TASK FORCE ON ENVIRONMENTAL ISSUES

ISSUE PAPER

SUBJECT: Environmental Liability of Trustees, Receivers and Interim Receivers.

ISSUES Whether Section 14.O6 of the BIA should be amended:

(1) to exempt a trustee from personal liability for remediation costs associated with environmental damage which is not caused by the gross negligence or wilful misconduct of the trustee;

(2) to provide that the bankrupt estate is not required to incur remediation costs associated with environmental damage which arose prior to the appointment of the trustee or while the trustee has custody of the property solely for the purposes of protecting it and investigating the environmental condition of the property;

(3) to require a trustee who utilizes the property of the bankrupt to exercise due diligence to prevent the creation or aggravation of an adverse environmental condition and to provide that any costs relating thereto s~all be paid out of the property utilized in priority to any other claims, including claims of secured creditors;

(4) to limit the environmental liability of a trustee who utilizes property of the bankrupt to the net proceed~ realized from the sale or other realization of the contaminated property and the tangible property owned by the bankrupt located thereon;

(5) to require a trustee to report environmental site contamination and to provide the government authorities with reports of any adverse environmental condition of the property obtained by the trustee;

(6) to permit the courts to give directions to a trustee relating to compliance with environmental laws which would be binding upon governmental authorities;

(7) to extend the protection afforded to trustees of bankrupt estates in the BIA to interim receivers, trustees acting under proposals and receivers as defined in Part XI of the BIA, and

(8) to provide that, notwithstanding sections 86 and 87 of the Act, any secured claim of the Crown in Right of Canada or of any province for remediation costs relating to environmental damages should rank as ~ secured creditor against the net proceeds realized from the contaminated property and any tangible property owned by the bankrupt located thereon.

.../2

BACKGROUND:

Section 14.O6(2) which was enacted in the 1992 amendments to the BIA was intended to provide a trustee with protection from personal liability for environmental damage or conditions which (i) occurred before the trustee's appointment and (ii) after the trustee's appointment except where the environmental damage or condition arose as a result of the trustee's failure to exercise "due diligence". It was hoped that section 14.O6(2) would permit trustees to professionally administer bankrupt estates without the fear of attracting personal liability for environmental damage or conditions for which they were not responsible, particularly in circumstances where clean-up costs exceeded the realizable value of the estate's

The concept of "due diligence" introduced in section 14.06(2) is not defined i the statute. The trustee is required to rely on jurisprudence which has established due diligence as a negligence standard based on the actions of a reasonable person in a given set of circumstances. Acceptable standards of due diligence defined in case law stipulate that a person must take all reasonable steps necessary to ensure that a discharge of a contaminant to the environment will not occur. Whether due diligence has been exercised is very much determined by the facts of a particular situation and involves the determination of whether a person has taken all reasonable steps necessary to ensure that an environmental incident will not occur.

In any particular situation the determination of whether or not there has been compliance with the due diligence standard is uncertain. Rather than take the risk of assuming liability, many trustees have refused to accept assignments which would involve taking possession of environmentally sensitive properties without an indemnity from a financially strong party. When the extent of the environmental liability is uncertain and the cost of remediation unquantifiable, such an indemnity is often unavailable. As a result, the trustee does not take possession of the property and it is left unprotected. Such a property may pose a hazard to neighbours and to children who may frequent the property when it is unattended. Also, any environmental condition may be aggravated when no one is responsible for informing the public authorities of the problem.

At the present time there are many provincial and federal reporting requirements relating to adverse environmental conditions. The complexity of these reporting requirements

has also discouraged trustees from accepting assignments relating to environmentally sensitive properties. The difficulty of ascertaining which reporting requirements apply to a particular situation could be significantly reduced if the Superintendent of Bankruptcy were authorized to issue directives specifying the nature and extent of environmental reporting requirements for trustees.

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To assist the government authorities with the remediation of environmental problems, trustees should be required to provide the governmental authorities with copies of environmental site reports obtained by the trustee.

When a trustee is appointed, the business of the bankrupt may be located on properties which are environmentally sensitive. Rather than incur a risk of liability for the remediation of the property, the trustee may decide not to operate the business and terminate the employment of all persons working on the site. In many cases, the trustee would be prepared to continue a viable business operation on an environmentally sensitive property if the trustee's liability for environmental remediation was limited to the net proceeds realized from the sale of the property. The trustee would be prepared to accept the risk of no recovery from the problem property but would not be prepared to pay for the cost of remediation from other assets of the bankrupt estate.

Many courts have recognized the necessity of protecting trustees and receivers from the risk of environmental liability. Court orders to this effect have been made in many receivership actions but there is considerable uncertainty as to the extent that such orders are enforceable and binding upon governmental authorities.

The 1992 amendments to the BIA also established a code for the enforcement of security by secured creditors. Many insolvent situations are administered by receivers (as defined in Part XI of the BIA). They are appointed by a secured creditor or by the court. A receiver has the same concerns as a trustee relating to liability for environmental conditions. In certain situations a receiver will not take possession of an environmentally sensitive property or will terminate operations rather than incur unquantifiable liability for environmental clean-up. To avoid property being left unprotected or the termination of viable business operations and the resulting loss of employment, receivers should be granted the same protection as trustees under the BIA.

In addition, interim receivers and trustees acting under proposals perform important roles with respect to the protection of creditors and restructuring of businesses. Both these roles have been excluded from the protection provided in section 14.O6 and, thus, they are left with a risk of responsibility for remediation of environmental conditions. Recognizing the importance of their roles, these persons should be provided with the same protection afforded to trustees under section 14.06.

Sections 86 and 87 of the BIA provide that in relation to a bankruptcy or a proposal, all secured claims of Her Majesty in the Right of Canada or a province for remediation costs relating to environmental damage are unsecured claims unless registered and if registered, are only valid in respect of amounts owing at the time of registration. The report of a Task Force on contaminated site liability to the Canadian Council of Ministers of the Environment (the "CCME" which was approved on May 12, 1993, recommended that the costs of environmental remediation should constitute a first charge on all the assets of the debtor,

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including assets which are not located on the contaminated site. This recommendation would result in a Crown lien for environmental clean-up costs ranking in priority to:

(a) municipal taxes;
(b) claims of employees for unpaid wages, vacation pay and other entitlements;
(c) claims of unpaid suppliers of inventory, and
(d) security granted to lenders for loans to finance the debtor's business and equipment.

Similar provisions are found in the federal legislation in the United States dealing with the clean-up of contaminated sites, the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) which have created a vary chaotic situation. A commentator has advised that 75% of all amounts spent by the Superfund established by CERCLA has been used to pay consultants' and lawyers' costs rather than the remediation of environmental conditions.

PRELIMINARY PROPOSALS/RECOMMENDED SOLUTIONS:

1. Exemption of Personal Liability of Trustees

Section 14.O6(2) of the BIA should be amended as follows:

> 14.O6(2) No person acting as trustee of a bankrupt estate, receiver, interim receiver, or trustee under a proposal shall be personally liable in respect of any adverse environmental condition which has not been caused by the gross negligence or wilful misconduct of that person.

Pros:

- Current provincial legislation does not make a distinction between the personal liability of a trustee of a bankrupt estate and the liability of the bankrupt estate itself. This recommendation makes it clear that the trustee is only personally liable for environmental damage which is caused by the gross negligence or wilful misconduct of the trustee.

Cons:

- No obvious corns.

2. Exemption of Liability of Trustee When Property Not Utilized

Section 14.06(3) would be added as follows:

> 14.06(3) A trustee of a bankrupt estate, receiver, interim receiver or trustee under a proposal shall not be liable in respect to any adverse environmental condition that,
>
> (a) arose or occurred before the appointment of such person, or
>
> (b) arose, occurred or continued after the appointment of such person if such person has not utilized the affected property owned or occupied by the insolvent person or the bankrupt.
>
> unless such adverse environmental condition was caused by the wilful misconduct or gross negligence of that person.

Pros:

- Exempting trustees from environmental liability when they take custodial possession of property, do not carry on the business, and do not sell or dispose of the property or any tangible property on the site, will encourage trustees to accept assignments relating to environmentally sensitive properties.
- This should result in better protective arrangements for environmentally sensitive properties and will enable environmental site assessments or other investigations to be performed without the risk of the trustee incurring liability for remediation of contaminated property.

Cons:

- No obvious cons.

3. Liability of Trustee for Due Diligence When Property Utilized

Section 14.06.(4) would be added to read as follows:

> 14.06(4) Subject to subsection (10), a trustee of a bankrupt estate, receiver, interim receiver, or trustee under a proposal who utilizes any affected property owned by the insolvent person or bankrupt shall exercise due diligence for the purpose of preventing the creation or the aggravation of an adverse environmental condition. All the costs relating thereto shall be payable as costs

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of administration out of the net proceeds of the realization from the affected property and any tangible property owned by the bankrupt or the insolvent person located thereon prior to any other claims against that property, including secured claims.

Pros:

- A trustee who utilizes an environmentally sensitive site would be responsible for exercising due diligence.
- The costs of such due diligence would be payable as costs of administration out of the affected property and any tangible property owned by the debtor located thereon before any payments to secured creditors with claims against such property.

Cons:

- No obvious cons.

4. Notice of Decision Not to Utilize Property

Section 14.O6(5) would be added to read as follows:

> 14.O6(5) A trustee of a bankrupt estate, receiver, interim receiver or trustee under a proposal shall, within six months from the date of its appointment, notify the Superintendent and the applicable federal, provincial and municipal authorities if it does not intend to utilize any affected property owned or occupied by the insolvent person or bankrupt.

Pros:

- A trustee would be given up to six months to determine whether or not it intended to utilize property.
- If a decision is made not to utilize contaminated property, notice of that decision would be given to the proper authorities.
- Under the present law many contaminated sites are abandoned without the proper authorities being aware of their abandonment or their condition.

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Cons:

- This would mean an additional reporting burden on trustees.

5. Abandonment of Property

Section 14.06(6) would be added as follows:

> 14.06(6) A trustee of a bankrupt estate, receiver, interim receiver or trustee under a proposal who has utilized any affected property owned or occupied by the insolvent person or a bankrupt shall not be liable for any adverse environmental condition arising after its abandonment of the affected property where:
>
> (a) it has exercised due diligence in respect of such abandonment, and
>
> (b) it has provided at least ten days' notice of its intention to abandon the affected property to the Superintendent and the applicable federal, provincial and municipal authorities.

Pros:

- A trustee who abandons property is required to exercise due diligence and to give notice of its intention of abandonment to the proper authorities.
- This requirement would help to ensure that remedial measures could be undertaken.

Cons:

- This requirement would be an additional burden on trustees in those provinces that do not have mandatory reporting requirements in their environmental legislation.

6. Clarification of Utilization of Property

Section 14.06(7) would be added as follows:

> 14.06(7) A trustee of a bankrupt estate, receiver, interim receiver or trustee under a proposal shall be conclusively deemed not to have utilized affected property owned or occupied by the insolvent person or the bankrupt where,
>
> (a) it may have acquired legal title to the affected property as a result of the provisions of this Act;

.../8

(b) it does not manage or control any business conducted on the affected property which shall not include either the mere capacity or ability to influence such management or the termination of the business conducted on the affected property as soon as practicable after its appointment;

(c) it does not exercise decision-making control over the environmental plans of the insolvent person or bankrupt relating to the affected property;

(d) it does not remove any tangible property, other than the books and records, of the insolvent person or the bankrupt from the affected property for the purpose of selling or otherwise realizing upon such property, and

(e) its activities, if any, in respect of the affected property are primarily for the purposes of one or more of the following:

(i) preserving or protecting the affected property;

(ii) inspecting, copying or removing the books and records of the insolvent person or the bankrupt,

(iii) determining the nature and extent of any adverse environmental condition relating to the affected property,

(iv) enforcing rights with respect to amounts owing to the insolvent person or bankrupt,

(v) advising with respect to a proposal, and

(vi) inspecting, counting or tabulating assets on the affected property.

Pros:

- This would clarify more clearly what actions would not constitute utilization of the property of the bankrupt.

Cons:

- The determination of what constitutes utilization is a factual question which would still need be determined in each particular case.

7. Reporting Requirements

Section 14.06(8) would be added as follows:

> 14.06(8) The Superintendent shall issue directives pursuant to paragraphs 5(4)(b) and 5(4)(c) of this Act setting out a list of all reporting requirements received by the Superintendent from federal, provincial and municipal authorities.

Pros:

- This would avoid a trustee having to sort through the myriad of existing statutes to ascertain the scope and extent of reporting requirements.
- It would ensure standard reporting requirements for trustees across Canada

Cons:

- No obvious cons.

8. Notification of Environmental Problems

Section 14.O6(9) would be added as follows:

> 14.O6(9) As soon as practicable, a trustee of a bankrupt estate, receiver, interim receiver or trustee under a proposal shall:
>
> > (a) report any adverse environmental condition of which he becomes aware to the applicable federal, provincial or municipal authorities in accordance with directives issued by the Superintendent pursuant to paragraphs 5(4)(b) and (c) of this Act and such reports shall be made in accordance with the reporting requirements in the applicable federal, provincial or municipal legislation, and
> >
> > (b) shall provide the applicable authority with any environmental site assessment reports which it has received relating to the affected property.

Pros:

- This provision would ensure that trustees would report environmental damage to the appropriate authorities and give such authorities access to any environmental site assessment reports relating to the contaminated site.

Cons:

- This requirement would be an additional burden on trustees in those provinces that do not have mandatory reporting requirements in their environmental legislation.

9. Limitation on Liability for Environmental Damage

Section 14.O6(1O) would be added as follows;

> 14.O6(10) A trustee of a bankrupt estate, receiver, interim receiver or trustee under a proposal shall not be liable with respect to:
>
> > (a) any adverse environmental condition for an amount greater than the net proceeds realized by such person from the sale or other disposition of the affected property and any tangible property owned by the bankrupt or insolvent person located thereon after deducting all fees and expenses of such person directly relating to the utilization and realization of that property, or
> >
> > (b) failing to report any adverse environmental condition pursuant to a reporting requirement not found on the list issued pursuant to the Superintendent's directives as provided in subsection (8) unless such adverse environmental condition was caused by the wilful misconduct or gross negligence of that person.

Pros:

- A trustee may be prepared to carry on a business located on a property where there is evidence that an environmental problem exists if there is protection that any liability for remediation would be limited to the amount of the net proceeds realized from the sale or other disposition of the property.
- The limit proposed includes the amount realized from any tangible property owned by the debtor located on the site.
- There is no limitation for liability if the trustee was guilty of wilful misconduct or gross negligence.
- This provision will avert the shut down of viable businesses to avoid environmental liability.
- Employment may be maintained if environmental liability is capped.

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Cons:

- The other assets of the bankrupt or insolvent person would not be available to pay the costs of any remediation required.

10. Statutory Liens for Environmental Remediation Costs

Section 14.O6(11) would be added to read as follows:

> 1 4.O6(11) (a) Notwithstanding sections 86 and 87 of this Act, for the purposes of distribution of the net realization of the property of a bankrupt, any secured claim of the Crown in the Right of Canada or of any province for remediation costs relating to environmental damage shall be paid from the net proceeds of the first realization from the affected property and any tangible property owned by the bankrupt located thereon in priority to all other claims, secured or otherwise, against the affected property and any tangible property owned by the bankrupt located thereon.
>
> (b) Any secured claim of the Crown in the Right of Canada or of any province for the costs of remediation of an adverse environmental condition shall be allocated against the aggregate net proceeds realized from the affected property and any tangible property owned by the bankrupt located thereon in proportions equal to the net amounts realized from each kind of asset.

Pros:

- If so provided by federal or provincial legislation, claims of the Crown for remediation costs relating to environmental damage will rank in priority to claims of secured creditors and others against the net proceeds from the property subject to the adverse environmental condition and any tangible property owned by the bankrupt located thereon. This would allow such claims to rank in priority to claims of municipalities for municipal taxes, claims of unpaid employees for wages or vacation pay and claims of unpaid suppliers of inventory and holders of security on equipment when the inventory and equipment were located on the contaminated site at the date of the bankruptcy.

- Limiting statutory liens for environmental clean-up costs to the proceeds from the contaminated site and the tangible property owned by the bankrupt located thereon should not unduly restrict the ability of borrowers to obtain financing from lenders.

- Statutory liens for environmental clean-up costs incurred by governmental authorities would no longer be converted solely to unsecured claims in the event of a bankruptcy or a proposal.

Cons:

- A fair and equitable distribution of the net proceeds of sale from the sale of the contaminated property and any tangible property owned by the bankrupt located thereon would have to be delayed pending completion of the realization of all such property.

- There may be difficulty in allocating the costs of realization against the various kinds of assets.

- Other assets of the bankrupt not consisting of the contaminated property or any tangible property located thereon would not be available to satisfy the secured claim for environmental clean-up although such claims could still rank as unsecured claims against other assets of the bankrupt.

11. Application to Court for Directions

Section 14.O6(12) would be added to read as follows:

> 14.O6(12) (a) A trustee of a bankrupt estate, receiver, interim receiver, trustee under a proposal or any other interested person may apply to the court for directions in relatior to the duties and obligations of a trustee of a bankrupt estate, receiver, interim receivei or trustee under a proposal relating to any adverse environmental condition.
>
> (b) Notice of an application pursuant to the provisions of paragraph (a) above shall be given to all the applicable federal, provincial and municipal authorities who are included in the list of authorities set out in the Superintendent's directives as provided in subsection (8).
>
> (c) Upon an application referred to in paragraph (a) above, the court shall give, in writing, such directions, if any, as it considers proper under the circumstances and such directions shall be binding upon all the federal, provincial and municipal authorities and other persons who were given notice of the application.

Pros:

- In a case of uncertainty, a trustee or any other person, including a governmental authority, may apply to the court for directions which would be binding on all parties who were given notice of the application.

- This would give the trustee protection in advance.

Cons:

- No obvious cons.

12. Definitions

Section 14.06(13) would be added to read as follows:

> 14.06(13) For the purposes of subsections (2) to (12) above inclusive,
>
> (a) "adverse environmental condition" includes, without limitation, any injury, harm, damage, impairment or adverse effect to the environmental condition of the subject property and the unlawful storage or disposal of waste or other contamination on or from the subject property,
>
> (b) "affected property" means any parcel of land which may be sold on a separate basis and which is subject to an adverse environmental condition, and
>
> (c) "receiver" means a receiver as defined in section 243(2) of this Act.

Pros:

- Clarification of key terms in section.

Cons:

- No obvious cons.

13. Priority Over All Other Federal or Provincial Legislation

Section 14.06(14) would be added to read as follows:

> 14.06(14) The provisions of subsections 14.06(2) to 14.06(13), inclusive, shall apply and be effective notwithstanding any provision of federal or provincial legislation respecting the protection, conservation, enhancement, remediation or rehabilitation of the environment or relating to the disposal of waste or other contamination.

Pros:

- The extent and scope of all liabilities of a trustee, receiver, interim receiver and trustee under a proposal with respect to environmental matters would be governed by the BIA and the BIA provisions would override any provisions to the contrary in other federal or provincial legislation.

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- This gives the trustee or receiver the certainty that it requires before assuming possession of or responsibility for property which may be subject to an adverse environmental condition.
- Clarification of the priority of statutory liens for environmental clean-up costs on a national basis will avoid the confusion and uncertainty of existing and proposed provincial standards and make financing more readily available to environmentally sensitive industries.

Cons:

- No obvious cons