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## Getting the Deal Done: a Survival Guide to Environmental Problem-Solving in Brownfields Transactions

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# GETTING THE DEAL DONE: A SURVIVAL GUIDE TO ENVIRONMENTAL PROBLEM-SOLVING IN BROWNFIELDS TRANSACTIONS

*Steven L. Humphreys\**

## INTRODUCTION

Since the early 1980's, a period when modern environmental statutes began to impose strict, joint and several liability against owners of contaminated property,<sup>1</sup> unwitting purchasers of industrial or commercial real estate all too often have found themselves mired in costly environmental cleanups or litigation they had not bargained for after entering into a purchase

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1. See, e.g., Comprehensive Environmental Response, Compensation, and Liability Act of 1980 § 103(a) ("CERCLA"), 42 U.S.C. §§ 9601-9675 (1994). CERCLA imposes strict liability retroactively on operators or landowners for the acts of prior property owners, operators, or tenants, even if the subject acts were neither illegal nor negligent at the time that they occurred. Under New York law, the New York Department of Environmental Conservation ("NYDEC") is authorized to order the owner of a disposal site that constitutes a significant threat to the environment, or any person responsible for the disposal of hazardous wastes at a site, to clean up the site, or to pay for the cost of cleaning up the site. See N.Y. ENVTL. CONSERV. LAW § 27-1313 (McKinney 1999). In addition, New York law authorizes the imposition of civil penalties against anyone who violates the state's prohibition against disposal without authorization. *Id.*

transaction.<sup>2</sup> Indeed, it has not been unusual for such cleanups to cost millions of dollars and take many years to complete, while at the same time causing expensive disruptions to business operations and tying up real estate that could be used for more productive purposes.<sup>3</sup> Combined also with inherent scientific uncertainties associated with the investigation and remediation of contamination,<sup>4</sup> the daunting prospect of environmental risk in business transactions has often prompted buyers to walk away from otherwise advantageous deals rather than take the risk of a financially draining site contamination problem. As a consequence, liability-imposing environmental regimes have had the unintended effect of discouraging the development of many properties located in industrial areas in favor of properties in environmentally pristine areas.<sup>5</sup> This unfortunate outcome has in turn contributed to a host of

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2. The mere ownership of real property will make the current owner fully and completely liable (perhaps jointly and severally with others) for the cost of remediation of all adverse environmental conditions on that property without regard to causation. *See* *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985). Some courts have even interpreted CERCLA in a manner suggesting that the owners of property may be held liable not only for the contamination caused prior to their ownership, but also for any contamination that might even "passively" migrate onto their property from neighboring sites. *See, e.g., Nurad, Inc. v. William E. Hooper & Sons Co.*, 966 F.2d 837, 844 (4th Cir. 1992) (holding that CERCLA's use of the term "disposal," which triggers liability under the statute, includes the "passive" migration of hazardous substances through soil or groundwater).

3. *See, e.g., Bancamerica Commercial Corp. v. Trinity Indus., Inc.*, 900 F. Supp. 1427 (D. Kan. 1995) (buildings demolished as part of site cleanup activities); *Wehner v. Syntex Corp.*, 681 F. Supp. 651 (N.D. Cal. 1987) (same); *T & E Indus., Inc. v. Safety Light Corp.*, 680 F. Supp. 696, 707 (D.N.J. 1988) (relocation of business to a new facility after contamination was discovered at existing facility).

4. *See* Steven L. Humphreys, *Science and Toxic Tort Law: Novel Strategies in the Woburn Litigation*, 1 TOXICS L. REP. (BNA) 374 (1986) (discussing scientific uncertainties associated with environmental investigations).

5. *See* COMMUNITY DEVELOPMENT: REUSE OF URBAN INDUSTRIAL SITES (GAO/RCED-95-172, June 30, 1995); SUPERFUND BARRIERS TO BROWNFIELDS REDEVELOPMENT (GAO/RCED-96-125, June 17, 1996).

land use planning problems such as "urban sprawl," insurance redlining, unemployment, and community decay.<sup>6</sup>

In recent years, a growing body of innovative state initiatives has emerged to combat the adverse effects of environmental liability regimes on the development of otherwise productive properties.<sup>7</sup> These initiatives, adopted in the form of both legislative and administrative programs, are designed to provide incentives for investors to redevelop underutilized commercial and industrial properties commonly referred to as "brownfields."<sup>8</sup> Under these programs, purchasers and other parties are now afforded a wide range of incentives, including risk-based cleanup standards, liability protections, tax incentives and low-interest loans, to develop potentially contaminated properties.<sup>9</sup> Thus, where properties involved in a real estate purchase transaction are located in urban, economically depressed areas, purchasers now may be

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6. See Harry F. Klodowski, Jr., *Redevelopment Under State Superfund Laws*, RISK MGMT. (Feb. 1995); *Urban Reclamation: Hearings Before the Subcomm. on Technology, Env't and Aviation of the House Comm. on Science, Space and Technology*, 103d Cong. 83-97 (1994) (statement of Timothy Fields, Jr., Acting Deputy Assistant Administrator, Office of Solid Waste and Emergency Response (OSWER), EPA).

7. See, e.g., California Expedited Remedial Reform Act of 1994, CAL. HEALTH & SAFETY CODE §§ 25260-25398 (West 1995); Illinois Environmental Protection Act, *as amended*, 415 ILL. COMP. STAT. ANN., 5/22.2b (*as amended by* P.A. 89-101, § 5, eff. July 7, 1995) (West 1995); Massachusetts Oil and Hazardous Material Release Prevention and Response Act, MASS. ANN. LAWS, ch. 21E, §§ 1 *et seq.* (Law Co-op. 1988 & Supp. 1995); Michigan Environmental Response Act, MICH. COMP. LAWS ANN. §§ 20101-20140 (West 1995); Ohio Voluntary Action Program, OHIO REV. CODE ANN. §§ 3746.01-3746.99 (Anderson 1994); Land Recycling and Envtl. Remediation Standards Act, 35 PA. CONS. STAT. §§ 6026.101-6026.909 (1995).

8. *Hearings Before the House Subcomm. on Water Resources and Env't of the Comm. on Transp. and Infrastructure*, 104th Cong. 20-33 (1995) (statement of Carol M. Browner, Administrator, EPA); *Energy Transp. and Infrastructure Program on State Programs to Address Brownfields: Hearings Before the Subcomm. on Commerce, Trade and Hazardous Materials of the House Comm. on Commerce*, 104th Cong. 272-306 (1995) (statements of Jan Lisenmeyer, Analyst, & Robert Atkinson, Senior Analyst, Office of Tech. Assessment, U.S. Congress).

9. See *supra* notes 7-8 and accompanying text.

able in large measure to offset the liability risks and other expenses associated with environmental problems.

Another beneficial factor coinciding with the rise of brownfields redevelopment incentives has been the development of innovative insurance products.<sup>10</sup> These products, known variously as "pollution legal liability" insurance, "remediation stop-loss," or "cost-cap" insurance, are specifically designed for use in purchase transactions involving potentially contaminated property and can provide parties to such transactions with greater certainty in calculating and allocating environmental risk.<sup>11</sup> Thus, by using such a product, the seller and purchaser can often allocate the risk of environmental liability associated with a transaction to a third-party insurer for a fixed amount. This may also enable the purchaser to obtain financing without necessarily having to provide the lender with an environmental indemnity from a credit-worthy entity.

While providing many potential advantages to parties involved in purchase transactions, due to their infancy and novel approach to site cleanups, the new brownfields incentives programs frequently raise a number of legal and practical issues that need to be addressed by parties to a purchase transaction involving contaminated property. For example, one issue that often arises in business transactions due to state brownfields laws, commonly referred to as the "how clean is clean?" issue, concerns which standard of cleanup is applicable to the remediation of the property. Because brownfields laws often allow some contamination to be left in place provided that restrictions, known as "institutional controls," are placed on the use of the property or groundwater at the property,<sup>12</sup> this issue arises with some frequency in purchase transactions as it may significantly affect the value of the property or restrict uses that may be necessary or desirable in the future. Typically, purchasers and their lenders prefer to have the property

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10. See *infra* Part III for a detailed discussion of these insurance products.

11. See *id.*

12. See Larry Schnapf, *Using Institutional Controls and Engineering Controls in Brownfield Redevelopment Projects*, ENVTL. DUE DILIGENCE GUIDE (BNA) No. 82, App. 231.825 (Dec. 1998); Amy Edwards, *Long-Term Enforcement and Stewardship of Institutional Controls*, ENVTL. DUE DILIGENCE GUIDE (BNA) No. 95, App. 231.1071 (Dec. 1999).

in question remediated to the point where it is relatively free of environmental contamination, as opposed to facing the possibility of being saddled with restrictions on their ability to use the property in the future. In addition to affecting certain possible uses of the property that may include facility expansions or modifications, these restrictions may negatively affect the purchaser's ability to re-sell the property at a later time without further remediation.

The development of new insurance products designed to assist with purchase transactions involving contaminated property also presents a number of practical concerns for parties to such transactions. The specimen forms of these policies contain a number of important terms and conditions that typically preclude coverage for certain types of costs and under certain conditions especially relevant to brownfields cleanups.<sup>13</sup> As a result, parties to transactions that use these products need to understand what the policies do not cover so they may appropriately allocate these uncovered risks in their contract documents. In addition, carriers are often willing to negotiate the terms and conditions of policies so as to provide coverage that is tailored to a particular transaction.

This article provides a practical "how-to" guide in addressing the host of environmental problems that typically arise in the context of transactions involving the transfer of brownfields property. These issues are explored in Part I from the overall perspectives of purchasers and sellers through an examination of the strategic concerns of the parties in protecting their respective interests in negotiating brownfields transactions. Part II provides a detailed overview of how to conduct an environmental due diligence investigation in connection with the purchase or sale of brownfields properties.<sup>14</sup> Part III discusses the availability of insurance to offset risks associated with the purchase or sale of brownfields properties and analyzes some of the key issues that arise in the negotiation of coverage terms and conditions in these insurance policies. Part IV analyzes contract negotiation issues that often arise in such

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13. See *infra* note 112 and accompanying text.

14. Although this article focuses primarily on environmental issues that arise in the context of transfers of real property, similar considerations apply to transactions involving the financing or leasing of real estate and the transfer, financing, or leasing of individual facilities or equipment.

transactions, and Part V discusses the process for resolving environmental problems that arise in the post-closing phase.

## I. GENERAL STRATEGIC CONSIDERATIONS FOR PURCHASERS AND SELLERS

### *A. The Purchaser's Perspective*

In any brownfields real estate transaction, the purchaser's focus for purposes of managing environmental risk is on the potential for incurring environmental liability or loss as a result of: (1) a contractual assumption of liability or risk of loss;<sup>15</sup> (2) being held responsible at law for contamination as an owner or operator of contaminated property;<sup>16</sup> or (3) being held responsible at law for contamination as a successor, including liability for contamination at other properties upon which the seller previously disposed of hazardous substances.<sup>17</sup> Moreover, purchasers can become responsible for compliance obligations under environmental statutes, resulting in the inheritance of ongoing compliance problems and the imposition of civil penalties,<sup>18</sup> requiring

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15. *See* *Olin Corp. v. Consol. Aluminum Corp.*, 807 F. Supp. 1133 (S.D.N.Y. 1992) (holding that the indemnification provisions in the agreement for sale of a hazardous waste site were clear on their face and effectively shielded vendor from liability to purchaser for future response costs under CERCLA), 5 F.3d 10 (2d. Cir. 1993), *aff'd in part and vacated on other grounds*.

16. *See* *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985); *Idylwoods Assocs. v. Mader Capital, Inc.*, 956 F. Supp. 410 (W.D.N.Y. 1997) (holding that purchasers of a contaminated parcel adjacent to a former rail yard near Buffalo, New York were liable for cleanup of site under CERCLA).

17. *See, e.g.,* *United States v. Carolina Transformer Co.*, 978 F.2d 832, 838 (4th Cir. 1992) (holding that an asset purchaser may be held liable for environmental contamination caused by the seller due to the purchaser's "continuity of enterprise"); *United States v. Mex. Feed & Seed Co.*, 980 F.2d 478, 487-88 (8th Cir. 1992) (discussing "substantial continuity" or "continuity of enterprise" theory).

18. For example, in *United States v. Price*, 52 F. Supp. 1055 (D.N.J. 1981), *aff'd on other grounds*, 688 F.2d 204 (3d Cir. 1982), the court held that a purchaser who bought a former landfill several years after the cessation of all dumping there nevertheless was "contributing to" the disposal of hazardous waste at the site within the meaning of

unanticipated expenditures,<sup>19</sup> or can become subject to various types of restrictions under environmental laws that may adversely affect their planned use of the property.<sup>20</sup>

Purchasers can effectively manage these environmental risks by: (1) ensuring that any environmental problems associated with the targeted property are fully identified through an appropriate due diligence review;<sup>21</sup> (2) evaluating the impacts that such problems may have on the property or its use;<sup>22</sup> (3) ensuring either that any problems are corrected prior to closing or that sufficient protections are obtained to address any contamination in a manner satisfactory to the purchaser;<sup>23</sup> and (4) avoiding third-party liability for any environmental problems associated with the subject property once the purchaser takes title.<sup>24</sup>

### 1. Due Diligence Review

Perhaps the most fundamental and widespread practice in managing environmental risks associated with a brownfields transaction is the performance of a rigorous environmental due diligence review. An effective due diligence investigation prior to the purchase will, among other things, ensure the purchaser's ability to identify as early as possible any potential environmental problems associated with the target of the transaction, establish a "baseline" of information concerning the seller's current operations and site conditions, from which a purchaser may distinguish

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section 7003 of the Resource Conservation and Recovery Act ("RCRA"), 42 U.S.C. § 6973 (1994). (RCRA was enacted in 1976 and amended in 1984). The court noted that the statutory definition of "disposal" includes "leaking," and that the current owner's studied indifference to the hazardous condition that now exists was sufficient to impose liability. *United States v. Price*, 52 F. Supp., at 1073.

19. *See, e.g., T & E. Indus., Inc. v. Safety Light Corp.*, 680 F. Supp. 696, 707 (D.N.J. 1988) (requiring relocation of entire business).

20. *Gazza v. New York State Dep't of Env'tl. Conservation*, 679 N.E.2d 1035 (N.Y. 1997) (rejecting purchaser's challenge to the NYDEC's denial of variance under the New York Tidal Wetland Act, N.Y. ENVTL. CONSERV. LAW §§ 0101-0601 (McKinney 1999), which prohibited purchaser from building a residence on the subject property).

21. *See infra* Part I.A.1.b.

22. *See infra* Part I.A.2.

23. *See infra* Part I.A.3.

24. *See id.*

environmental problems created prior to closing from problems created post-closing, and establish a basis for asserting various defenses to liability arising under environmental laws.<sup>25</sup>

*a. Benefits of Due Diligence Review*

By identifying potential environmental problems as early as possible, a comprehensive due diligence review will serve to ensure that environmental risks associated with the property in question are appropriately addressed in advance of the purchase and allocated under the contract. As a threshold matter, where the purchaser may be unwilling to shoulder a certain degree of risk, especially when weighing the extent of risk against the relative size or value of the transaction, early knowledge about significant environmental concerns associated with the targeted property can result in substantial savings of cost and time in the event that the purchaser decides not to proceed with the purchase. In such a case, the purchaser may be able to minimize its transaction costs, as well as avoid the loss of an earnest money deposit by exiting the transaction at a more opportune time.

A second important benefit of the due diligence process is the timely incorporation of environmental risk allocation into the parties' business arrangement underlying the transaction. As the pertinent environmental concerns are considered through the investigation, they will become the operating basis for the parties' negotiations and will dictate the form of contractual protections the purchaser will need in order to protect against unwarranted liability risks. Should the parties fail to identify these problems early in the contract negotiation process, other timing considerations driving the transaction may preclude the performance of additional study (such as invasive site sampling activities) needed to reduce uncertainty as to the magnitude of environmental risks. As a result, ill-defined environmental risks can quickly become a significant area of contention between the parties involved in the transaction

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25. See, e.g., CERCLA's "innocent landowner defense," 42 U.S.C. § 9601(35)(A) (1994), and "third party defense," 42 U.S.C. § 9607(b)(4) (1994); *New York v. Lashins Arcade Co.*, 91 F.3d 353, 362 (2d Cir. 1996) (holding that the purchaser of a New York shopping center was not liable under CERCLA for contamination caused by a tenant of the former owner pursuant to CERCLA's "third-party defense").

that, in turn, can lead to inadequate or overprotective contractual terms and conditions to allocate risk that are unfair to the seller or the purchaser, and can even lead to an impasse in negotiations and a breakdown in the deal.

A third overall benefit of the due diligence process is that it establishes a "baseline" of information on the current environmental condition and compliance status of the property. After the transaction is consummated, this information may provide a critical tool in determining whether the seller, the purchaser, or a third party was the actual cause of an environmental problem that is not discovered until after the closing of the deal. For example, where the purchaser's environmental due diligence investigation has clearly identified the locations where certain operations were conducted at a facility, as well as the specific types of hazardous substances used in these operations, the purchaser will be in a better position months or years after the closing to demonstrate that the seller caused the environmental contamination prior to the closing. In contrast, if the purchaser has failed to establish this baseline and in fact has used the same hazardous substances as the seller in performing its commercial operations, it may be difficult for the purchaser to prove that the contamination was indeed caused by the seller or any other party for whose acts the seller is responsible, vis-à-vis the purchaser. As a result, the purchaser could be held responsible for a larger amount of future cleanup costs even though the contamination was actually caused by the seller.

An effective due diligence program will also serve to identify contamination in a timely manner and minimize the future risk of incurring liability to third parties, whether to a governmental agency for costs associated with environmental cleanup of the target property<sup>26</sup> or to neighboring landowners whose properties may have been affected by the contamination.<sup>27</sup> In addition to

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26. See *Idylwoods Assocs. v. Mader Capital, Inc.*, 956 F. Supp. 410, 420 (W.D.N.Y. 1997).

27. In *Sterling v. Velsicol Chem. Co.*, 855 F.2d 1188 (6th Cir. 1988), for example, five representative plaintiffs were initially awarded \$12.7 million, and an undetermined amount of compensatory damages was awarded to a 100-member class for various damages stemming from groundwater contamination by a hazardous waste landfill in Hardemann County, Tennessee. Also, in *Ayers v. Township of Jackson*, 525 A.2d 287 (Sup. Ct. 1986), lump-sum payments totaling \$8.2 million were awarded

identifying problems before they lead to further damages, the due diligence process can provide a basis for establishing possible defenses to liability, such as the "innocent landowner" or third-party defense to CERCLA liability.<sup>28</sup>

This "innocent landowner" defense, which evolved out of a common recognition of the extreme unfairness in holding truly "innocent landowners" strictly liable under CERCLA for contamination caused by their predecessors in title, provides that a purchaser will not be liable under CERCLA if it can prove that it: (1) acquired title to the property after the disposal or placement of hazardous materials occurred on the site; (2) performed an appropriate inquiry consistent with good commercial or customary practices; and (3) did not know and had no reason to know that any hazardous substance which was the subject of the release or threatened release was disposed of on, in, or at the facility.<sup>29</sup> Unfortunately, this defense has rarely been used successfully.<sup>30</sup> The few cases in which the defense has been invoked successfully suggest that the courts will consider a variety of factors in determining its merits in a particular case. These factors include a review of local jurisdiction practices at the time of the purchase, the parties' knowledge of past uses of the property, the

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to 339 residents near the township's hazardous waste landfill to pay for medical monitoring costs alone.

28. See 42 U.S.C. § 9607(b)(3) (1994). Specifically, there is no liability under this subsection if the otherwise liable person can prove by a preponderance of the evidence that the release or threat of release of a hazardous substance and the resulting damages therefrom were caused solely by:

(3) an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant . . . if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions.

*Id.*

29. See *id.*

30. See, e.g., *United States v. Pac. Hide and Fur Depot, Inc.*, 716 F. Supp. 1341 (D. Idaho 1986).

relationships between the seller and the purchaser, and any actual investigation that was performed at the site.<sup>31</sup>

*b. The Due Diligence Review Process Defined*

From a purchaser's perspective, the due diligence review should incorporate two essential elements: (1) the identification of potential contamination at, on, or near the property or contamination affecting the subsurface or groundwater below the property (and in some cases, even at off-site properties to which hazardous substances have been shipped from the property);<sup>32</sup> and (2) the identification of ongoing operational problems such as the need for process improvements (e.g., the installation of pollution control equipment or appropriate engineering controls) that will require significant capital expenditures in order to comply with environmental regulatory requirements.<sup>33</sup> In order to ensure proper identification of these potential concerns, it is important to coordinate the environmental consultant's technical review with the purchaser's internal engineering staff and legal counsel to ensure that the technical review is based on a thorough understanding of environmental regulatory requirements applicable in the relevant jurisdiction.

In general, there are several accepted approaches for performing an effective environmental due diligence review.<sup>34</sup> The most

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31. *See, e.g.,* United States v. Serafini, 28 Env't Rep. Cas. (BNA) 1759 (M.D. Pa. 1988) (holding that the innocent landowner defense does not apply where the buyer physically views the site or conducts an investigation prior to purchase); Sterling Steel Treating, Inc. v. Becker, 94 B.R. 924 (Bankr. E.D. Mich. 1989) (knowledge of past uses of property).

32. *See, e.g.,* United States v. Carolina Transformer Co., 978 F.2d 832 (4th Cir. 1992); United States v. Mex. Feed & Seed Co., 980 F.2d 478 (8th Cir. 1992).

33. For example, a purchased manufacturing facility may require the installation of expensive air pollution control equipment in order to meet minimum emissions standards required for an air permit under the Clean Air Act. *See* 42 U.S.C. § 502(a) (1994) (prohibiting operation of stationary sources of air pollutants without a permit).

34. *See* ASTM, STANDARD PRACTICE FOR ENVIRONMENTAL SITE ASSESSMENTS: PHASE I ENVIRONMENTAL SITE ASSESSMENT PROCESS, E 1527-00 (Am. Soc'y for Testing and Materials 2000) [hereinafter ASTM E 1527-00].

common approach uses the standard industry protocol for performing Phase I investigations known as the American Society for Testing and Materials ("ASTM") standard E 1527-00. This protocol, which was developed by ASTM in conjunction with various environmental professionals, is designed to provide a model approach for conducting Phase I investigations to identify potential environmental conditions at a site as well as to help establish the basis for a prospective purchaser to assert the "innocent landowner" defense to liability under CERCLA and similar state statutes.<sup>35</sup> If warranted, based on the results of the Phase I investigation, a Phase II investigation may be necessary in order to assess specific site impacts through soil and/or groundwater samples.<sup>36</sup> Together with a careful review of other applicable information, these investigations will help provide the necessary background to fully evaluate the environmental condition of the property.

## 2. Evaluation of Due Diligence Review Results

After the relevant environmental concerns associated with a targeted property are identified through a due diligence investigation, a purchaser should evaluate the impact that these concerns may have on various aspects of the transaction. For example, the purchaser may need to obtain specific contractual protections backed by a financial security mechanism in order to offset its potential liability for any identified contamination as an owner or operator of the site.<sup>37</sup> In addition, the identification of contamination could adversely affect the purchaser's ability to obtain the requisite financing for the transaction<sup>38</sup> or could make it

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35. A detailed explanation of the components of a typical environmental due diligence investigation is provided *infra* in Part II.

36. See ASTM, STANDARD GUIDE FOR ENVIRONMENTAL SITE ASSESSMENTS: PHASE II ENVIRONMENTAL SITE ASSESSMENT PROCESS, E 1903-97 (Am. Soc'y for Testing and Materials 1997) [hereinafter ASTM E 1903-97].

37. See *infra* note 46 and accompanying text.

38. Notwithstanding the recent adoption of statutory liability protections in various federal and state laws, lenders continue to view transactions involving potentially contaminated property with great caution due to ongoing risks of liability not fully addressed by such provisions. See Larry Schnapf, *Lenders Face Continued Exposure to*

difficult for the purchaser to sell the property at a future date at full value due to the stigmatizing effect of contamination.<sup>39</sup>

Furthermore, the purchaser must be concerned with the potential for identified contamination at a targeted property to disrupt planned business operations once it has assumed ownership of the site.<sup>40</sup> For example, if contamination is identified in the soil or groundwater below a building that requires remediation by demolishing part of the building or relocating equipment inside it for any extended period of time, the resulting impact on business operations could impair the company's ability to maintain anticipated levels of production. Moreover, these disruptions could last for significant periods of time, as environmental cleanups often require extended efforts involving the site characterization of environmental problems, subsequent remediation activities, follow-up operation and maintenance activities to confirm that the cleanup has been completed in accordance with the applicable federal, state and local regulatory requirements, and ultimate approval of the cleanup by state or local regulators.

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*Environmental Liability*, ENVTL. DUE DILIGENCE GUIDE (BNA) No. 73 App. 231: 681 (Dec. 1999) (describing scenarios under which lenders may still face exposure to liability notwithstanding Congress' clarification of "secured creditor exemption" from CERCLA liability in the Asset Conservation Under Liability, and Deposit Insurance Protection Act of 1996, Pub. L. 104-208, subtitle E, 110 Stat. 3009 (Sept. 30, 1996) (codified at 42 U.S.C. § 9601(20)(a) (1994)).

39. Courts in reviewing claims for recovery of property value diminution have recognized the stigmatizing effect of contamination. *See, e.g.*, *Palo R.R. Yard PCB Litig. v. S.E. Pa. Transp. Auth.*, 35 F.3d 717 (3d Cir. 1994), *aff'd in part, vacated in part, rev'd in part*, 221 F.3d 449 (3d Cir. 2000) (ruling that property owners could proceed on a claim that stigma amounted to permanent damage of property under Pennsylvania law); *State v. Brandon*, 898 S.W.2d 224 (Tenn. 1994), *rev. den.*, 1995 Tenn. LEXIS 234 (May 8, 1995) (ruling that evidence of contamination should have been admitted in a condemnation proceeding); *MHE Assoc. v. United Musical Instruments*, 1995 U.S. Dist. LEXIS 5808 (N.D. Ohio 1995) (holding that a business could be awarded stigma damages); *Criscuola v. Power Auth. of N.Y.*, 81 N.Y.2d 649, 653 (Ct. App. 1993) (holding that owners of property condemned for a high voltage line could introduce proof of loss in market value due to "some prevalent perception of a danger emanating from the objectionable condition.").

40. *See, e.g.*, *T & E Indus., Inc. v. Safety Light Corp.*, 680 F. Supp. 696, 707 (D.N.J. 1988).

### 3. Addressing Remediation Issues

As noted above, the imposition of strict, joint and several liability under modern environmental statutes has often affected the willingness of potential purchasers to acquire contaminated industrial sites that may be targeted by federal or state regulators for cleanup at some point in the future. In view of these liability risks, a purchaser will want to fully evaluate all available options for ensuring that the remediation is performed in a timely manner, in conformance with all applicable regulatory requirements and consistent with the purchaser's planned use of the property, and ensure that payment of the remediation costs is provided for through appropriate contractual protections or other funding mechanisms.

The first approach for the purchaser to consider is the achievement of full resolution of identified environmental problems associated with the targeted property, if possible, prior to closing. This approach may serve to minimize the risk that the cost of remedying known contamination may change over the course of cleanup.<sup>41</sup> Consequently, if circumstances and time permit, prospective purchasers may insist on having the seller undertake the cleanup of a targeted property in accordance with the applicable regulatory requirements prior to closing of the deal. In most states, an appropriate cleanup program requires the submission of a project application to the state environmental agency, followed by reports identifying the environmental conditions of the site and the proposed cleanup remedy, and a final cleanup report that certifies that the property has been fully remediated. Once this final report has been approved, most states will provide the applicant with a release either through a "No Further Action" letter or some other form of "comfort" correspondence.<sup>42</sup>

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41. *See, e.g., In re T.P. Long Chem. Corp.*, 45 B.R. 278 (Bankr. D. Ohio 1985) (enlarging scope of cleanup of spill after many buried drums of hazardous wastes were discovered on the site).

42. The NYDEC, for example, issues letters stating that "no further action is required" at a particular site following its approval of a final cleanup report showing that contamination at the site has been remediated in conformance with applicable state and federal regulatory requirements. DIV. OF SPILLS MANAGEMENT, NYDEC, SPILL TECHNOLOGY AND REMEDIATION SERIES [hereinafter STARS MEMO NO. 1], PETROLEUM-CONTAMINATED SOIL GUIDANCE POLICY (Aug. 1992).

Even in cases where contamination is cleaned up prior to the consummation of the transaction, there are numerous other actions that a purchaser should take to minimize potential liability for environmental problems discovered later. For example, a purchaser may wish to review the technical aspects of the cleanup, such as whether the area of contamination was sufficiently characterized and the remediation properly performed to eliminate risks to human health or the environment. This review is especially important where the seller has performed the cleanup without any outside review or has not coordinated its cleanup activities with any governmental agency, due to the risk that the cleanup may have to be reexamined in the future.<sup>43</sup> In addition, while in many cases closure documentation showing that the cleanup has been properly completed may be obtained from the relevant agency, it is normally prudent to “look behind” this documentation in order to ensure that regulatory oversight was properly exercised and fully addressed all of the issues of concern.<sup>44</sup> In performing these reviews, it may be beneficial to obtain the assistance of environmental legal counsel with expertise in the cleanup requirements of the relevant state in order to confirm that the cleanup fully conforms to all applicable regulatory requirements.<sup>45</sup>

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43. The potential risks associated with a non-approved, or “at risk” remediation is illustrated by a case involving a property owner that conducted such a cleanup, although not in connection with a transaction. In *Reardon v. United States*, 947 F.2d 1509 (1st Cir. 1991), a property owner/developer who completed cleanup without having coordinated with EPA was later assessed over \$300,000 in EPA’s administrative costs and was required to pay for re-remediation of the entire site.

44. In most cases, state closure documentation (such as a “No Further Action” letter) will contain an express qualification that the approval is conditioned on full disclosure of relevant information by the party seeking the approval. *See, e.g.*, N.J. STAT. ANN. § 7:26C-2.6(c)-(d) (West 1997) (amended 1999) (providing for rescission of a No Further Action Letter based on the New Jersey Department of Environmental Protection’s (“NJDEP”) finding that approved remediation is no longer protective of human health. More information is available on the NJDEP website, available at <http://www.state.nj.us/dep> (last modified Dec. 27, 2000).

45. The specified cleanup procedures and related cleanup standards for remediating a contaminated site may vary widely from state to state. *See, e.g.*, STARS MEMO NO. 1, *supra* note 42; Texas’ Risk Reduction Rules, 30 TEX. ADMIN. CODE § 335.8 (West 1993); Illinois’ Tiered Approach to Corrective Action Objectives (“TACO”) regulations,

In many cases, however, it is not possible to complete the remediation of identified contamination prior to closing given the relatively short timeframe for some purchase transactions and the normally lengthy process for most remediation work. Consequently, it may become necessary for purchasers to negotiate contractual protections to ensure that the remediation will be completed in a timely and appropriate manner even after closing. To ensure that these cleanups are properly performed and adequately financed, purchasers may insist on the establishment of financial security, such as an escrow account, to ensure payment for cleanup activities in the event that the seller fails to satisfy its cleanup responsibilities in an appropriate manner.<sup>46</sup>

If the particular contaminated property is located in an urban, economically depressed area, the purchaser may also be able to take advantage of any number of specific brownfields incentives to assist with the cost of investigating or remediating the site, or limiting the purchaser's liability for contamination at the site.<sup>47</sup> These programs provide purchasers and other parties with various practical incentives, including risk-based cleanup standards, liability protections, tax breaks and low-interest loans.<sup>48</sup>

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ILL. ADMIN. CODE tit. 35, § 742 (1998); New Jersey Technical Requirements for Site Remediation, N.J. ADMIN.CODE tit. 7, § 26E (1997).

46. Other security mechanisms may include, for example, an outright adjustment in the purchase price, insurance or holdbacks. See Transaction Guidelines, *Envtl. Due Diligence Guide* (BNA) No. 83 (Dec. 1999).

47. See *supra* note 7 and accompanying text for a discussion of various state brownfields laws. Currently, New York State has adopted an informal voluntary remediation program, which allows a private party who is not responsible for causing a discharge to voluntarily perform a cleanup and receive a "no further action" approval from the DEC. See New York State Dep't of Env'tl. Conservation Voluntary Cleanup Program Application, which can be obtained by calling the New York State DEC Office of Environmental Remediation at (518) 457-7894; N.Y. ENVTL. CONSERV. LAW §§ 56-0501 *et seq.* (McKinney 1999).

48. Under New York's Environmental Site Restoration Program, for example, a municipality is entitled to receive from the state seventy-five percent of the funds to remediate a site that is not listed on the New York State Registry of Inactive Hazardous Waste Sites as a Class "1" or Class "2" site, provided that the municipality is not responsible for disposing hazardous substances at the site. See N.Y. COMP. CODES R. & REGS., tit. 6, § 375-4.3 (McKinney 1999). See also Larry Schnapf,

Liability protections provided under brownfields laws can serve to reduce or even eliminate the purchaser's risk of incurring liability for contamination at a property. For example, under Maryland's voluntary cleanup law and Pennsylvania's Land Recycling and Environmental Remediation Standards Act, parties may obtain a release of liability from the state from any future cleanup requirements if they conduct a voluntary cleanup of a brownfields site under the state's oversight and approval.<sup>49</sup> Similarly, Pennsylvania's Act 2 brownfields law provides for a full release of state liability after the owner conducts an investigation and submits a "Notice of Intent to Remediate" the site, complies with certain public notice requirements, and files and obtains approval of a "Final Remediation Report" from the state once the cleanup has been completed.<sup>50</sup> Other states, such as Arkansas, have enacted statutes that provide exemptions from liability for purchasers of contaminated property who perform voluntary cleanups of the property.<sup>51</sup>

In addition to providing protection from future liability, these state laws generally allow the cleanup of sites under much less stringent cleanup standards than traditional regulatory standards.<sup>52</sup> For example, many states allow those parties who elect to remediate a site under a voluntary cleanup program to select among several possible sets of cleanup standards. These may include: (1) a standard based on the levels of the specific contaminants of concern that naturally occur in the area (i.e., "background" levels);<sup>53</sup> (2) state-wide, uniform, health-based standards like Maximum Contaminant Levels ("MCLs") established under the federal Safe Drinking Water Act<sup>54</sup> that may not necessarily reflect

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*Financing Brownfields Development*, ENVTL. DUE DILIGENCE GUIDE (BNA) No. 72 App. 231:651 (Dec. 1999).

49. MD. CODE ANN., Environment §§ 7-501 *et seq.* (1999); Pennsylvania Land Recycling and Environmental Remediation Standards Act [hereinafter Act 2], 35 PA. CONS. STAT. § 6026.101 to 6026.909 (1995).

50. See 35 PA. CONS. STAT. § 6026.302-.304, .501 (1995).

51. ARK. CODE ANN. § 8-7-1101 *et seq.* (Michie 1999).

52. See, e.g., Texas' Risk Reduction Rules, 30 TEXAS ADMIN. CODE § 335.8 (West 1993); Illinois' TACO regulations, ILL. ADMIN. CODE TIT. 45, § 742 (1998).

53. See *supra* note 52.

54. See 42 U.S.C. §§ 300(f) *et seq.* (1994).

the actual risk to human health or the environment presented by site-specific conditions;<sup>55</sup> or (3) site-specific, risk-based standards that take into account real-world exposure and risk scenarios and provide the greatest flexibility to property owners.<sup>56</sup> Where available, parties performing the cleanup often select the risk-based cleanup approach, which usually allows for the most cost-effective approach for remediating a site.

In addition to these state incentives, several recent federal administrative initiatives have been undertaken that are aimed at providing additional incentives for voluntary cleanups. For example, EPA has taken a number of steps as part of its CERCLA administrative reform process to encourage voluntary cleanups, including the issuance of new policies that: (1) outline the types of assurances that the federal government will provide against future liability for prospective purchasers,<sup>57</sup> "innocent landowners,"<sup>58</sup> owners of properties located down gradient from other contaminated sites,<sup>59</sup> for voluntary site cleanups under state laws,<sup>60</sup> and (2) provide for the issuance of "comfort" letters stating whether the Agency plans to take any future action at a particular site.<sup>61</sup> EPA has also provided grant money for the development of

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55. See, e.g., Texas' Risk Reduction Rules, 30 TEX. ADMIN. CODE § 335.8 (West 1993).

56. See *id.*

57. See EPA, GUIDANCE ON SETTLEMENTS WITH PROSPECTIVE PURCHASERS OF CONTAMINATED PROPERTY (BNA) No. 40 (May 24, 1995) (Revised 1999); EPA, MEMO ON EXPEDITING REQUESTS FOR PROSPECTIVE PURCHASER AGREEMENTS (BNA) No. 94 (Oct. 1, 1999).

58. See EPA, GUIDANCE ON LANDOWNER LIABILITY UNDER SECTION 107(A)(1) OF CERCLA (June 6, 1989), available at <http://es.epa.gov/oeca/osre/890606.html>; Notice of Availability of "Land Use in the CERCLA Remedy Selection Process," 60 Fed. Reg. 29595 (June 5, 1995).

59. See EPA, POLICY TOWARD OWNERS OF PROPERTY CONTAINING CONTAMINATED AQUIFERS (May 24, 1995), available at <http://es.epa.gov/oeca/osre/950524-1.html> (last visited Dec. 18, 2000).

60. See EPA, FINAL DRAFT GUIDANCE FOR DEVELOPING SUPERFUND MEMORANDA OF AGREEMENT LANGUAGE CONCERNING STATE VOLUNTARY CLEANUP PROGRAMS (BNA) No. 70; 62 Fed. Reg. 47495 (Sept. 9, 1997) (*subsequently withdrawn* (Nov. 26, 1997)).

61. See EPA, POLICY ON THE ISSUANCE OF COMFORT/STATUS LETTERS (Nov. 8, 1996); 62 Fed. Reg. 4624 (Jan. 30, 1997), available at <http://www.es.epa.gov/oeca/osre/961108.html> (last visited Dec. 18, 2000).

brownfields pilot projects,<sup>62</sup> and favorable tax treatment is available under federal law for qualifying remediation projects as well.<sup>63</sup>

While providing many advantages to parties involved in brownfields transactions, voluntary cleanup programs frequently raise a number of legal and practical issues that parties can best address in consultation with environmental counsel. For example, although Pennsylvania's Act 2 law provides a full release from liability for sites that have been cleaned up under the program, it also contains a "reopener" provision that renders the release invalid in the event that new information surfaces indicating the existence of previously undiscovered contamination at the site. The provision also invalidates the release if new information is discovered about a particular regulated substance at the site that requires the establishment of a revised risk-based cleanup standard.<sup>64</sup> In addition, these state laws generally do not clearly specify that the release of liability granted under the voluntary cleanup program will provide the party with assurances against federal, as well as state, liability.<sup>65</sup>

While several state laws may provide at least some level of assurance that the federal government generally will not take any future action at a site once the cleanup is satisfactorily completed, many state programs do not provide any form of adequate assurance or protection from further federal involvement in sites where a voluntary cleanup has been performed.<sup>66</sup> Finally, some

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62. *See, e.g.*, EPA, THE BROWNFIELDS ECONOMIC REDEVELOPMENT INITIATIVE, EPA 500-F-99-288 (Oct. 1999).

63. *See* EPA, INTERNAL REVENUE SERVICE REVENUE RULING 94-38, RELATING TO TAX TREATMENT OF CERTAIN HAZARDOUS WASTE CLEANUP COSTS (BNA) No. 29 (July 1994) (discussing Rev. Rul. 94-38, 1994-25 I.R.B., dated June 20, 1994); EPA, INTERNAL REVENUE SERVICE REVENUE PROCEDURE 98-47, RELATING TO DEDUCTION OF QUALIFIED ENVIRONMENTAL REMEDIATION EXPENDITURE (BNA) No. 81 (Nov. 1998) (discussing Rev. Proc. 98-47, 1998-37 I.R.B., dated Sept. 14, 1998).

64. *See* 35 PA. CONS. STAT. § 6026.505 (1995).

65. *See, e.g.*, 35 PA. CONS. STAT. § 6026.501 (1995).

66. EPA has entered into agreements with individual states under which EPA generally will not take removal or remedial action at sites that have been addressed under an approved voluntary cleanup program for that state. *See* EPA, INTERIM APPROACHES FOR REGIONAL RELATIONS WITH STATE VOLUNTARY CLEANUP PROGRAMS (Nov. 14, 1996), available at <http://www.epa.gov/swerosps/bf/html-doc/vcp.htm>

states do not adequately define the types of sites that may be covered by their voluntary cleanup laws or express whether these laws can be used for highly contaminated sites that are eligible to be included on the CERCLA National Priorities List ("NPL").<sup>67</sup>

### *B. The Seller's Perspective*

Sellers of contaminated properties also face a number of important legal and practical issues before attempting to consummate a sale. These issues include: (1) selecting an appropriate strategy for marketing the property and addressing potential environmental concerns; (2) effectively managing environmental problems that may arise during the due diligence review; (3) ensuring that the seller's company complies with any applicable regulatory and property transfer requirements related to the brownfields transaction; and (4) drafting and negotiating appropriate contractual provisions to protect the company from a seller's perspective.

#### 1. Marketing Strategy

Depending on the circumstances of the transaction, a seller of possibly contaminated property will want to decide early on how it will approach the potential environmental issues that may arise in connection with the transaction. For the seller, there are two basic approaches to choose from in addressing these environmental issues when marketing the property. First, the seller may wish to place the property on the market without initially undertaking an

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(last visited Dec.18, 2000). However, these agreements do not apply to compliance requirements arising under other state laws, such as those pertaining to hazardous waste management, for which EPA has reserved its rights to "overfile" if there is a violation of federal law.

67. For example, some of the state voluntary cleanup laws expressly prohibit a site from being eligible for the benefits of participating in a state voluntary cleanup program if that site has already been addressed under the federal CERCLA program or is subject to a pending enforcement action. *See, e.g.*, MD. CODE ANN., Environment § 7-506 (1997). The NPL is a list of sites that EPA is required to maintain pursuant to section 105(a)(8)(B) of CERCLA for purposes of identifying those sites at which a release or threat of release of a hazardous substance has occurred that needs attention on a priority basis. *See* 42 U.S.C. § 9605(a)(8)(B) (1994).

examination of the environmental issues that may be associated with the property, leaving it to a potential purchaser to conduct its own environmental due diligence review and identify any potential problems.<sup>68</sup> Alternatively, the seller may elect to take a more proactive approach by conducting its own full due diligence review and either correct any environmental problems prior to marketing the property, offer the property on an “as-is, where-is” basis without performing any corrective measures at the site, or agree to perform or pay for the remediation subsequent to closing. Each of these approaches has its advantages and disadvantages, as discussed below.

Under the first approach (marketing the property without first performing a due diligence review), the seller and purchaser may draw up a “term sheet” laying out the overall parameters of the transaction and conditions precedent to closing and post-closing obligations. Careful preparation and review of these terms is important because they will serve as the basis for a purchase contract that will allocate the parties’ respective environmental rights and obligations.<sup>69</sup> As part of this approach, it is customary for the purchaser’s obligation to proceed with the transaction to be contingent on a satisfactory environmental due diligence review conducted by the purchaser, usually with specific time limitations. In some cases, if the purchaser’s due diligence review identifies environmental contamination at the property, the parties agree to make the purchase contingent on the seller’s remediation of the contamination before closing.

Where circumstances permit, a seller may effectively manage the approach outlined above, in a manner that minimizes the costs

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68. Although this approach is usually not the best strategy for the seller, it is by far the most common, probably because environmental due diligence is often viewed in a light similar to other routine pre-transaction investigation activities, such as financial due diligence.

69. In general, from the seller’s perspective, the letter of intent should be crafted so as to ensure that if any environmental investigation is conducted on the subject property, all parties will maintain the confidentiality of any information derived from such investigation. Through the letter of intent, the parties can insist on the necessary representations and warranties, indemnities, and changes in deal structure or they can withdraw from the transaction should the investigation identify material environmental risks.

associated with addressing identified environmental concerns.<sup>70</sup> These costs can vary widely depending on a host of factors, including the expertise and quality of the particular consulting and environmental engineering services employed, specific cost-containment strategies available through innovative technologies or proper selection of a technical approach permissible under regulatory requirements, and negotiation with the purchaser and governmental agencies.<sup>71</sup> Therefore, it is important for sellers to adopt an effective strategy aimed at minimizing costs associated with any required or anticipated remediation.

It is also in the seller's interest to limit the scope of the purchaser's proposed environmental due diligence investigation and minimize the amount of any sampling and testing proposed by the prospective purchaser. In many cases, purchasers may wish to perform extensive investigation at a site in order to provide the greatest certainty against discovering unanticipated environmental problems in the future. However, it is usually in the seller's interest to limit the scope of any sampling activities to those areas where material contamination may be present based on specific, identified concerns in particular geographical areas.

The standard approach outlined above discussing completion of all due diligence and remediation activities prior to closing may not be practical or even desirable for the seller in particular circumstances. For example, timing constraints associated with the transaction often preclude the completion of a due diligence investigation and/or full remediation of identified contamination prior to closing. Moreover, in some cases the seller may not want to trigger a regulatory obligation to report any contamination identified through the due diligence process to state or federal environmental agencies and thereby become the target of an enforcement action requiring cleanup under governmental oversight and direction. A reporting obligation may arise under either state<sup>72</sup> or federal<sup>73</sup> law, potentially invoking a response by

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70. Sellers generally view these as "sunk" costs that will probably not be of any benefit to the seller in the future.

71. See *infra* Part IV for a discussion of the specific cost-containment issues that may arise in the context of the contract negotiation process.

72. Reporting obligations under state law may be extremely broad and even apply to the purchaser or its consultants. For example,

authorities at either or both levels of government. In such a case, governmental involvement at this stage of the transaction could delay the closing by first requiring satisfaction of all the requisite cleanup requirements imposed by the regulatory agency and payment of additional unanticipated (and often significant) cleanup costs before the deal may proceed.

Another concern that sellers typically face with a pre-closing due diligence/remediation approach is that the discovery of substantial contamination during the due diligence phase could fundamentally alter the economics of the transaction, rendering the property less marketable to the point where the purchaser decides not to go forward with the transaction. In such a case, not only may the seller

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regulations promulgated under the Oil Spill Act by the NYDEC require an "owner or operator of any facility from which petroleum has been discharged" to notify the NYDEC within two hours after a discharge occurs. N.Y. COMP. CODES R. & REGS., tit. 17, § 32.3 (1999). A recent administrative ruling by the NYDEC indicates that this obligation may be so broad as to require virtually anyone with knowledge of contamination to report -- including purchasers and their consultants. In the case, DEC Commissioner, John Cahill, reversed a ruling by a DEC administrative law judge (ALJ) to find that an environmental consultant who observed contamination at a property was required to notify the DEC within two hours of becoming aware of the contamination, even though the consultant was not personally involved with any due diligence or remediation activities at the site. *See In re Middleton, Kontokosta Assoc.*, DEC File No. R1-6039, 1998 WL 939495 (N.Y. Dep't Env'tl. Conserv. Dec. 31, 1998).

73. For example, section 103(a) of CERCLA requires persons in charge of a facility to notify the National Response Center in the event of a "release" that in a 24-hour period equals or exceeds a "reportable quantity" established by EPA for the particular substance released. 42 U.S.C. § 9603(a) (1994). Reporting obligations may also be triggered under the Resource Conservation and Recovery Act ("RCRA") in the event that the contamination at a property presents an "imminent or actual emergency situation." 40 C.F.R. § 264.56(a) (1999). In such a situation, the owner/operator of the facility is required to immediately notify appropriate state or local agencies with designated response roles. *Id.* In addition, pursuant to regulations implementing RCRA, owner/operators of underground storage tank systems ("USTs") must notify the appropriate state or federal agency within 24 hours of discovering a "suspected release" of hazardous substances or petroleum from USTs. 40 C.F.R. § 280.50 (1999). A "suspected release" includes the presence of contamination or vapors in soils. *Id.*

be unable to sell the property, but it may also be saddled with an expensive cleanup obligation that it would not have otherwise had.

In light of the foregoing concerns, the parties may need to resort to an alternative method of resolving environmental concerns associated with a subject property. It may be possible, for example, to "carve out" a clean parcel from other contaminated parcels for purposes of allowing the sale to proceed for the clean parcel only. However, the viability of this approach as a means of protecting the purchaser from potential liability is highly dependent on the nature of contamination and the particular mix of liability regimes that apply to the site under federal and state law. For example, some state laws contain specific prohibitions and limitations on the subdivision of properties containing hazardous substances.<sup>74</sup> On the other hand, laws in other states specifically provide for subdividing clean parcels from contaminated parcels for purposes of facilitating transfers.<sup>75</sup> If the nature and extent of the contamination implicates treatment of the site under CERCLA, however, a subdivision approach may leave the purchaser exposed to potential Superfund liability in connection with any cleanup of adjacent parcels even though they were intentionally excluded from the sale. This may occur because the term "facility," as defined under CERCLA,<sup>76</sup> might include all lots that are subdivided from the original parcel. The purchaser may be able to assert the "innocent purchaser" defense and avail itself of the de minimis settlement provisions of CERCLA to minimize its actual exposure to CERCLA liability. Nevertheless, the seller may find itself named as a potentially responsible party ("PRP") in an enforcement action by the government and may be subject to joint and several liability for the entire cost of cleanup of all adjacent parcels deemed part of the CERCLA facility.<sup>77</sup>

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74. *See, e.g.*, CAL. HEALTH & SAFETY CODE §§ 25220-25240 (West 1995).

75. For example, New Jersey's Industrial Site Recovery Act [hereinafter ISRA] allows parties contemplating the sale of property to obtain ISRA approval for individual parcels, thereby allowing such parcels to be transferred individually. *See* N.J. STAT. ANN. § 13:1k-11.8 (West 1993).

76. 42 U.S.C. § 9601(9) (1994).

77. *See, e.g.*, *Tanglewood East Homeowners v. Charles-Thomas, Inc.*, 849 F.2d 1568 (5th Cir. 1988) (rejecting a challenge to a federal lien

Another possible marketing approach for the seller is to postpone any due diligence and/or remediation activities until after the transaction is completed, subject to an appropriate financing mechanism such as an escrow account specifically devoted to environmental cleanup. However, where there is a particular concern that the property may be significantly contaminated, (e.g., based on historic activities involving relatively large quantities of hazardous substances), and especially where the seller's due diligence is being postponed until after closing, this approach may entail risks that are too great for the seller. As the seller normally will have to give the purchaser adequate contractual protection for any identified contamination, this approach may expose the seller to an unknown risk. Similarly, given the inherent scientific uncertainties associated with site remediation, postponing the completion of such activities until after closing may expose the seller to additional costs arising, for example, from the discovery of more extensive contamination than was previously thought to be present at the property or the infeasibility of a particular remedial technology not discovered until the completion of bench-scale testing or actual implementation in the field.

One possible solution that may allow the parties to proceed with a post-closing investigation and/or remediation approach is the availability of environmental insurance. For example, it may be possible to obtain a cost-effective pollution legal liability insurance policy that effectively shifts the risks associated with any contamination discovered post-closing to the insurance carrier. In addition, remediation stop-loss or cost-cap insurance may be available to shift the risk of cost overruns for remediation activities to the carrier.<sup>78</sup>

Another approach aimed at avoiding the seller's assumption of unknown risks associated with post-closing due diligence investigations and/or remediation is for the seller to market the property on an "as-is, where-is" basis. This approach requires the purchaser to assume any risks associated with unknown

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against property subdivided from a larger parcel that included an industrial facility that was the source of contamination).

<sup>78</sup>. As discussed *infra* in Part III, these policies should be carefully scrutinized, and in some cases their terms and conditions negotiated with the carrier, in order to ensure full coverage for the risks associated with a particular property.

environmental problems at the site in return for a purchase price reduction. Under this approach, the seller may elect to conduct its own environmental due diligence review and then offer the written results of the review to prospective purchasers as part of an "as-is, where-is" offer.

This approach provides the seller with several important advantages in attempting to market its property. First, the seller can identify environmental problems prior to marketing the property and undertake appropriate remedial measures under its own control in a more cost-effective manner than may be possible if the seller had to coordinate its activities and satisfy the purchaser's more onerous conditions. Moreover, the seller will have the option under this approach to forego any remedial activities and instead market the property on an "as-is, where-is" basis with an offer of a purchase price reduction based on its estimated cost of remediation. This approach may allow the seller to shift the risk of any future costs of cleanup and the possibility that these future cleanup costs could exceed the projected estimated costs to the purchaser. Alternatively, as noted above, the seller may be able to shift these risks to an insurance carrier by purchasing remediation stop-loss or cost-cap insurance. However, in pursuing an "as-is" approach, a seller should carefully review the pertinent contractual language used for disclaiming responsibility, as courts have sometimes refused to apply such language to environmental contamination.<sup>79</sup>

## 2. Managing Environmental Problems

Several important concerns may arise for sellers in managing environmental problems that are identified during the course of a property purchase transaction. For example, in the event that a

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79. See, e.g., *Int'l Clinical Lab. v. Stevens*, 710 F. Supp. 466, 469-70 (E.D.N.Y. 1989) (holding that an "as is" clause did not bar a claim for cleanup costs asserted by the current owner of contaminated property against the prior owner); *Mobay Corp. v. Allied-Signal, Inc.*, 761 F. Supp. 345 (D.N.J. 1991) (holding that the "as is" clause does not absolve seller from CERCLA liability); *Southland Corp. v. Ashland Oil, Inc.*, 696 F. Supp. 994, 1002 (D.N.J. 1988) (holding that provisions in the contract were not specific enough to transfer liabilities for all waste disposal activities to the purchaser because "a clear transfer or release of future 'CERCLA-like' liabilities is required").

significant problem is discovered during the due diligence review phase, the seller may automatically be placed at a disadvantage in negotiating the purchase contract. The discovery of a problem (such as on-site contamination) can easily become a critical factor exploited by a prospective purchaser to bargain for a lower price or impose overly stringent contractual obligations on the seller, or both.

Therefore, it is important for the seller to approach any serious environmental problem in as proactively and timely a manner as possible so that she will be in a position to resist efforts by the purchaser to obtain concessions that go beyond what is reasonably appropriate under the circumstances. To achieve this goal, a seller should work with environmental counsel to develop an effective strategy for addressing any cleanup responsibilities that are identified during the course of a site investigation. For example, a seller can best manage environmental problems that arise during the due diligence phase by obtaining advice from an environmental attorney familiar with the regulatory cleanup requirements and the governmental oversight process in the particular jurisdiction where the property is located. In many cases, environmental counsel will also have an established working relationship with regulatory officials that may serve to expedite the regulatory approval process and to achieve the quickest and most cost-effective resolution of cleanup obligations possible.

### 3. Property Transfer Requirements

Many transactions involving the sale of property require specific property transfer approvals from state environmental regulatory agencies or some form of formal disclosure to the purchaser concerning environmental conditions associated with the property that are identified during the due diligence process or are otherwise known to the seller. Sellers should consult with environmental counsel in order to determine preliminarily whether any such requirements will be triggered in a particular brownfields transaction and, if so, how to address these requirements within an acceptable timeframe.

One of the most far-reaching examples of state property transfer laws is New Jersey's Industrial Site Recovery Act.<sup>80</sup> This statute

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80. See N.J. STAT. ANN. §§ 13:1K-6 *et seq.* (West 1993).

imposes investigation and/or remedial requirements on owner/operators of "industrial establishments" (as defined under the statute) as a prerequisite to certain corporate transactions affecting the ownership of the establishment. Corporate transactions that are subject to ISRA requirements include the transfer of ownership in industrial establishments, as well as the cessation of operations and leases in excess of ninety-nine years involving such establishments. In addition to ISRA-type obligations, many other states have adopted various property transfer requirements that do not require remediation per se, but may instead impose pre-closing requirements such as notice in writing<sup>81</sup> or in a deed<sup>82</sup> to prospective purchasers of known environmental problems associated with the property.

Under common law principles in some states, sellers may also be held liable for failing to disclose known environmental problems at a property to the purchaser. In general, cases involving a seller's failure to disclose the presence of environmental contamination located either on or under the property have focused on one of two forms of fraudulent activities. First, various courts have recognized a cause of action for fraudulent concealment in cases in which a seller has failed to disclose a defect on the property known to her. Second, other courts have recognized a cause of action for fraudulent misrepresentation in cases where the seller has affirmatively misrepresented the condition of the property.<sup>83</sup>

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81. *See, e.g.*, CONN. GEN. STAT. § 134-134(e) (1996).

82. Under the Hazardous Substances Cleanup Act ("HSCA"), 35 PA. STAT. ANN. § 6020.512(b) (West 1995), a grantor of property who has actual knowledge that a hazardous substance has been disposed of or is currently being disposed of on the property must include in the deed an acknowledgement of such disposal. Likewise, pursuant to Pennsylvania's Land Recycling and Environmental Remediation Standards Act [Act 2], 35 PA. STAT. ANN. § 6026.101 (West 1995), any person who remediates a contaminated property site in accordance with site-specific standards is required to put a written notice regarding the site's condition into the deed for the subject property specifying whether residential and non-residential exposure factors were used to comply with the site-specific standard.

83. *See Roberts v. Estate of Barbagallo*, 531 A.2d 1125 (Pa. Super. Ct. 1987) (holding that the seller was responsible for an agent's failure to disclose the presence of urea formaldehyde foam insulation in a purchased residence); *Haney v. Castle Meadows, Inc.* 839 F. Supp. 753 (D. Colo. 1993) (holding that, under Colorado law, a seller of real

Finally, sellers may even have certain disclosure obligations in transferring properties under various federal regulatory requirements. For example, under OSHA regulations, building owners who have information concerning asbestos-containing materials must maintain relevant records for the duration of ownership and must transfer these records to successive owners.<sup>84</sup> In addition, pursuant to rules for transfers of hazardous waste treatment, storage or disposal ("TSD") facilities adopted under RCRA, an owner/operator of property containing a TSD facility must record a notice in the appropriate land records after closure of the first disposal unit at the facility.<sup>85</sup>

## II. DUE DILIGENCE PHASE

The need for exercising caution in the review of environmental concerns associated with the purchase of property is now commonly recognized and has led to the widespread practice of performing environmental due diligence as part of any

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property who failed to disclose the presence of a well contaminated by radioactive materials on property could be held liable for fraudulent concealment, even though the contract for sale stated that the buyer was taking the property "as is" and even though the buyer inspected the property but failed to detect the defect); *but see* Redwing Carriers, Inc. v. Saraland Apts., Ltd., 875 F. Supp. 1545 (S.D. Ala. 1995) (disallowing a fraudulent concealment claim by an apartment complex developer against a prior owner of property who allegedly failed to disclose contamination on the property, explaining that under Alabama common law, the rule of *caveat emptor* (or "buyer beware") applies to sales of real property, with the exception of certain transfers of residential property); Commerce Redevelopment Agency v. Am. Home Prods., 1993 U.S. Dist. LEXIS 15478 (C.D. Cal. 1993) (dismissing a claim of fraudulent misrepresentation against a seller who allegedly supplied false information to a purchaser in an environmental assessment report regarding contamination at the property, and holding that, because the purchaser had conducted and relied on its own investigation of the environmental condition of the property, it was barred from bringing such a cause of action because, under California law, a prospective purchaser who investigates property is presumed to have obtained all of the information that would have been disclosed if his own inquiries had been diligently pursued).

84. See 29 C.F.R. § 1926.1101(n)(6) (1999).

85. See 40 C.F.R. § 264.119 (1999), 42 U.S.C. §§ 6901 *et seq.* (1994).

investigation or review phase in a brownfields transaction. An effective due diligence review may not only assist a purchaser in identifying potential environmental concerns and establishing an environmental baseline for purposes of allocating environmental responsibilities, but, as noted above, may also be used as a basis for establishing certain defenses to potential liability if the targeted property were to ever become the subject of a cleanup requirement or environmental "toxic tort" litigation.<sup>86</sup>

An effective due diligence review should generally focus on two key areas. First, this review should determine whether there is a need to perform some form of cleanup or other type of corrective measure at the property that is the subject of the transaction. Moreover, if the targeted property transferred hazardous materials or was otherwise involved in arranging for the use of these materials at another site, this review may include an examination of the potential environmental contamination at these other sites, as well.<sup>87</sup> In addition, this review may consider the potential environmental and industrial hygiene regulatory compliance problems that may be associated with the future operation of the property. Various environmental issues that may be examined would include air and water emissions, the management and handling of hazardous and solid wastes, used oil, the use of toxic and hazardous substances, aboveground and underground storage tanks, the underground disposal (i.e., injection) of waste materials, the use of pesticides, polychlorinated biphenyls and asbestos, and various reporting requirements, among other things, as well as any other state and local environmental regulatory requirements that may have a material bearing on the operation of the facility.<sup>88</sup> As

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86. See *supra* note 25 and accompanying text (citing CERCLA's "innocent landowner" and third-party defense to liability).

87. See *supra* notes 27, 32 and accompanying text for a discussion of the potential risks of off-site liability.

88. These requirements arise under various federal and state laws, including the Resource Conservation and Recovery Act ("RCRA"), 42 U.S.C. §§ 6901 *et seq.* (1994), the Water Pollution Control Act ("CWA"), 33 U.S.C. §§ 1251 *et seq.* (1994), the Clean Air Act ("CAA"), 42 U.S.C. §§ 7401 *et seq.* (1994), the Toxic Substances Control Act ("TSCA"), 15 U.S.C. §§ 136 *et seq.* (1994), the Safe Drinking Water Act ("SDWA"), 42 U.S.C. §§ 300(f) *et seq.* (1994), and the Occupation Safety and Health Act of 1970 ("OSHA"), 29 U.S.C. §§ 651 *et seq.* (1994).

part of this investigation, it may also be prudent to include a review of the use and management of hazardous chemicals,<sup>89</sup> the hazard communication standard program,<sup>90</sup> and other health and safety issues regulated by OSHA.<sup>91</sup>

### *A. Identifying Contamination*

There are several standard approaches to identifying the environmental conditions at a targeted site. First, if the prospective purchaser prefers to obtain an initial, low-cost preliminary assessment of the overall environmental status of the targeted property, it can undertake a so-called "transaction screen" review. This process generally involves having the seller complete a questionnaire form addressing various environmental aspects of the targeted property. The American Society has prepared a written standard, known as ASTM E 1528-93, which includes a model questionnaire, for Testing and Materials for purposes of performing this review.<sup>92</sup> A transaction screen review may be especially appropriate where the prospective purchaser is considering the purchase of a package of properties and has the option to exclude certain properties from the transaction.

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89. See 29 C.F.R. § 1910.000 (1999) (establishing permissible exposure levels ("PELs") for specific air contamination in the workplace).

90. See 29 C.F.R. § 1910.1200(e) (1999) (describing a program used by employers to provide training and awareness to employees regarding possible hazards presented by chemicals used in the workplace).

91. See, e.g., 29 C.F.R. § 1910.119 (1999) (requiring employers to adopt a process safety management ("PSM") program to lessen "the consequences of catastrophic releases of toxic, reactive, flammable, or explosive chemicals"); 29 C.F.R. § 1910.120 (1999) (Hazardous Waste Operations and Emergency Response ("HAZWOPER") standard) (establishing worker protection requirements for employers to meet when responding to releases or threats of releases of hazardous substances); Occupational Health and Safety Act, 29 U.S.C. § 654(a)(1) (1994) (the "general duty clause") (requiring employers to keep their workplaces free of recognized hazards likely to cause death or serious physical harm where there is a feasible and useful method to correct the hazard).

92. ASTM, STANDARD PRACTICE FOR ENVTL. SITE ASSESSMENTS: TRANSACTION SCREEN PROCESS E 1528-93 (Am. Soc'y for Testing and Materials 1993) [hereinafter ASTM E 1528-93].

While the “transaction screen” review process may be helpful in certain transactions, most significant brownfields transactions begin with the performance of a more detailed site investigation commonly referred to as a Phase I investigation. This investigation generally involves a review of site conditions following the approach adopted in ASTM E 1527-00, which has become the voluntary industry standard for review of sites.<sup>93</sup> Under the ASTM standard, a typical investigation will include, among other things:

- visually inspecting the property to identify any apparent indications of potential contamination (e.g., stained soils or concrete, stressed vegetation, evidence of underground storage tanks, vent or fill pipes, etc.);
- reviewing documents maintained on-site in order to identify areas involving the use of hazardous substances, both present and past, and other potential environmental problems such as poor hazardous substances handling practices that may suggest the potential for on-site contamination;
- interviewing employees of the company which owns the target property who are responsible for environmental matters;
- reviewing relevant government documents and other publicly-available records (including information available through computer databases), which may reveal the presence of hazardous substance containment structures or spills at or near the property;
- evaluating other historical documents concerning the site such as fire insurance maps, telephone directories and/or aerial photographs in order to identify prior uses of the property that potentially involved the use of hazardous substances; and
- giving attention to potential environmental contamination at any surrounding properties that may affect the property.<sup>94</sup>

After conducting the Phase I investigation, the consultant will normally prepare a written report that is submitted to counsel summarizing the results of this investigation. Based on the results of the investigation, the consultant renders her professional opinion as to whether a more environmentally intrusive investigation should be performed in order to analyze specific areas of potential contamination in surface or subsurface soils and/or surface or groundwater. Counsel, in order to evaluate their potential legal and

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93. See ASTM E 1527-00, *supra* note 34.

94. *Id.*

practical ramifications, normally reviews these findings for the transaction and to provide guidance to the prospective purchaser in its ongoing negotiations with the seller.

For many brownfields transactions, as discussed above, it may be prudent to supplement the traditional Phase I with other key information. For example, it may be prudent to expand any prospective purchaser's review to include a review of potential contamination at any off-site properties to which hazardous substances have been transported from the properties involved in certain types of corporate transactions such as mergers, acquisitions, or consolidations. A list of these properties may be requested from the seller and/or obtained from a review of the subject facility's hazardous waste manifests that have been prepared in shipping hazardous waste generated from plant operations to off-site facilities.<sup>95</sup> These sites can be crosschecked against the list of sites contained in available governmental databases that identify contaminated sites that are subject to governmental cleanup orders.<sup>96</sup> Thus, for example, if a disposal site that has been used by the target business is identified during an environmental review as being on EPA's National Priorities List or a similar list of state sites designated for further site investigation or cleanup, further inquiry should be made into whether the business has any future contingent responsibility or liability for the cleanup of that site. If so, adequate protection should be incorporated into the purchase contract to cover the cost of any such liability.<sup>97</sup>

Should the Phase I identify certain environmental conditions at the site and recommend the performance of a more detailed investigation, the purchaser will generally undertake what is commonly referred to as a "Phase II" investigation. A Phase II investigation involves examining the specific environmental conditions of the site and determining the actual levels of contamination in the subsurface and groundwater at the site. A

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95. See 40 C.F.R. § 263 (1999).

96. For example, EPA maintains a list, known as "CERCLIS" (Comprehensive Environmental Response, Compensation, and Liability Information System), of all sites at which a release or threatened release of hazardous substances has been reported or identified. See 40 C.F.R. § 300.5 (1999).

97. A discussion of potential contractual issues is provided *infra* in Part IV.

widely used industry standard for performing Phase II investigations is known as ASTM E 1903-97.<sup>98</sup> This standard is used in conjunction with various other standards and federal and state regulatory policies to determine an appropriate technical approach to investigate a specific site.<sup>99</sup>

As set forth in ASTM E 1903-97, a Phase II investigation should include: (1) the preparation of an investigation work plan (commonly referred to as a "Scope of Work") by an environmental consultant; (2) the performance of assessment activities by the consultant at the site, including the collection of soil and/or groundwater samples using proper sampling handling, preservation and chain-of-custody procedures; and (3) the incorporation of the laboratory results for the samples into a written report which verifies that the appropriate media were sampled at appropriate locations and depths, and which describes the extent of any identified contamination and the need for any remediation.<sup>100</sup> In the event that contamination is discovered, it may also be necessary for the consultant to perform additional Phase II sampling activities in order to fully assess the lateral and vertical extent of contamination and determine an appropriate method for remediation, if remediation is required by law or otherwise desired by the parties.<sup>101</sup>

Once the extent of contamination at the target property is identified through the Phase II process, it is then possible to proceed to the next stage, which is the design and implementation

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98. *See supra* note 36 and accompanying text.

99. For example, solids and liquids are usually analyzed using EPA, TEST METHODS FOR EVALUATING SOLID WASTE, PHYSICAL/CHEMICAL METHODS, SW-846, and wastewater is usually analyzed using EPA, METHODS FOR ORGANIC CHEMICAL ANALYSIS OF MUNICIPAL AND INDUSTRIAL WASTEWATER, EPA-600. (These sources may be ordered from <http://www.ntis.gov/product.index.html>). *See also* 61 Fed. Reg. 27349 (May 31, 1996); EPA, NOTICE OF AVAILABILITY OF SOIL SCREENING GUIDANCE (BNA) No. 52; EPA, POLICY DIRECTIVE ON USE OF MONITORED NATURAL ATTENUATION (BNA) No. 87 (Apr. 21, 1999) (OSWER Directive No. 9200.4-17P).

100. *See* ASTM E 1903-97, *supra* note 36.

101. For example, it may be necessary to install additional groundwater monitoring wells down-gradient from an identified contaminant source in order to delineate the "plume" of contamination in groundwater or to take additional soil samples to identify other potential sources of contamination in soils.

of a remediation plan. This stage, often referred to as "Phase III," usually involves the preparation of a remedial action work-plan that outlines the method of remediation and the procedures that will be followed by the consultant for implementing the remediation.<sup>102</sup> The method of remediation is in turn based on a review of the applicable cleanup standards for the particular contaminants involved, as well as the goals of the parties involved in the transaction. In many cases, the parties will be required by law to submit the work-plan to the relevant state or local regulatory agency for pre-approval prior to beginning work.<sup>103</sup> Even where this is not required, the parties may choose to do so anyway under the state's voluntary cleanup program to obtain governmental oversight.<sup>104</sup> Following completion of remediation, this governmental agency may then issue some form of closure documentation indicating that the cleanup has been approved and/or no further action is required.<sup>105</sup>

### *B. Assessing Regulatory Compliance Status*

In addition to environmental contamination, purchasers may be concerned about the possibility of other environmental problems that could impair the purchaser's ability to use that property in the future following the closing of the deal. These problems may arise out of concerns that a particular facility located on the subject property that will be used by the purchaser is not in compliance with the applicable federal, state and local environmental regulatory requirements. While purchasers generally cannot be held responsible for any of the regulatory infractions that might have been committed in the past by the sellers themselves, the purchaser should become informed about the regulatory status of any facility on the property once it assumes the ownership and responsibility for the facility and its operations. In addition, should the review indicate that the facility is not in compliance with certain

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102. The Phase III process is generally guided by state regulations that establish cleanup criteria for particular types of contamination. *See, e.g.*, New York's STARS MEMO NO. 1, *supra* note 42.

103. *See, e.g.*, N.J. STAT. ANN. § 13:1k-7 (West 1993).

104. *See supra* Part I.A.3. for a discussion of state voluntary cleanup programs.

105. *See supra* note 44 and accompanying text for a discussion of state closure letters.

environmental regulatory requirements or that new significant regulatory requirements may soon be imposed that could require the company to undertake extensive equipment repairs or make substantial capital improvements, the prospective purchaser may wish to conduct a more in-depth review of planned uses of the facility prior to assuming ownership. Once any possible regulatory compliance problems are identified at a property targeted for acquisition, the purchaser should work together with its own internal engineering staff and outside environmental consultants to evaluate the magnitude of the potential environmental problems and possible solutions to these problems.

### *C. Retaining a Consultant*

Environmental issues arising in property transfers often involve a wide range of highly technical and complex issues that require the use of fully trained and qualified consultants. These issues include such matters as the need to determine whether a facility is in compliance with environmental regulatory standards or whether certain capital equipment must be installed at a facility, or in the case of contaminated properties, the need to undertake a proper assessment of a contaminated site and the implementation of the appropriate cleanup remedy.<sup>106</sup> The resolution of these issues will usually determine the outcome of most actions involving industrial facilities and contaminated industrial parcels of real estate.

Environmental counsel also should be consulted in the retention and oversight of a qualified environmental consultant to perform Phase I and Phase II investigation activities and any related reviews aimed at determining if there are any regulatory compliance problems at the subject property. Because of their frequent involvement in these matters, environmental counsel may be relied on to retain a consultant in a particular location or with a specific area of expertise related to the types of potential environmental concerns associated with a particular transaction. In addition, given their familiarity with particular consulting firms based on prior experience, environmental counsel can ensure that the consultant chosen will be fully qualified and capable for the task. It is also beneficial to have qualified counsel supervise the consultant's

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106. See discussion *supra* Part I.A.1. discussing the benefits of the due diligence process.

work, that minimizes the risk that potential contamination is overlooked.<sup>107</sup>

It is generally recommended that an environmental consultant be retained through a written contractual agreement. This agreement should clearly specify the appropriate scope of work to be performed and include several other key terms and conditions. The terms should include, at a minimum:

- an express provision acknowledging that the consultant has no conflicts of interest in performing the work;
- a broad-form indemnity (without financial limitation) for any damages arising from the consultant's negligence or breach of contractual duties;
- an indemnity from the consultant for any liens imposed by subcontractors;
- a minimum insurance provision with appropriate levels of coverage, covering such areas as employer's liability, automobile liability, errors and omissions liability, completed operation coverage, comprehensive general liability, and environmental impairment liability;
- an express provision requiring the consultant to name the client as an additional insured on its policies; and
- a confidentiality provision ensuring that various aspects of the environmental investigation (such as sensitive communications with the consultant and draft reports and memoranda) are held in strict confidence and subject to privileges against discovery.<sup>108</sup>

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107. As illustrated by the growing number of cases involving due diligence investigations, effective consultant selection and oversight is an important aspect of a purchaser's environmental risk management strategy. For example, in *BCW Assocs. v. Occidental Chem. Corp.*, 1988 U.S. Dist. LEXIS 17026 (E.D. Pa. 1988), a company that purchased a warehouse and its tenant were unable to recover more than \$640,000 in environmental cleanup costs they were forced to incur after their consultants failed to detect the contamination. Similarly, in *Lasalle Nat'l Trust, N.A. v. Jerry Schaffner*, 1993 U.S. Dist. LEXIS 15478 (N.D. Ill. 1993), a purchaser of contaminated property whose consultant failed to detect the contamination was unable to avail itself of the "innocent landowner defense" and thereby win an early dismissal of claims brought against it for the cost of cleaning up the property.

108. A standard consultant retaining agreement containing the referenced terms and conditions may be obtained from the author by mail

As a practical matter, it is often prudent to have any consultant involved in due diligence retained through outside counsel. This approach may assist the company in establishing any of the applicable legal privileges and other rights to protect against the disclosure of protected confidential information. Protections against disclosure may be derived, for example, under the attorney-client privilege,<sup>109</sup> the attorney work product doctrine,<sup>110</sup> and the self-evaluative privilege.<sup>111</sup>

For any company that is frequently involved in purchasing and/or selling properties, or that is planning a series of divestitures and/or acquisitions involving potentially contaminated properties, the

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at Kelley Drye & Warren LLP, 5 Sylvan Way, Parsippany, New Jersey 07054, or by e-mail at shumphreys@kelleydrye.com.

109. The attorney-client privilege provides that a party cannot be compelled to disclose confidential communications between an attorney and the client that relate to legal advice, unless the privilege is waived. 8 WIGMORE, EVIDENCE § 2292 (McNaughton ed., 1961). Although the privilege does not protect client communications that relate only to business or technical data (*see, e.g.*, *Simon v. Searle & Co.*, 816 F.2d 397, 403 (8th Cir. 1987), *cert. denied*, 484 U.S. 917 (1987)), client communications that are intended to keep the attorney apprised of business matters nonetheless may be disclosed where they constitute "an implied request for legal advice." *Jack Winter, Inc. v. Koratron Co.*, 54 F.R.D. 44, 46 (N.D. Ca. 1971).

110. The work product doctrine provides that a party cannot be compelled to disclose information or materials prepared by or for counsel "in anticipation of litigation or for trial," unless the party seeking the disclosure demonstrates a "substantial need" for the information and that equivalent information cannot be obtained without "undue hardship." FED. R. CIV. P. 26(b)(3). Factual information that is inextricably intertwined with opinions by legal counsel may be protected. *See In re Grand Jury Subpoena*, 599 F.2d 504, 512 (2d Cir. 1979).

111. The self-evaluation doctrine provides a qualified protection against the compelled disclosure of information gained through self-analysis aimed at achieving compliance with the law, so that parties are not discouraged from performing a vigorous self-evaluation for fear of producing information that may be used to penalize or impose liability against them. *See WIGMORE, supra* note 109, § 2285. In general, protection against compelled disclosure may apply under this doctrine where: (1) the communications are made with the understanding that they will not be disclosed; (2) confidentiality is essential to a full and satisfactory relationship between the parties; (3) the relationship is one which public policy ought to foster; and (4) the injury to the relationship from compelled disclosure outweighs the benefits of the disclosure. *Id.*

company should consider adopting a broad “master” contract approach in which a particular consultant is generally retained for a range of upcoming projects. This approach may help facilitate obtaining favorable rates of service from technical experts and reduce the need to renegotiate the terms and conditions of consulting agreements on a frequent basis.

### III. NEGOTIATING ENVIRONMENTAL INSURANCE COVERAGE

Until recently, obtaining environmental insurance to cover environmental liability risks associated with properties involved in real estate and corporate transactions was a largely futile effort. In most cases, the few policies available for such risks were prohibitively expensive and riddled with exclusions rendering them of little use in providing adequate protection. More recently, however, with the advent of state and federal programs aimed at promoting the redevelopment of brownfields and a general maturing of the science of environmental site assessment, a number of leading major carriers have started offering less expensive insurance products intended to tap into this growing market.<sup>112</sup> Consequently, parties to transactions involving potentially contaminated real estate are increasingly looking to environmental insurance as a way to cost-effectively manage environmental liability risks, seeking to shift certain environmental risks that were once allocated privately between the buyer and seller to an insurance policy. However, in determining whether insurance is a practical approach for a particular brownfields transaction, there are a number of issues that should be carefully considered in order to ensure that the coverage will provide the necessary protection.

In general, there are two types of insurance policies that may be used to offset a purchaser’s environmental risk in a brownfields

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112. See, e.g., *Envtl. Response, Compensation and Liability Ins. Policy*, Kemper *Envtl. specimen policy* (Apr. 2000), available at <http://www.kemperenvironmental.com/envrs.html> (“Kemper Specimen Policy”); *Real Estate Envtl. Liability Ins. Policy*, Zurich Ins. Co. specimen policy, STF-REL-100A CW (Dec. 1999) (“Zurich Specimen Policy”); *Pollution and Remediation Legal Liability Policy*, Greenwich Ins. Co. (ECS) specimen policy, GIC-PARL3CP (July 1999) (“ECS Specimen Policy”); *Pollution Legal Liability Select Policy*, Am. Int’l Group, Inc. (AIG) specimen policy, 73612 (Jan. 1999) (“AIG Specimen Policy”).

transaction: Pollution Legal Liability (“PLL”) policies and “Cost Cap” or “Remediation Stop-Loss” policies.<sup>113</sup> PLL policies are designed to protect the insured from the risk of incurring environment-related liability for property that may be contaminated from prior uses of the property, but for which there is generally no currently identified contamination requiring active remediation.<sup>114</sup> “Cost Cap” policies, on the other hand, provide coverage to ensure that the cost of specific environmental remediation activities at sites with known contamination will not exceed a certain amount.

The primary concerns associated with obtaining coverage under PLL and/or cost cap policies for a given transaction include the following:

#### *A. Scope of Claims Coverage*

Purchasers should ensure that the policy’s definition of covered “claims” is appropriately worded so that the policy will respond under appropriate circumstances. For example, certain of the common form policies’ insuring clauses provide coverage only for “claims” against the insured for damages.<sup>115</sup> In prior cases involving the application of Comprehensive General Liability (CGL) policies to environmental contamination, some of the same terms and conditions used in both types of policies have been interpreted so as to exclude coverage for certain types of cleanup costs.<sup>116</sup> For example, such costs have been denied where the

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113. *See id.*

114. Carriers may offer PLL coverage for sites at which active remediation is required subject to a specific exclusion for such remedial requirements.

115. A “claims-made” policy, unlike an “all risk” or “all loss” policy, provides coverage only for claims actually made against the insured during the policy period, regardless of when the damage occurred. Michael Gerrard, *Envtl. Law Practice Guide* ¶ 8.02[2] (Mar. 2000 Supp.) (M.B.).

116. *See, e.g., Mraz v. Can. Universal Ins. Co.*, 804 F.2d 1325, 1329 (4th Cir. 1986) (holding that CERCLA response costs are not recoverable because “one cannot equate response costs with ‘injury to or destruction of tangible property’”); *but see Kutsher’s County Club Corp. v. Lincoln Ins. Co.*, 119 Misc. 2d 889, 465 N.Y.S.2d 136 (Sup. Ct. 1983) (holding that cleanup costs constituted “property damage” within the meaning of a CGL policy since such costs were imposed by virtue of the state’s power to preserve and protect the public’s natural resources);

insured has not been issued any type of order or demand letter by a governmental authority or where the only form of documentation issued by a governmental authority is a notice letter, or similar document, stating that the recipient is a potentially responsible party (PRP) at a site.<sup>117</sup> Thus, depending on the jurisdiction, an insured may be unable to obtain coverage under these provisions for cleanups performed in response to a PRP notice letter issued pursuant to CERCLA, or a similar state law.

### B. Scope of "Cleanup Costs" Coverage

Instead of triggering coverage upon the occurrence of a "claim," certain of the carrier's specimen policies are triggered when the insured incurs cleanup costs. This type of coverage is apparently designed to avoid the problems that insured parties have encountered in the past with "claims" coverage, as discussed above. The term "cleanup" costs, however, is often defined in the form policies as being limited to costs that the insured is legally obligated to incur, and then only to the extent required by law. As a result, coverage under these provisions could be excluded for cleanup costs incurred: (1) to clean up contamination where there is no current legal obligation but where the insured would be subject to potential liability or an affirmative order or directive;<sup>118</sup> or (2) to achieve a higher level of cleanup in order to avoid the use of institutional controls that may adversely affect the insured's ability to use the property as necessary for its contemplated business.<sup>119</sup>

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Lansco, Inc. v. N.J. Dep't of Env'tl. Conservation, 350 A.2d 520 (Super. Ct. 1975) (holding that the costs of cleaning up contamination resulting from the discharge of oil spilled from storage tanks owned by the insured were recoverable as "property damage" as that term was defined under a standard CGL policy).

117. See, e.g., County of Broome v. Aetna Cas. & Sur. Co., 511 N.Y.S.2d 147, 126 A.D.2d 818 (A.D. 3d Dep't 1987), *aff'd as modified*, 540 N.Y.S.2d 620, 146 A.D.2d 337 (A.D. 3d Dep't 1989) (holding that a DEC administrative proceeding did not give rise to any duty to defend as there was no "suit for damages"); *In re Combustion Equip. Assocs.* (Carter Day), 73 Bankr. 85 (S.D.N.Y. 1987) (holding that a PRP letter is not a suit because it is not a "final agency action").

118. See County of Broome, 511 N.Y.S.2d at 147; Combustion Equip. Assocs., 73 Bankr. at 85.

119. Cf. Sumitomo Mach. Corp. of Am. v. Allied-Signal, Inc., 81 F.3d 328 (3d Cir. 1996) (holding that the purchaser was not entitled

### *C. Scope of Property Damage Coverage*

Some policies' insuring clauses contain a third type of trigger, providing coverage for "property damage." In some jurisdictions, however, this term has also been interpreted so as to exclude coverage for CERCLA-type costs.<sup>120</sup> In addition, some policies specifically define "property damage" so as to exclude coverage for damage to an insured's own property, although such "first-party" coverage is available under other potential policies such as "cleanup cost" coverage.<sup>121</sup> Thus, it is important when evaluating the scope of coverage under various policies (or forms of coverage under a single policy) to pay close attention to the specific manner in which the coverage terms are defined.

### *D. Voluntary Cleanup Program Cost Coverage*

A key coverage issue that may arise in the event of a claim on a policy growing out of a brownfields site is whether the policy responds to costs incurred for a cleanup that is conducted pursuant to a state "voluntary cleanup program." As noted above, absent some form of directive from a state or federal agency, coverage for these costs may not be available under those policies that provide coverage only for damages that the insured becomes "legally obligated to pay." Some of the newer policies now contain specific provisions that are aimed at providing coverage for these types of costs; however, the scope of coverage afforded under these provisions is often ambiguous. For example, one policy requires that the voluntary cleanup be "required" by a governmental authority.<sup>122</sup> Since participation in a voluntary cleanup program is inherently voluntary, it is unclear whether cleanup costs incurred under such a program would be covered under this policy language,

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under seller's indemnity to a cleanup that did not involve the use of institutional controls allowing contamination to be left in place).

120. See, e.g., *Mraz*, 804 F.2d at 1329.

121. See, e.g., *AIG Specimen Policy*, *supra* note 112.

122. The specimen policy offered by Zurich provides first-party coverage for cleanup costs, but only if the costs are "required by a 'governmental authority.'" The term "governmental authority" is defined to include any remedial action plan that "meets the requirements of a voluntary cleanup program." *Zurich Specimen Policy*, *supra* note 112.

in light of the policy's language that the costs must be "required" by a governmental authority.

#### *E. Scope of Legal Expense Coverage*

Another important issue for purchasers of brownfields properties to consider is the types of legal expenses that will be afforded coverage under the policy. Some policies provide specific coverage for legal costs incurred by the insured, but exclude coverage for such costs that are incurred: (1) for any purpose other than to defend a claim in court;<sup>123</sup> (2) to resolve "claims" with governmental authorities without the carrier's prior written consent;<sup>124</sup> or (3) to advise the insured and assist with negotiations regarding cleanups conducted pursuant to voluntary cleanup programs.<sup>125</sup> These restrictions could result in significant coverage gaps depending on the relative degree of legal assistance that may be required in order to conduct a cleanup pursuant to a voluntary cleanup program.

#### *F. Contractual Claims Exclusion*

Certain of the policies exclude coverage for liability arising under the contract unless there is an independent basis at law for the imposition of such liability.<sup>126</sup> As a result, the insured would not be covered for any cleanup costs to the extent that those costs are incurred for the purpose of satisfying a purely contractual duty. This issue may arise, for example, in an asset or stock purchase transaction where the seller assumes responsibility for pre-existing contamination, such as in an "as-is" purchase, or in a lease transaction where the tenant has generally assumed responsibility for environmental matters arising at the leased property.

In numerous cases, carriers have been willing to modify the language in their specimen policies in order to address the concerns identified above. Parties to brownfields transactions should therefore retain environmental counsel to negotiate the appropriate

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123. See ECS Specimen Policy, *supra* note 112.

124. See Kemper Specimen Policy, Zurich Specimen Policy, and AIG Specimen Policy, *supra* note 112.

125. See ECS Specimen Policy, *supra* note 112.

126. See Zurich Specimen Policy, ECS Specimen Policy, and AIG Specimen Policy, *supra* note 112.

modifications to the policy needed under the particular circumstances of the transaction.

#### IV. RESOLVING CONTRACT ISSUES

Contractual provisions designed to allocate environmental risks are negotiated against the backdrop of a complex and ever-changing panoply of environmental legal requirements, as well as inherently uncertain methods for identifying potential contamination at a given property. Consequently, these provisions can easily become traps for the unwary, with attendant costly results. In light of these concerns, it is especially important that counsel with specific environmental expertise be used in the contract drafting and negotiation phases to ensure that proper attention is given to all of the provisions--covenants, warranties, representations, indemnification clauses and other key terms and conditions--in the transaction instruments that allocate possible risks associated with environmental liability.

Given the potential for significant environmental problems to surface at a property sometimes years after the transaction is complete, it is not unusual to find cases in which the respective responsibilities of parties to a transaction for unforeseen significant remedial costs have turned on a few fortuitous words or phrases in the contract. For example, in one recent case, *SmithKline Beecham Corp. v. Rohm & Haas Co.* ("*SmithKline*"),<sup>127</sup> a purchaser's failure to clearly define the precise types of liabilities covered by an indemnification clause resulted in the court's refusal to give effect to what the purchaser had originally believed to be a broadly-worded indemnification. In *SmithKline*, a corporation had sold a manufacturing concern that had been contaminated by the industrial operations of its corporate predecessor. The purchaser was aware of the contamination at the site at the time of the purchase and consequently obtained what appeared to be a broad indemnification from the seller that he believed would encompass any costs associated with cleaning up the contamination at the property. This indemnification specifically required the seller to indemnify the purchaser for "all material liabilities relating to the

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127. 89 F.3d 154 (3d Cir. 1996).

conduct of the Business” arising prior to the effective date of the agreement.<sup>128</sup>

Eight years after the purchaser acquired the company, EPA performed a significant CERCLA cleanup of the site. The purchaser subsequently sued the original seller, arguing that the seller was responsible not only for the share of cleanup costs associated with the period during which it owned the site, but also for the earlier period of time during which the site was owned and operated by the seller’s predecessor. However, the U.S. Court of Appeals for the Third Circuit ruled otherwise and found that the indemnification agreement did not cover any liabilities associated with the period of the seller’s predecessor tenure at the site.<sup>129</sup> In justifying its opinion, the court interpreted the word “business” as relating only to the business owned by the actual seller--not the corporate predecessor.<sup>130</sup> Consequently, finding that the parties had not clearly imposed an indemnification obligation on the seller for the cleanup costs attributable to the operations of its predecessor, the Third Circuit refused to hold the seller responsible for all of the pre-closing environmental obligations at the site.<sup>131</sup>

The *SmithKline* case clearly sends an important signal to any future drafters of agreements involving the sale of property. This case emphasizes the need to ensure that careful and precise wording is used particularly in allocating environmental liabilities with significant costs at stake. Thus, in order to ensure that a proper contractual allocation of risks for environmental problems is achieved, parties will benefit significantly from environmental counsel’s drafting expertise and wealth of model contract language in crafting a contractual approach that meets the needs of a particular transaction. As the Third Circuit’s ruling in *SmithKline* demonstrates, a seller or purchaser will want to ensure that indemnities and other contractual obligations pertaining to environmental concerns are drafted in harmony with all other parts of the agreement so that all environmental costs or liabilities will be fully allocated in accordance with the parties’ true understanding of the agreement.

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128. *See id.* at 157.

129. *See id.* at 163.

130. *See id.* at 162.

131. *See id.* at 163.

Environmental counsel can also be particularly instrumental in the negotiation of specific contract terms and conditions in any transaction involving contaminated or potentially contaminated property. The specific terms of any deal will be influenced by the identifiable environmental risks associated with the property or business involved in the transaction, the objectives of the purchaser and seller in addressing those risks, the parties' relative bargaining leverage, and the relative skill and expertise of counsel. For example, a purchaser's objectives will often consist of obtaining broad protections that will ensure that any required cleanups will be paid for and completed in a timely manner, and will not interfere with its ongoing business operations. These parties will want to ensure that they will not be exposed to third-party claims for environmental costs in the future that are caused by pre-closing conditions and that any such costs will be paid for by the seller. In general, if the properties involved in the transaction or other potential environmental problems have not been well-studied, the purchaser will want greater protections than if these problems have been fully defined and quantified.

Sellers, on the other hand, will generally be motivated by their desire to minimize any costs associated with potential remedial activities and other corrective measures. Similar to purchasers, sellers will not want to be held responsible for any environmental issues that they did not cause and will therefore want to receive a guarantee of indemnification by the purchaser for any liabilities that arise post-closing for which they are not responsible.

While particular environmental contract issues that arise in any given transaction may vary widely depending on the specific environmental risks and business concerns of the parties to the deal, the most common questions that arise in brownfields transactions include:

- What is the scope and term of an indemnification obligation?
- To what standard should the site be cleaned up?
- Who should control the cleanup?
- How are any potential impacts on the purchaser's business operations to be addressed?
- Is the seller responsible for contamination voluntarily discovered/reported by the purchaser?
- Who is responsible for the purchaser's exacerbation of contamination?

- Who is responsible for additional costs/obligations arising from future changes in law?

Each of these questions is discussed below.

#### *A. Scope and Term of Indemnity*

One of the most extensively negotiated terms in allocating environmental risk in any brownfields transaction is the indemnification obligation and the scope, length and any other possible limits on such obligation. In certain cases it may be appropriate for the parties to limit the scope of the indemnity to a breach of either parties' warranties and representations and/or covenants, e.g., where the seller has offered the property on an "as-is, where-is" basis with representations that it is not aware of any environmental problems. Typically, however, the purchaser will demand a full indemnification for any costs or damages incurred due to contamination present at the property prior to closing, while the seller may negotiate for a specific limitation to its indemnification obligation for any costs or damages that the purchaser incurs as a result of environmental conditions that develop at the site after closing. The seller may also be able to narrow its indemnification responsibility for pre-closing conditions to only that contamination which was actually caused during its period of ownership. Many common contract negotiation issues involve refinements of this basic allocation approach.

As part of any negotiations regarding the indemnification obligation, there are several key factors that are subject to extensive negotiations, including the length of time and the amount of monies (or "financial cap") covered by any indemnification requirement. For example, a seller may wish to limit the duration of its indemnification responsibility to a specific number of years after the closing. If so, determining what an appropriate length of time should be can prove especially problematic, as it is often difficult or impossible to affix outer time limits on when environmental problems may arise in the future. In contrast, potential purchasers may wish to ensure that the indemnification responsibilities of sellers are extended sufficiently to allow for the manifestation of previously unknown environmental problems or to cover environmental matters that may not necessarily require remediation until some point in the future. These matters include, for example, abandoned containment structures such as underground storage

tanks and their contents, which may eventually leak or require removal in the future, and/or asbestos-containing materials (such as insulation materials and floor and ceiling tiles) which may not need to be addressed until a facility is renovated or demolished in the future.

In addition to key factors such as the length of time, contractual negotiations regarding the scope of the indemnity may involve the amount and/or types of damages and losses by the purchaser for which the seller will be responsible. For example, the purchaser may want the seller to indemnify it for consequential or economic losses resulting from business interruptions caused by remedial activities or for the repair/replacement of equipment or buildings damaged during remedial efforts.

### *B. Cleanup Standards*

Often referred to as the "how clean is clean?" issue, another important issue is what standard of cleanup will apply to contamination at a targeted site. Today's brownfields laws allow contamination to be left in place in some cases provided that restrictions (known as "institutional controls") are placed on the use of the property or groundwater at the property.<sup>132</sup> Therefore, the "how clean is clean?" issue now arises with greater frequency because purchasers often strive to obtain property that is free of environmental contamination and generally do not want to be saddled with significant restrictions on their abilities to operate in the future following closing at the site. In addition to affecting certain possible uses of the property that may include facility expansions or modifications, these restrictions may in various cases negatively affect the purchaser's ability to re-sell the property at some point in the future without further remediation.

A recent case demonstrates the importance of the cleanup standard issue and its potential implications in resolving future disputes over the environmental conditions of corporate property that has been previously sold. In *Sumitomo Machinery Corp. of America v. Allied-Signal, Inc.* ("Sumitomo"),<sup>133</sup> the U.S. Court of Appeals for the Third Circuit rejected the purchaser's claim that an

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132. See, e.g., 415 ILL. COMP. STAT. § 5/58-5/58.14 (West 1996).

133. 81 F.3d 328 (3d Cir. 1996).

agreement for the sale of industrial property required the seller to remediate the property to the stringent cleanup level desired by the purchaser. In this case, the purchaser sued the seller for the costs of cleaning up radioactive waste on property that had been previously acquired. Because the parties' agreement required the seller to clean up the contamination at the site in conformance with applicable "requirements," the seller took the lead in negotiating a cleanup plan with the New Jersey Department of Environmental Protection ("NJDEP").<sup>134</sup> Not surprisingly, the seller's proposed cleanup plan required the purchaser to accept limitations on the future use of its property in lieu of more stringent cleanup levels that would have left the site cleaner.<sup>135</sup>

In response, the purchaser claimed that the sales agreement clearly required the seller to clean up the site to a more stringent level so that no restrictions on the future uses of the property would be placed on the purchaser, which would serve to decrease the value of its property.<sup>136</sup> However, the court rejected the purchaser's argument, finding that the language of the sales agreement was vague and unclear as to the extent of the cleanup that the seller was required to perform.<sup>137</sup> Consistent with this finding, the court determined that since the NJDEP did not strictly "require" a more stringent level of cleanup, the agreement could reasonably be interpreted to only require the seller to satisfy the minimum, less-costly standard acceptable to the NJDEP.<sup>138</sup>

The court's decision in *Sumitomo* certainly demonstrates the potential for a purchaser to be left with property that is of lesser economic value than it bargained for where it has not clearly specified the parties' respective obligations relating to the cleanup of contaminated property in the purchase agreement. Thus, purchasers should carefully review the relevant indemnity language in the contract with environmental counsel in order to ensure that it appropriately addresses the question of the cleanup standard that will govern any future remediation activity at the purchased property.

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134. *See id.* at 330.

135. *See id.*

136. *See id.* at 333.

137. *See id.*

138. *See id.* at 334.

*C. Control of Cleanup*

Another key issue that often becomes a topic of intense contractual negotiations is which party will have the right to control any cleanup activities and accompanying negotiations with governmental agencies that may have to be undertaken in the future at any contaminated site that is intended to be conveyed to the purchaser. Normally, a seller may want to retain this right as a means of ensuring that it maintains control over the cleanup itself, and consequently, any costs of remediation. However, in contrast, purchasers may demand some role in both the remediation process and in negotiating with governmental officials in order to: (1) ensure that the remediation is undertaken in a timely manner; (2) avoid potential regulatory penalties as the current property owner that may be incurred if the state governmental oversight agency becomes concerned about delays in remedial activities or improper conduct by the seller's consultant or remediation contractor; and (3) ensure that the remedial activities are adequate for the purchaser's future purposes in acquiring the site. In order to reconcile these competing demands, a typical approach in brownfields transactions is to provide the seller with the first right to implement the cleanup at a contaminated site, but at the same time, give the purchaser the opportunity to participate in the selection of a consultant or contractor and the right to review the contractor's work and any proposed remedial plan that is developed for cleaning up the site. Once the remedial plan is developed, a purchaser would then have the opportunity to comment on this plan and make possible recommendations that could be adopted at the discretion of the seller.

There may be cases, however, in which the purchaser insists on controlling the cleanup efforts and implementing its desired remedial option. In such cases where the purchaser obtains the right to control the remediation, the seller may still attempt to impose some limits on the amount of costs that may be incurred in remediating the site. These limits may take the form of establishing a specific escrow or "basket" account under the sales agreement from which remedial costs may be paid under certain conditions for a specified period of time. Alternatively, the parties can expressly provide a specific limit of monies in the agreement that the seller is

obligated to incur to reimburse the purchaser for its cleanup activities.

*D. Impacts on the Purchaser's Business Operations*

Regardless of who performs any required cleanup activities, these remedial actions can often have a disruptive effect on site operations while the remediation is taking place. Consequently, many purchasers will insist on including specific contractual language requiring the seller, if it is undertaking remedial activities at the property, to take reasonable measures to avoid any adverse impacts on the purchaser's business operations. In addition, a more problematic issue, with potentially more significant ramifications for remediation costs, is whether the seller must pay for a more expensive remedy or other measures in order to avoid impacts on the purchaser's business operations. For example, if contamination is located in a key operations area, a purchaser may want to require that the seller pay for the cost of expensive measures such as relocating equipment to another area in the plant.

*E. Contamination Voluntarily Discovered/Reported*

Sellers are typically concerned about the possibility of their indemnification obligations becoming, in effect, an insurance policy for the purchaser which can be used to cover any kind of potential cleanup problems at the site in the future following closing, regardless of whether these problems are subject to mandatory or voluntary corrective measures. Given this concern, sellers often attempt to limit their indemnification responsibility in negotiating sales agreements to remediation of contamination that is required only as a matter of law or by involuntary duress, such as through governmental directive or an investigation by a third party. Otherwise, the seller's indemnification of the purchaser may become in effect a "blank check" for the purchaser to conduct unlimited post-closing environmental investigations that may be more frequent and extensive in scope than the seller would have authorized in the pre-closing stage, with the object of finding "every molecule" of contamination and remediating it at the seller's expense irrespective of whether the purchaser was under any legal requirement to do so.

*F. Purchaser's Exacerbation of Contamination*

A related subject for negotiation in brownfields transactions is whether the seller will be responsible for pre-existing contamination at a property that the purchaser exacerbates in the process of performing its pre-closing investigation, surveying and/or remediating any subsequently identified contamination, or as a result of its business operations following closing. For example, assume that the purchaser is undertaking a Phase II investigation prior to closing and hires a consultant to conduct an environmental investigation to delineate the extent of potential contamination in the groundwater below the site. In performing these activities, the contractor unknowingly installs a monitoring well that extends through a confining layer of clay into a lower aquifer. Suppose this monitoring well is not properly sealed in order to prevent contamination present in the upper aquifer from migrating into the lower aquifer and, as a result, the lower aquifer becomes contaminated for the first time due to this investigation. In general, since the prospective purchaser solely caused this problem, the purchaser should fairly and equitably assume this expense and fully indemnify the seller for any costs and damages that the seller incurs in addressing the problem. Thus, in order to ensure that it is not held liable for such actions, the seller may wish to include express language in the contract specifying that the seller should not be held responsible for any contamination caused by the purchaser and that the purchaser will hold the seller harmless and fully indemnify the seller for any damages or costs that are caused by the actions of the purchaser in performing its due diligence prior to the closing.<sup>139</sup>

However, while this form of contractual protection may appear to be fair, purchasers may raise additional concerns such as whether the parties will be able to properly apportion any damages that are caused by the exacerbation of contamination that cannot be easily attributed to one party or another. For example, assume that the purchaser has caused additional contamination at a property beyond the pre-existing environmental problems because of facility

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139. Most contracts further specify that the prospective purchaser covenants to return the property to its original condition following any investigation performed by that party should the deal not be consummated for any reason.

expansion activities in which contaminated soils at a discrete, but previously unknown, area of the site are further distributed throughout the site. In such a situation, the purchaser may claim that while its own actions obviously have increased the costs of remediating the soil contamination throughout the site, it should still not be held entirely liable for some of the contamination originally caused by the seller. On the other hand, from the seller's perspective, this problem would probably have never been caused in the first instance had the purchaser not compounded the problem by spreading the contamination throughout the entire site.

Questions relating to the fair and proper allocation of cleanup liabilities frequently arise not only in cases involving brownfields transactions, but also throughout the various facets of the practice of environmental law. Nevertheless, sellers can often take several approaches in anticipating this problem within the context of a brownfields transaction. These approaches may include such far-ranging options as specifying in the sales agreement that the seller should have no responsibility for any costs or expenses of remediation at the site caused by, or relating to, the purchaser's actions; or alternatively, that any of the seller's indemnification obligations do not include cleanup costs to the extent that they are caused by the purchaser's sole and direct negligence. Under the latter approach, a seller would be required under a sales agreement to indemnify the purchaser for any costs or damages resulting from the purchaser's exacerbation of existing contamination, but only if (and to the extent that) the purchaser had acted negligently in causing additional contamination at the site beyond the levels that had been presumably caused by the seller. This approach incorporates common law notions of comparative fault into the parties' private contractual arrangement, thereby ensuring a fair process for dividing the costs on the basis of legal standards well suited for this purpose.

### *G. Future Changes in Law*

Due to its relative infancy, environmental law is one of the most rapidly changing areas of law, with frequent changes occurring in environmental regulatory requirements both on the federal and state governmental levels. Because of this particular characteristic of environmental law, parties in brownfields transactions often become involved in negotiating the issue of which party should be

held responsible for any future changes in law that may impose more stringent requirements on the property. For example, with environmental requirements in a constant state of flux with respect to varying cleanup standards and substances that become subject to cleanup requirements, it is possible that a post-closing change in law or regulations could have the effect of rendering site contamination subject to a cleanup requirement that would not have been subject to a cleanup requirement at the time of closing. Thus, unless specific contractual provisions for allocating the risk of future changes in law to the seller are included in the purchase agreement, it is possible that the purchaser could be left without a contractual remedy against the seller even though the purchaser was forced to take corrective action with respect to an environmental problem that may have been initially caused by the seller.

#### V. RESOLVING ISSUES IN POST-CLOSING PHASE

In the post-closing setting, ongoing environmental expertise may be needed to protect the client's interests in addressing ongoing site remediation issues. For example, in the event that contamination was known at closing or is discovered after closing at a site that requires remedial activities, a purchaser may wish to coordinate with environmental counsel with respect to several important issues that may eventually arise in connection with these remedial activities. First, environmental counsel can assist in evaluating the parties' respective rights and obligations under the purchase contract if a dispute ever arises in connection with the remedial activities. In some cases, contract interpretation issues may involve the evaluation of evidence extrinsic to the contract, such as consideration of the parties' intentions in incorporating particular risk-allocating provisions as evidenced by comments on drafts and other circumstances (e.g., information about specific environmental problems or potential problems) which the parties were aware of at the time they negotiated the contract. In addition, contract interpretation issues may need to be evaluated in light of case law in the particular jurisdiction that the parties have designated as the

choice-of-law jurisdiction.<sup>140</sup> Environmental counsel may provide expertise in interpreting these contract provisions based on a familiarity with case law both in and outside the applicable jurisdiction, as well as broad experience with similar contract issues in other transactions.

Once the relevant contract interpretation issues have been evaluated, a purchaser should continue to work with environmental counsel to resolve various fundamental issues that may arise in connection with the transaction following closing. For example, if the contract gives the purchaser or the seller the option of assuming control of any remediation that is required following closing of the deal, the purchaser should consult with environmental counsel regarding the relative benefits and drawbacks in performing the remediation itself. In addition, the purchaser should give further consideration to the possible regulatory approaches for performing any corrective measures at the site and the advantages and disadvantages of selecting any particular measure. Various issues that will need to be considered will include an analysis of applicable regulatory requirements in the appropriate jurisdiction, the cleanup requirements implied under the respective options, and the contractual requirements affecting the cleanup, including any contractual terms or conditions that allocate financial responsibility among the parties.

Consider the following hypothetical as an illustration of how these issues may arise in the post-closing phase: In this case, assume that the parties were aware of potential subsurface contamination beneath a manufacturing facility at the time of closing and subsequently agreed that the seller would indemnify the purchaser for costs associated with cleaning up this contamination. However, while agreeing in general to indemnify the purchaser for cleanup costs associated with pre-closing activities, the seller was able to negotiate certain express limitations and conditions on the indemnity obligation. These terms provided, among other things, that it would have the right to control any subsequent cleanup at the site, subject to the purchaser's right to make reasonable modifications to the cleanup plan if they were necessary either to avoid a disruption of the

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140. If the parties have not designated a choice-of-law jurisdiction in the contract, the interpretation of the contract may also require an analysis of choice-of-law issues.

purchaser's business and/or to comply with any regulatory requirements in effect at the time of the cleanup. Assume also that upon further investigation after closing, it was determined that the contamination below the building was more extensive than previously thought and that any remediation of this contamination would entail significant costs in order to avoid disrupting the purchaser's business.

Under this scenario, because it has the right to control the actual means of remediating the site, the seller can minimize the expenditure of cleanup costs that it will be responsible for by seeking the lowest-cost solution that still provides sufficient protection of human health and the environment. For example, the seller may determine that an "active" remediation of the contamination could be avoided under the state's voluntary cleanup law, which may permit the use of a risk-based cleanup remedy for the site.<sup>141</sup> After being retained by environmental counsel, an expert consultant would then perform a risk assessment at the site and determine whether employee exposure to the contamination via inhalation may be ruled out. For example, perhaps the contamination at issue is located under a concrete floor that effectively serves as a barrier against the emission of vapors into the building. In addition, a groundwater investigation may be performed that will possibly confirm that the contamination is not migrating off-site. As a result, it may be appropriate to employ a "passive," risk-based remediation approach at the site in which the contamination would be left in place with the expectation that it would naturally attenuate over time, although the groundwater may have to be monitored periodically to prevent off-site migration. Thus, in implementing this "passive" cleanup approach, the seller may avoid an intrusive, expensive remediation of the entire subsurface soil contamination at the site. The seller could then negotiate with the purchaser to pay a limited amount in return for a complete release of any further responsibility at the site.

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141. As noted above, numerous state laws allow for the use of risk-based standards in voluntary remediations of contaminated sites. See *supra* note 52 and accompanying text.

## CONCLUSION

During each phase of a transaction involving the transfer of a brownfields property, the transaction team for the purchaser or seller will benefit greatly from a working familiarity with the practical issues and concerns that typically arise in the course of such transactions. In addition, armed with an in-depth understanding of the pertinent regulatory and liability regimes at the federal, state and local levels and any particular property transfer laws that may apply to the deal, as well as case law trends and policy developments that may impinge on the specific liability risks posed by the transaction, parties to these transactions will be in a position to craft an effective strategy for dealing with environmental problems as they arise during the course of the transaction and after closing. These parties, therefore, should work closely with environmental counsel who can provide practical advice on how these various laws will impact their respective rights and obligations and on their implications for any specific transaction. In this way, purchasers and sellers of brownfields properties can best ensure that the impacts of contamination in such transactions will be properly identified and incorporated into the framework of a workable agreement that properly protects their interests.

