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Fraud and Concealment of Contaminated Land: Do Your Due Diligence, Purchaser

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Cases Considered:

Motkoski Holdings Ltd. v. *Yellowhead (County),* 2008 ABQB 454 (Q.B.), *Motkoski Holdings Ltd.* v. *Yellowhead (County)*, 2010 ABCA 72 (C.A.)

As both environmental standards and the demand for strategically located land increase, there is a greater likelihood that contaminated land will come on the market. What is clear from the case of *Motkoski Holdings Ltd.* v. *Yellowhead (County)* is that the burden of thoroughly investigating a site remains firmly on the purchaser's shoulders, despite the sometimes inequitable difference in bargaining power between a vendor and a purchaser. Standard real estate contractual terms will often transfer land "as is" and exclude representations and warranties outside the four corners of the contract as well as exclude any collateral agreements. A contractual term that excludes any warranty as to the soil conditions, particularly in light of an engineering report that recommends further investigation, should put the purchaser on notice that further investigation may be necessary. If there are any concerns raised from preliminary investigation of the site, the purchaser neglects to follow up or investigate at its own peril.

The Facts

For a number of years Ron Motkoski, the owner of the plaintiff corporation, Motkoski Holdings Ltd., had his eye on a parcel of land in Robb, then owned by the defendant, Yellowhead County, and located at the intersection of a highway and an access road. He thought this site was well-suited for a motel and commercial complex (CA judgment at para. 2).

It was common knowledge in the community that there had been a landfill or nuisance ground near that site, though no one could recall its precise location (CA judgment at para. 3). In 2000 Mr. Motkoski and his partners paced off a 6½ acre area, believing that portion to be free of contamination (CA judgment at para. 3). This area of land became Lot 1 and the remaining portion believed to contain the landfill became Lot 2. A subsequent investigation and report of May 2001 (the "Omni-McCann report"), pursuant to a Subdivision Servicing Feasibility Study conducted on behalf of the County, turned up no evidence of contamination on Lot 1, but "recommended that any potential purchaser of the property be advised of the possible existence of buried waste" (CA judgment at para. 7). The same recommendation was echoed by Alberta Environment in August 2001 (QB judgment at para. 44).

After a tendering process, the County eventually sold Lot 1 to the plaintiff in October 2001 on an "as is" basis, the contract acknowledging there were "no representations or warranties...as to the condition of the soils within, on or under the Development Lands" (CA judgment at para. 15).

Over the winter, the plaintiff cleared and levelled the land in preparation for development (CA judgment at para. 16). In the spring, the plaintiff's engineers dug test holes in preparation for sewer work. It was at this stage that solid waste was discovered on Lot 1 (CA judgment at para. 17). Alberta Environment was notified and work ceased on the site.

Alberta Environment advised that the regulations for landfills required a 300 metre setback, a setback that would encompass the whole of Lot 1 (QB judgment at para. 74). In the fall, an engineering report was prepared for the County to determine the extent of the contamination. The report estimated that Lot 1 held about 2,500 to 3,500 cubic metres of refuse, with a cost to clean-up the site at $110,000 to $120,000 with a further $70,000 to $80,000 needed to separate and remove the refuse (QB judgment at para. 80).

Subsequent investigation indicated that Alberta Environment did have a record of a landfill on Lot 1, but it was filed under the wrong legal description. Further, a record of a landfill on Lot 1 was held in files the defendant County received when subdivision authority, along with the relevant records, were transferred to the defendant County in 1994. However, no one seemed to be actually aware of this until after the transaction was completed (CA judgment at para. 19).

The Trial Judgment

At the outset the plaintiff faced a difficult task since the contract, as is typical in real estate agreements, excluded any collateral agreements or warranties (CA judgment at para. 39) and was not ambiguous (QB judgment at paras. 96-97). An argument that the contract was frustrated was abandoned (CA judgment at para. 21). Instead of asking for the contract to be set aside, the plaintiff sought damages on the basis of a fraudulent misrepresentation as to the state of the land or a reckless concealment of a latent defect in the land (QB judgment at para. 98). It does not appear that negligent misrepresentation was either pleaded or argued (See the commentary on the pleadings in the CA judgment at paras. 20-24). However, short of a covenant performed negligently it would not have been actionable in this case. To succeed, the plaintiff would need to establish fraud or concealment.

Citing *TWT Enterprises Ltd.* v. *Westgreen Developments (North) Ltd.* (1991), 78 Alta. L. R. (2d) 62 (Q.B.), aff'd (1992) 3 Alta. L. R. (3d) 124 (C.A.), the trial judge, Madam Justice L.J. Smith, set out the elements of fraud as follows:

1. a false representation or statement made by the defendant;
2. which was knowingly false [or recklessly so];
3. which was made with the intention to deceive the plaintiff; and
4. which materially induced the plaintiff to act, causing him damage (QB judgment at para. 102).

Justice Smith found that the plaintiff relied on two representations: (1) that the defendant County would "facilitate the motel development" and (2) that the defendant County would "prepare a preliminary report" or "investigate site suitability" (QB judgment at paras. 103 and 106). These representations were "knowingly false since the defendant had corporate knowledge that a registered reclaimed landfill existed on the site making the property dangerous for human habitation" (QB judgment at para. 104). She found that Mr. Beck, the Acting Director and Director of Planning for the defendant County, having read all the planning documents, had "knowledge that a registered nuisance ground existed on Lot 1" (QB judgment at para. 48) and that his instructions to include an indemnity clause for the nuisance ground without informing the plaintiff was "an act of concealment" (QB judgment at para. 49). With the knowledge that a

landfill existed on the site it was reckless to proceed with the subdivision and sale without further investigation (QB judgment at para. 87). On this basis, Justice Smith found the defendant County liable in fraud.

In the alternative, Justice Smith found that the landfill was a latent defect (QB judgment at 113) and that the defendant County had concealed the latent defect from the plaintiff (QB judgment at 118). She found that the defendant County had "corporate knowledge" of the landfill on Lot 1 and Mr. Beck, having read all the planning documents, specifically had knowledge of the landfill (QB judgment at para. 115). The concealment consisted of failing to make adequate inquiries, to perform further investigation, and to provide relevant documents or failing to advise the plaintiff of the potential problems; instead, Mr. Beck instructed the preparation of an indemnity clause in "a deliberate attempt to conceal the truth" (QB judgment at para. 118).

Had this judgment stood, it would have placed a heavy burden on municipal authorities, and other vendors of potentially contaminated land, to thoroughly investigate the state of their land and to disclose any potential risk to potential purchasers before tendering land for sale. In my view, it would have placed too onerous a burden on the vendor in this case and not enough on the purchaser to perform due diligence, particularly in light of the fact that both parties knew there was a landfill nearby, just not its precise location, and given the right of the parties to negotiate the terms of their own contract.

The Court of Appeal's Decision

The Court of Appeal (Chief Justice Catherine Fraser, Justice Peter Martin and Justice Frans Slatter) sent the matter back for a new trial, largely because it was unable to make a determination on the record as to whether the defendant County had acted recklessly. What the Court said about the issues of fraudulent misrepresentation and concealment is critical.

Fraud and Recklessness

The Court of Appeal clarified the two branches of fraud before dealing with the question of what constitutes recklessness. First, fraud can be established if the defendant knew that a statement was false and made it knowing or intending that the plaintiff would rely on it. Second, fraud can also be established even if the defendant does not know the statement is false, but makes the statement recklessly (CA judgment at paras. 57-58). According to the Court of Appeal, it is not "sufficient that the defendant "should have known" the truth, or should have been more careful and made further inquiries; actual knowledge or actual indifference to the truth is required" (CA judgment at para. 58).

The trial judge had found the defendant County reckless, largely on the strength of certain shortcomings in Mr. Beck's conduct: his lack of effort to investigate the site and the County's own records and his failure to adequately inform the plaintiff of potential problems. Citing *Derry* v. *Peek* (1889), 14 A.C. 337 (H.L.) for the proposition that not caring whether a statement is true or false is sufficient in some cases, the trial judge had said: "The defendant's corporate knowledge, and its disregard of the existing zoning information showing a registered nuisance ground on the precise location of Lot 1, proves the defendant recklessly disregarded the truth. The degree of its recklessness is further proven by the fact that despite anecdotal evidence pointing to historical dumping, the defendant failed to consult the historical documents in its possession" (QB judgment at para. 104).

The Court of Appeal found this reasoning problematic. First, the Court could not find any basis for a finding of fraud based on the defendant County's "corporate knowledge." According to the

Court of Appeal, citing *BG Checo International Ltd.* v. *British Columbia Hydro and Power Authority* (1990), 44 B.C.L.R. (2d) 145 (C.A.), aff'd [1993] 1 S.C.R. 12, it was impossible for "corporate knowledge" to become fraudulent without fraudulent intention or conduct of a corporate representative (CA judgment at para. 89). The Court of Appeal said:

> Knowledge and ignorance are incompatible opposites. Statements cannot be made recklessly, without caring whether they are true or false, unless the person making the representation is aware, at least, that there is some issue about the truth of the fact. A person who is ignorant of the existence of information that might throw the fact into doubt cannot be reckless in this sense of the word (CA judgment at para. 90).

In other words, Mr. Beck's failure to examine the County's records, of which he was not aware but should have been aware, might be negligent but it did not amount to a fraud.

Second, the Court of Appeal found the reasons of the trial judge on the defendant County's failure to investigate ambiguous: "it is unclear whether "recklessness" is used in its true meaning of "not caring whether the statement is true or false", or whether the word is used merely to describe negligence or carelessness" (CA judgment at para. 92). According to the Court of Appeal, it would only amount to recklessness if the defendant County "deliberately did not look in [its] old files, because it did not care what was in them" (CA judgment at para. 93).

Latent Defect and Concealment

The Court of Appeal found that the contamination was not a latent defect because everyone knew there was a landfill on the subject lands, but its precise location was unknown, and the Omni-McCann report put the plaintiff on notice of the risk (CA judgment at paras. 79-80). "The latency had to do with the location of the defect, not the nature or existence of the defect" (CA judgment at para. 80). The plaintiff had a duty to make its own inquiries and to conduct its own investigation.

Even if the contamination was a latent defect, the Court of Appeal found no evidence of concealment from the record. The trial judge had never set out the legal definition of concealment before making her finding that the defendant had concealed the contamination (CA judgment at para. 65). The Court of Appeal carefully set out the criteria as follows: "Concealment requires a positive step to hide a defect in the land, coupled with an intention to withhold knowledge of the defect from the purchaser. If a defect is concealed, it is treated the same way as a representation that the defect does not exist; concealment therefore often amounts to fraud" (CA judgment at para. 59). Concealment is distinguished from non-disclosure or mere silence. Absent a duty to disclose, non-disclosure or mere silence is not actionable (CA judgment at para. 60). Accordingly, the Court of Appeal found that the defendant County did not conceal the possibility of a landfill from Alberta Environment, since it had specifically advised Alberta Environment of the "proximity to former landfill" and enclosed a copy of the Omni-McCann report (CA judgment at para. 66). Similarly, the defendant County did not conceal the possibility of a landfill from the plaintiff either, since it provided the Omni-McCann report to the plaintiff (CA judgment at para. 66). Finally, the inclusion of an indemnity clause simply represented good risk management by the defendant County during negotiations and could not be interpreted as concealment (CA judgment at paras. 67-76).

Discussion

I propose to deal with three aspects of the Court of Appeal's reasons in the context of a typical real estate transaction: what does it mean to be reckless, whose duty is it to investigate, and what conduct amounts to concealment.

What Does it Mean to be Reckless?

The first issue that arises from the Court of Appeal's decision is the meaning of recklessness under the second branch of the definition of fraud. I propose to deal with recklessness as it applies to a vendor's duty to investigate and inform. In practical terms, it boils down to asking at what point is a corporate representative sufficiently aware of an issue so that they should turn their mind to further inquiry or inform the purchaser? Somewhere along a continuum from intention through to ignorance lies recklessness.

The Court of Appeal defined recklessness as follows:

> "Recklessly" in this context means that the statement was made "without caring whether it was true or false". "Recklessly" does not just mean the statement was made with "very great negligence", nor that it was made in a highly risky context, such that the probability of someone relying on the statement to their detriment was enhanced. As Lord Herscell said in *Derry* v. *Peek* at p. 375, "making a false statement through want of care falls far short of, and is a very different thing from, fraud, and the same may be said of a false representation honestly believed though on insufficient grounds" (CA judgment at para. 58).

To demonstrate this continuum, the Court of Appeal used the example of a person with key knowledge who "intentionally" withholds that information, knowing or intending that others will proceed on the basis of false information (CA judgment at para. 89). But neither intention nor actual knowledge equates with recklessness. If there is an intention to deceive or actual knowledge that a fact is false, fraud may be established based on the first branch. There is no need to inquire as to the whether the defendant failed to turn their mind to the truth of the statement. At the other end of the scale, ignorance is not sufficient. At minimum, a person must be aware that there is an issue about the truth of a fact (CA judgment at para. 90). It must also be more than mere negligence or carelessness (CA judgment at para. 99). The Court of Appeal refers to "actual indifference" (CA judgment at para. 58) but what does that actually mean? For the Court of Appeal actual indifference requires a deliberate act by the defendant (CA judgment at para. 93).

According to the trial judge:

> In my view, Mr. Beck`s interpretation of the Omni-McCann report recklessly ignored that its conclusions were based largely upon the anecdotal information from one person and that if that person's recollection were near to correct, then safety implications arose for developments involving human habitation on and within the set back distances of Lot 2 (QB Judgment at para. 24).

This is an important point because regardless of whether the landfill was on Lot 1 or Lot 2, there was a setback issue that would affect any motel development on Lot 1. Until the actual location of the landfill could be determined, it could not be established if the motel development could proceed on Lot 1 subject to restriction or at all. Neither of the applications for subdivision of Lot 1 or Lot 2, as forwarded to Alberta Environment, referred to the former landfill, although the

Omni-McCann report was included (QB judgment at para. 36). Not only was Mr. Beck aware of this, he had information in his actual possession that would have triggered a call by Alberta Environment for further investigation of the site (QB judgment at paras. 40-48). This included Area Restructure Plan documents and a By-Law passed to adopt the Area Restructure Plan, both of which referred to the landfill on the subject lands and neither of which were presented to Alberta Environment. Alberta Environment approved the subdivision of the subject lands without knowledge of the former landfill. Instead of advising the plaintiff of the potential problem or conducting further investigation, as recommended by both the Omni-McCann report and the Alberta Environment letter, Mr. Beck instructed the preparation of sale documents for Lots 1 and 2, requesting that both agreements include an indemnity clause in respect of the former landfill. According to the trial judge "Mr. Beck's failure to bring this to the plaintiff's attention was an act of concealment" (QB judgment at para. 49). For the trial judge this act of concealment was the smoking gun, the deliberate act.

The Court of Appeal, on the other hand, rejected this reading of the facts. The Court of Appeal found that Mr. Beck's conduct might be careless or negligent but it could not be characterized as reckless (CA judgment at para. 99). There was no intention to sell the land with a landfill under it; in fact it was just the opposite (CA judgment at para. 101). There was no evidence that Mr. Beck was ever aware that the landfill was even on Lot 1 (CA judgment at paras. 104-105). Everyone presumed the former landfill was under Lot 2 and not Lot 1. Even if the Area Structure Plan had been reviewed by the parties or Alberta Environment, the Plan said the former landfill was "reclaimed" (CA judgment at para. 103). Prior to the sale, the Area Structure Plan was made public and the plaintiff could have discovered the problem on his own (CA judgment at para. 106). Accordingly, there was no deliberate attempt to conceal the existence of the prior landfill from Alberta Environment, the plaintiff, or the public. Mr. Beck's conduct might be careless or negligent but it did not amount to a deliberate attempt to conceal the facts.

What the Court of Appeal seemed to have in mind with "recklessness" in this context is something more akin to a wilful blindness to the truth than gross negligence or "very great negligence" (a term referred to in the CA judgment at para. 58), although wilful blindness is not typically used outside criminal or quasi-criminal matters. It would seem to involve a statement of fact made by the vendor that there is no contamination on the land, when it was aware of information to the contrary, and not caring that the purchaser is proceeding on false information, and also a deliberate act to prevent that information from coming to the purchaser's attention. The fault lies in the deliberate act to conceal the truth.

Whose Duty is it to Investigate? Knowledge and the Latent Defect Problem

This case raises another interesting question: who has the duty to investigate when the risk that the land may be contaminated comes to light? Is it the purchaser or the vendor? On what basis does a vendor's knowledge give rise to a fraud, and is that similar to the reason the purchaser's knowledge makes the defect patent and not actionable? Based on the Court of Appeal's approach, a purchaser might have to determine whether adjacent lots are also contaminated because they would be subject to a 300 m setback. The vendor, who was in the better position to discover the location of the contamination and who had relevant information about the prior uses of the land, had no duty to inquire or inform because the defect was patent. The possibility Lot 1 was contaminated made the defect patent even though everyone wrongly believed the contamination was on Lot 2. The vendor could rely on its "as is" exclusion and entire agreement clause even though it failed to disclose relevant information. On the other hand, the purchaser had a duty to make further inquires because the risk of error was known. So where is the balance? Clearly, the purchaser bears the burden of further investigation if put on notice.

Under such an approach, one can easily envision a scenario that would give rise to considerable unfairness. Take for example a case where a developer suspects that there may be contamination on its land. Buyers are advised of the possibility. The developer obtains an engineering report that recommends further investigation. Despite these concerns the developer proceeds to subdivide the land into 100 lots and to sell each lot to a series of purchasers. The same engineering report is provided to each purchaser. Only one lot is discovered to actually have contamination under it. However, all the adjacent lots are subject to a 300 m setback that would prevent the lots from being used for human habitation, even though no contamination is found on those lots. The owners of those adjacent lots would have no recourse against the developer since the defect was patent and the contract stands. In this scenario one can see a problem of fairness.

What about the considerable cost of separate investigations for each of the 100 lots? Under these circumstances it would be more economical for the vendor to perform the investigation, given its original ownership of the whole of the subject lands and its superior access to information about the prior uses of that land. In such a case it seems reasonable to place the burden on the vendor to perform a more thorough investigation.

It seems to me that the reason for this bias in favour of the vendor is the Court of Appeal's defence of the sanctity of contract. Whether a claim is made for fraudulent misrepresentation or the concealment of a latent defect, the plaintiff is asking the court to look outside the strict words of the contract, an extraordinary remedy that courts are reluctant to provide except in the clearest cases of unfairness. The parties are free through their contract to determine which of the parties bear the risk. To ask the court for a remedy after-the-fact for something the aggrieved party could have dealt with in the contract during negotiations amounts to asking the court to rewrite the contract with the benefit of hindsight. If the contract imposes too onerous a burden on the purchaser, the purchaser is free to renegotiate the terms of the contract or to walk away.

What is not answered by this case is what degree of risk differentiates between a latent and a patent defect. At some point the risk is so remote that it cannot be considered one that would require further investigation.

What Conduct Amounts to Concealment?

This brings us to one last question raised by this case: what conduct amounts to a concealment of the facts? On this point, the trial judge said:

> What then is the act of concealment? In my view there are more than one. Despite concerns about the existence of the nuisance ground, Mr. Beck or his department failed to provide Alberta Environment with documents relevant to the rezoning which would have disclosed the nuisance ground. Despite warnings that the 'dump' was old, Mr. Beck or his department failed to access the files provided to them from the prior authority. Despite Omni-McCann and Mr. Lewis recommending that subsurface testing be done, none was. Despite their recommendation that the purchaser be advised of potential problems, Mr. Beck did not so advise the plaintiff and instead instructed the preparation of agreements for sale of both lots to include an indemnity in relation to nuisance grounds. Vis-a-vis the plaintiff, this instruction is a positive act of concealment, a deliberate attempt to conceal the truth. In my view, this act either shows that Mr. Beck knew of the nuisance ground or recklessly disregarded the information pointing towards its existence in order to complete the deal with the plaintiff (QB Judgment at para. 118).

The Court of Appeal disagreed with the trial judge's analysis. Citing *Leeson* v. *Darlow*, [1926] 4 D.L.R. 415 (Ont. C.A.), the Court noted that concealment required a positive step: "Active concealment of a fact is equivalent to a positive statement that the fact does not exist. By active concealment is meant any act done with intent to prevent a fact from being discovered" (CA judgment at para. 61). Mere silence or non-disclosure is not the same as concealment (CA judgment at para. 63).

The Court of Appeal then provided as an example the case where the defendant, knowing the landfill was on Lot 1, ordered gravel to be spread over the lot to hide the landfill as an example of active concealment (CA judgment at para. 64). However, if the defendant knew that the landfill was on Lot 1 and simply said nothing that would amount to a non-disclosure that was not actionable absent a covenant to disclose (CA judgment at para. 64). While the failure to make sufficient inquiries and to inform Alberta Environment might be careless, there was no evidence the defendant concealed the fact of the landfill to Alberta Environment; in fact, the defendant did just the opposite, it provided the engineering report to Alberta Environment specifically in regard to the "proximity to [a] former landfill" (CA judgment at para. 66). Everyone knew there was a landfill on the land, but no one knew exactly where that was. The engineering report was also provided to the plaintiff. All the Plan documents were publicly available (CA judgment at para. 55). Further, the inclusion of the indemnity clause in the contract indicated nothing more than good negotiation practice, placing the risk that the landfill was actually on Lot 1 upon the plaintiff (CA judgment at para. 69).

Conclusion

What is clear from this case is that the purchaser is bound by the strict terms of the purchase agreement for the land and has limited recourse outside the square corners of the contract. A vendor has a limited duty to disclose information about the property once the purchaser has been put on notice of the risk. Unless there is a deliberate attempt to conceal a fact about the property, the purchaser is bound by its contract and attempts to avoid the contract and sue for damages are unlikely to succeed. A purchaser of potentially contaminated land must take all reasonable steps to investigate the state and condition of the land, including any potential risks posed by adjacent lands. Once the purchaser is put on notice of a risk of contamination, the risk becomes a patent defect because the question is not as to its nature but only as to its location.

This leaves the unexplored option. The Court of Appeal noted in passing that the plaintiff had also pleaded, in the alternative, that the contract was frustrated because the subdivision should not have proceeded (CA judgment at para. 21). However, the plaintiff had not argued contract frustration at the trial, but instead sought damages for the tort of deceit (QB judgment at para. 121). The remedy for a frustrated contract, if applicable, is merely to set the contract aside (see *Klein* v. *Sanderson*, 1928 CarswellAlta 19 (S.C.A.D.) at para. 18). *Restitutio in integrum* applies and the parties, so far as can be done, are returned to the state they would have been in before the frustrating event. Under the *Frustrated Contracts Act*, R.S.A. 2000, c. F-27, ss. 3-5, as amended, sums paid by the plaintiff would be refundable and expenses incurred by the plaintiff and benefits accrued to the land would be chargeable. The plaintiff sought damages for loss of profits or loss of opportunity (QB judgment at paras. 120-150). There would be no such remedy for a frustrated contract.