution of the lease, or the separate security agreement, as the case may be. Of course, such PPSA registrations must be kept current to ensure the continuing perfection of the security obtained by the landlord. For example, in the event of a change of name of the tenant,

either by articles of amendment or as a result of an amalgamation, the landlord, as a secured creditor, has 30 days from actual notice to amend the PPSA filing to reflect the new name, failing which the perfection of its security will lapse.

Notwithstanding the need for this type of "housekeeping," taking such security from a commercial tenant is often well worth the trouble.



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Increased Directors and Officers Liability for Environmental Matters (Bill 133)

Introduction

The *Environmental Enforcement Statute Law Amendment, 2005* ("Bill 133") proposes to amend the *Environmental Protection Act* and the *Ontario Water Resources Act*. Bill 133 will force directors and officers of corporations to prove that all reasonable care was taken to prevent an offence from occurring. Directors and officers, will therefore have a duty to prevent a breach of the *Environmental Protection Act* ("EPA") and/or *Ontario Water Resources Act* ("OWRA"), their regulations, and any approvals, permits or orders from occurring. Bill 133 also changes the test as to what constitutes an "unlawful discharge" and shortens the time from for appealing penalties.

There are many articles and public comments about the potential detrimental impacts of Bill 133 on industry in general along with its negative impacts on directors, officers and employees. There is clearly increased potential liability for directors and officers set out in Bill 133. However, in reality we antic-

ipate that the Ministry of the Environment will focus on certain industries that are known to be heavy polluters. The Minister of the Environment has publicly stated that it is the Ministry's intention to target industries in Ontario that discharge effluents into surface waters (MISA industries). However, Bill 133 could have an impact on other industries and directors, officers and other individuals should be ready to deal with it.

Directors and officers should be proactive in dealing with their company's environmental risk-management practices to avoid prosecution. Depending on the type of industry we recommend that directors and officers go on record as having reviewed its existing operations to ensure that all environmental standards and requirements are being met. This is a difficult

task as directors and officers will need some assistance, depending on the nature of the industry and operations they are involved in, to determine the environmental standards that the company needs to meet. This type of proactive

There is clearly increased potential liability for directors and officers set out in Bill 133. However, in reality we anticipate that the Ministry of the Environment will focus on certain industries that are known to be heavy polluters.

approach will reduce the potential for personal liability for directors and officers and satisfy the duty to prevent any breaches of environmental legislation.

Background

The EPA is the principal pollution control statute in Ontario and is used, along with the OWRA, to prosecute for unlawful discharges (“spills”) to the environment. Both the EPA and the OWRA define what constitutes an unlawful discharge into the environment.

The EPA prohibits the discharge of a contaminant into the air, water or onto land.¹ Unintentional discharges including deposits, emissions and leaks are also prohibited.² A contaminant is defined broadly to include any “solid, liquid, gas, odour, heat, sound, vibration, radiation or combination of any of them resulting directly or indirectly from human activities that may cause an adverse effect.”

The OWRA regulates the use of water and the discharge of wastewater to water bodies. The OWRA prohibits anyone from discharging any material in any waters that may impair the quality of the waters. “Waters” are broadly defined to include wells, lakes, rivers, ponds, springs, streams, reservoirs, artificial watercourses, intermittent watercourses, ground water or other waters or watercourses.

Both the EPA and the OWRA contain penalty provisions for any individuals or corporations causing or permitting illegal spills or discharges. The penalties include fines and possible incarceration for those convicted. Both Acts also contain provisions permitting the imposition of “Administrative Monetary Penalties” (“AMPs”). AMPs are monetary penalties that can be imposed by regulatory officials when a spill is discovered. However, these sections allowing the imposition of AMPs have never been proclaimed and therefore are not in force.

Impact of Bill 133

Bill 133 received first reading on June 9, 2005 and received Royal Assent on June 13, 2005.

Bill 133 proposes significant changes to the EPA and the OWRA. Individuals, directors and officers should be wary of these changes. The proposed changes will make it easier for the Ministry of the Environment to penalize corporations for causing discharges and spills into the environment.

The proposed amendments to the EPA and OWRA set out in Bill 133 include:

- a new type of monetary penalty called “Environmental Penalties”;
- increasing directors and officers liability;
- eliminating the use of a due diligence defence against the imposition of Environmental Penalties;
- requiring persons charged to demonstrate that they took all reasonable care to prevent a discharge (This is a reverse onus provision. Under the current environmental laws the Crown is required to prove guilt.);
- increased penalties for corporations, including the option of jail time for corporate officers and directors; and
- limiting the court’s discretion in reducing fines.

Some of the key changes proposed for the EPA and OWRA are discussed below.

The legislation takes away currently available defences to individuals and corporations of due diligence and mistake of fact. The reverse onus provision will require officers and directors of a corporation charged with a spill to prove that they took “all reasonable steps to prevent” the spill.

Environmental Penalties

Bill 133 proposes implementing Environmental Penalties of up to \$100,000 per day for corporations who are responsible for unlawful discharges. These penalties can be imposed by the direction of the Ministry of the Environment shortly after a spill occurs.

In addition to being responsible for an Environmental Penalty, individuals and corporations can also be prosecuted and convicted under the EPA and OWRA. This may result in fines and possible penal sanctions being imposed on top of the Environmental Penalty.

Environmental Penalties can be imposed even where the corporation took all reasonable steps to prevent the spill. These penalties can also be imposed regardless of whether the corporation held an honest and reasonable belief in a mistaken set of facts that, if true, would have rendered the contravention innocent. The legislation takes away currently available defences to corporations of due diligence and mistake of fact.

The reverse onus provision will require officers and directors of a corporation charged with a spill to prove that they took “all reasonable steps to prevent” the spill.

Environmental Penalties can only be disputed on very limited grounds before the Environmental Review Tribunal and only within seven days of the Environmental Penalty being imposed. There is no proposed cap on the amount of the Environmental Penalties for a corporation.

Director’s and Officer’s Duty

Bill 133 requires that every director and officer of a corporation take “all reasonable steps” to prevent the corporation from committing any offence under the legislation or regulations, or contravening an order, certificate of approval, certificate of property use, licence or permit.

This places what could become an unreasonable burden on officers and directors to be knowledgeable about all environmental issues and matters affecting that corporation. The director or officer charged will have the onus of proving that they took all reasonable care to prevent the corporation from committing the offence or violating the approvals.

Increased Fines

Bill 133 proposes to increase the maximum daily fines for corporations for general offences from \$100,000 to \$250,000 on a first conviction and from \$200,000 to \$500,000 for every subsequent conviction.

Bill 133 also specifies minimum fines for categories of offences that are designated. Higher fines (up to \$1,000,000

for corporations) and longer prison sentences are imposed for these designated offences. These designated offences include discharges that cause or may cause an adverse effect, specified contraventions relating to industrial/hazardous waste, obstruction, and contravening a legally binding numerical limit (such as limits set out in Certificates of Approval).

Sentencing Considerations

Bill 133 sets out a list of aggravating factors that the court is required to consider when determining the appropriate penalty for designated offences.

Aggravating factors include: any offence causing an adverse effect; offences committed intentionally or recklessly; offences motivated by monetary benefit; failing to cooperate; failure to take prompt action to mitigate effects; lack of compensation to affected parties; previous convictions; and any other aggravating factors that may be prescribed by the regulation.

When aggravating factors are established, the severity of the penalty imposed by the court is required to reflect the number of aggravating factors and the seriousness of the particular circumstances of each aggravating factor. Should the court decide that an aggravating factor does not warrant the imposition of a more severe penalty, the court is required to give reasons for that decision.

In light of the increased liability in Bill 133, we would recommend that companies dealing directly or indirectly with any hazardous substances, solid waste, liquid industrial waste or sanitary sewage disposal, or that are discharging to the air, ground and surface water, review their environmental risk management practices.

Broader Definitions

Bill 133 proposes to broaden the definition of what constitutes an “unlawful discharge” and will be found to cause an adverse effect under the EPA and OWRA. The current threshold is where a contaminant “causes or is likely to cause” an adverse effect. This threshold is considerably lowered in Bill 133 to where a contaminant “may cause” an adverse effect. The proposed new definition will greatly increase the number of unlawful discharges that occur along with the number of reportable discharges. Under the proposed amendment the release of any contaminant into the environment, regardless

of whether it is actually adverse or not, may be considered a chargeable offence. We will have to wait to determine how this new definition will be applied and interpreted by the Ministry of the Environment investigators and prosecutors.

This slight change in the wording could potentially have significant impacts on any person(s) responsible for a spill. This change in the legislation is expected to substantially increase the number of spills that will be subject to a charge.

Bill 133 also has a provision entitling the MOE and municipalities to recover reasonable costs from the party responsible for the spill. Any amounts owed to a municipality is given the status of a lien and will rank ahead of other property encumbrances such as mortgages.

Conclusion

In light of the increased liability in Bill 133, we would recommend that companies dealing directly or indirectly with any hazardous substances, solid waste, liquid industrial waste or sanitary sewage disposal, or that are discharging to the air, ground and surface water, review their environmental risk management practices. Failing to consider the responsibilities raised under Bill 133 could have a significant impact on a corporation's operations and could result in personal liability for directors and/or officers.

Directors and officers will need some assistance in determining the potential environmental risks and liabilities facing their industries. For example, an environmental risk analysis should be conducted so that directors and officers are familiar with the nature of its operations including, among others:

- historic and current solid waste and liquid waste management practices, with identification of all historic landfill and lagoon sites;
- procedures for hazardous materials and wastes;
- discharges to air and ground and surface water;
- spill and emergency plans and training, emergency and spill response equipment and procedures;
- sanitary sewage disposal; and
- monitoring procedures and data management.

The new regulatory measures being introduced effectively eliminate the common law defences of due diligence and honest mistake. The government appears to be creating a legislative regime where corporate directors and officers are presumed guilty until proven innocent.

We will continue to monitor on the progress of Bill 133 and provide

updates of any changes or revisions.

Failing to consider the responsibilities raised under Bill 133 could have a significant impact on a corporation's operations and could result in personal liability for directors and/or officers.



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1 The *Environment Protection Act*, s. 1 “Natural Environment” is defined as “air, land, or water, or any combination or part thereof, of the Province of Ontario.”

2 *Ibid.*, s.1 the definitions state that “discharge” when used as a verb, includes “add, deposit, leak or emit and, when used as a noun, includes any addition, deposit, emission or leak.”

Announcements

Upcoming Events

Paula Lombardi will be presenting a paper on “Environmental Issues in Commercial Real Estate” at the Law Clerks Forum on July 20, 2005.

Lang Michener is pleased to again be a sponsor of the RealLeasing Conference at the Metro Toronto Convention Centre on September 29, 2005.

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