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How Lawyers Deal with the Recent Changes in the Area of Environmental Law

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HOW LAWYERS DEAL WITH THE RECENT CHANGES IN THE AREA OF ENVIRONMENTAL LAW

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I. INTRODUCTION

Recent changes in the area of environmental law regarding the cleanup of hazardous waste sites, particularly in the federal arena, are forcing lawyers to revise their strategy when advising commercial real estate developers. Lawyers have traditionally focused upon the economic aspects of a commercial real estate transaction such as the enforceability of leases, mortgage encumbrances, restrictions, title issues, and site inspection of the premises. In addition to focusing upon these traditional aspects, new and important emphasis must be placed on the analysis and determination of the condition of the physical property itself. Recent federal legislation such as the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (hereinafter CERCLA), 42 U.S.C. § 9601, *et seq.*, and its amendment have created an area of uncertainty and confusion with respect to the liability for the cleanup of contaminated property.

CERCLA was enacted to fill the gaps that were perceived in prior laws regarding the handling and disposal of hazardous substances. It provides for the creation of liability merely by the status of ownership where a property has been classified as a hazardous waste site.¹ There is no requirement of a causal relationship for the imposition of liability. CERCLA places liability not only upon persons who have some casual connection with the environmental harms, but also upon "innocent" owners who have acquired title subsequent to the disposal or release of the hazardous substances into or upon the property. CERCLA is far reaching in that it imposes strict liability on current and former owners

¹ Cyphert, *Impact of Environmental Laws on Real Estate Transactions*, REAL EST. L. INST. B. A. OF GREATER CLEVELAND, Oct. 1985, at 6.

of property containing hazardous substances. It also imposes potential liability on lessors where the lessees/operators are generating the hazardous substances. Furthermore, potential liability is found for financial institutions which foreclose on a contaminated site and take title to the property.² The United States Environmental Protection Agency (EPA) is governed with the administration and enforcement of CERCLA.³

Congress recently amended CERCLA when it passed the Superfund Amendments and Reauthorization Act of 1986 (hereinafter SARA), 42 U.S.C. § 9601(35)(A). SARA revised the definition of the "owner or operator" of contaminated property by adopting the EPA's position that the holding of legal title is sufficient to make a person strictly liable for environmental cleanup costs.⁴ SARA also limited the "third-party defense" found in CERCLA and makes an owner liable even when the contamination was caused solely by a third party, unless the owner either took title involuntarily or did not have reason to know of the contamination at the time it took title. This limitation is commonly referred to as the "Innocent Landowner" exception.⁵

SARA further imposed a federal lien on real estate that is affected by a federal cleanup. This federal lien is not a superlien such as the ones that are found in several state statutes.⁶ State superliens create a superior lien on the real estate which is not subordinated to any mortgages or prior encumbrances on that property while federal liens are subordinated to secured claims and prior encumbrances on the property. SARA also provides for a *de minimus* settlement in which the government has discretion to settle claims for the reimbursement of cleanup costs and damages if a successor-owner qualifies.⁷

These statutes impose affirmative obligations on purchasers and sellers of real estate to identify and clean up environmental problems prior to closing. SARA places substantial contamination and remedial obligations on the purchasers and sellers of property. SARA appears to place a duty of inquiry and care on the purchaser with respect to environmental contamination if he is to fall under the "Innocent Landowner" protection.

Since the purchaser is burdened with this duty of inquiry and care in order to fall within the exception to CERCLA, the issue of environmental cleanup should be addressed and resolved during the negotiation stage of the transaction. The closing should be made conditional upon the

² *United States v. Maryland Nat'l Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986).

³ 42 U.S.C. § 9606(a) (1980).

⁴ *Berz & Spracker, Landowner Liability Under CERCLA: New Obligations for Sellers and Buyers*, CHEMICAL WASTE LITIGATION REP. 705 (1987).

⁵ *Id.*

⁶ See generally *Massachusetts Oil and Hazardous Material Release Prevention and Response Act*, MASS. GEN. LAWS ANN. ch. 21E (West 1983).

⁷ SARA § 122(g)(1)(B); CERCLA § 122(g)(1)(B), as amended.

resolution of any cleanup measures. By addressing the issue of potential environmental liability during the negotiating stage of the transaction, the purchaser and seller may avoid the expenses involved in later defending CERCLA liability litigation.⁸ However, caution must be exercised where the purchaser and seller attempt to remedy the environmental contamination without the participation of federal and state regulatory authorities. Without federal and state involvement, the purchaser and seller have no assurance that a proposed cleanup passes regulatory muster.⁹ Purchasers or sellers may also face citizens' suits challenging the adequacy of the cleanup.

II. POTENTIAL LIABILITY WHICH THE PURCHASER/DEVELOPER MAY ENCOUNTER UNDER CERCLA AND SARA

CERCLA requires the cleanup of property where there is an imminent and substantial endangerment to the public health and welfare or the environment.¹⁰ The cleanup is conducted under the jurisdiction of the EPA.¹¹ CERCLA provides the EPA with a fund in which to pay for hazardous site cleanup. However, Congress, noting that the fund it set aside would be insufficient to cover all of the hazardous waste sites reported in the United States, granted the EPA authority to seek reimbursement from the owner or operator of the property.¹² CERCLA provides that in addition to the EPA recovering funds, the states and third parties may also seek reimbursement under this Act.¹³

The parties liable under CERCLA include present owners or operators of the site and any predecessors who owned the site when the hazardous substances were disposed upon or into the land.¹⁴ Operators under CERCLA include individuals who control the ownership entity and the operation of the facility in question. In addition to owners and operators, transporters of hazardous substances to hazardous waste dumps are also liable under CERCLA. As one can see, CERCLA is a treacherous trap for the unwary purchaser of land which has potential environmental liability.

CERCLA provides for the recovery of the cost of removal and remedial actions and for damages for injury to, destruction of, or loss of natural resources. The cleanup costs may exceed the cost of the property itself.

⁸ Berz & Spracker, *supra* note 4, at 706.

⁹ *Id.*

¹⁰ See generally 42 U.S.C. §§ 9601-9657 (1980).

¹¹ *Id.*

¹² McNealey, *How Hazardous Waste Law Impacts on Real Estate Transfers: A Warning to Sellers and Purchasers*, REAL PROP. SEC. NEWS., OHIO ST. B. A., Apr. 1985, at 2.

¹³ *Id.* at 5.

¹⁴ *Id.* at 5; Cyphert, *supra* note 1, at 6-7.

The scope of liability under CERCLA is strict joint and several liability.¹⁵

There are limited defenses available to the owner of a hazardous site. These defenses include (1) act of God; (2) act of war; and (3) act or omission of a third party not an employee or agent of the defendant, or not one whose act or omission occurs in connection with a direct or indirect contractual relationship.¹⁶ This last defense is commonly referred to as the "Third-Party Defense" which was later amended under SARA.

The amendment to CERCLA, SARA, broadened the definition of "owner or operator" to ostensibly include a foreclosing lender who takes title to the contaminated property. Under SARA, the trend is not to narrow the number of parties who may be liable, but rather to expand who is liable (in the hopes of including a deep-pocket). SARA also amended the third-party defense in CERCLA by creating the "Innocent Landowner" exception. SARA redefined "contractual relationship" to exclude land contracts when:

[T]he real property . . . was acquired by the defendant after the disposal or placement of the hazardous substance on, in, or at the facility. . . .

and when:

[O]ne or more of the circumstances described in clause (i), (ii) or (iii) is also established by the defendant by a preponderance of the evidence:

(i) At the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or have threatened release was disposed of on, in, or at the facility¹⁷

To qualify under this safe harbor, "defendant must have undertaken, at the time of acquisition, all appropriate inquiry into previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability."¹⁸ The purchasers of commercial land are held to an especially high standard of prior examination. The defense is not available to a previous owner who is liable under CERCLA for cleanup. Also, previous owners who transfer ownership without disclosing their knowledge of hazardous releases on the site are fully liable under CERCLA and are barred from using this defense.

¹⁵ Cyphert, *supra* note 1, at 6-7; *see also* New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985).

¹⁶ Cyphert, *supra* note 1, at 8-9.

¹⁷ SARA § 101(f); CERCLA § 101(35)(A), as amended.

¹⁸ SARA § 101(f); CERCLA § 101(35)(B), as amended.

SARA also provides for a remedy where the owners failed to conduct "appropriate inquiry." This remedy is known as a *de minimus* settlement available for "almost innocent" landowners who are responsible for cleanup. In order to fall under the *de minimus* settlement provision, the owner must not have conducted nor permitted "the generation, transportation, storage, treatment or disposal of any hazardous substance at the facility."¹⁹ Furthermore, the owner must not have contributed to a release at the facility "through any action or omission,"²⁰ and must not have actual or constructive knowledge that hazardous substances were generated, transported, stored, treated or disposed of at the facility.

SARA does not provide any guidance in calculating an appropriate settlement amount, and, therefore, EPA officials may have little incentive to make settlements if they have not been able to identify other parties that have sufficient assets to pay for costs and damages.

III. ASSISTING THE PURCHASER/DEVELOPER OF COMMERCIAL REAL ESTATE IN MINIMIZING OR AVOIDING POTENTIAL LIABILITY UNDER CERCLA/SARA

The lawyer is most effective in protecting his client if he is able to represent the purchaser from the initial contact with the potential seller. In this regard, the lawyer can assist the client in establishing proper due diligence procedures. The first step in determining whether an environmental liability exists is to develop a detailed ownership history including prior uses and activities of the property. The lawyer may request from the title company, a list of the chain of title for as far back as the title searcher can go on that particular property. If the ownership history indicates a potential release of hazardous substances by previous owners or lessees, it is suggested that an inspection and test for hazardous substances be conducted.

At this point, the purchaser may request an environmental audit and retain the right to select the entity to conduct the audit while having the seller agree to pay for the audit. The purchaser should provide that the closing of the sale is conditional upon the results of the environmental audit. It is imperative that the parties define the parameters as to what a "clean" or "dirty" audit is, and also to provide for the purchaser's option to terminate the contract if a "dirty" audit is found. The purchaser would be well advised to examine newspaper clippings or security filings for any notices of suspected release of hazardous substances. Local health and fire departments, if approached in a discreet manner, may be able to provide some insight as to whether there were any complaints lodged against the

¹⁹ SARA § 122(g)(1)(B); CERCLA § 122(g)(1)(B), as amended.

²⁰ *Id.*

seller. The purchaser should inquire as to the past and present uses of neighboring property since hazardous waste discharged upon adjoining land can seep into the land next to it.

The purchaser should contact regulatory agencies to determine the existence of any pending litigation, cleanup order or investigations. It is important to note here that under present federal law, it is unclear whether any adverse findings, for example from the environmental audit, must be reported to the appropriate agency.²¹ CERCLA appears to impose reporting liability only to those who are "in charge of" a "facility."²² It appears that if the purchaser were to come upon any adverse findings, he is not liable for failing to report this to the applicable agency. However, since this is not a settled area of the law, the purchaser may want to protect himself by providing in the purchase agreement that the seller is responsible for complying with the CERCLA reporting requirements.

The lawyer should check deed and county records for liens or use restrictions regarding hazardous waste. This is particularly important in light of the fact that the American Land Title Association (ALTA) title insurance policies were rewritten to expressly exclude from coverage "any law, ordinance or governmental regulation relating to environmental protection."²³ Title insurance policies do not cover environmental matters and liens unless notice is recorded in certain specified public records. The lawyer should not rely upon the title search conducted by the title company with regard to federal liens or the superliens imposed by various state statutes.

If problems are discovered under the environmental audit or under the other examinations conducted by the purchaser and/or lawyer, an estimate should be obtained of the cost to correct any problems discovered. Once this estimate has been obtained, the purchaser should request the seller to pay for the cleanup costs. The purchaser may want to require the seller to obtain a bond to guarantee payment and may place this in an escrow fund to cover the cleanup costs.²⁴ If the seller refuses to pay for the cleanup costs, the purchaser must weigh the costs of cleanup and other potential future liability versus the future economic benefits he anticipates from the transaction. CERCLA cleanup costs could exceed the value of the property and the anticipated future earnings. If the seller refuses to pay for the cleanup costs, the purchaser may want to renegotiate the sales price to reflect his potential liability for cleanup costs. Keep in mind

²¹ 42 U.S.C. § 9603 (1980).

²² *Id.*

²³ Pedowitz, *Title Insurance: Non-Coverage of Hazardous Waste Super-Liens*, 13 A.B.A. SEC. REAL PROP., PROBATE & TRUST 46 (Spr. 1985).

²⁴ *Panel Discussion on Environmental Problems in the Purchase, Sale and Financing of Real Estate*, CLEV. B.A. REAL EST. INST. 1987, at 14.

that the purchaser will not be liable for CERCLA cleanup costs unless he buys the land.

In addition to conducting due diligence, the lawyer can also protect his client, the developer, by including a number of provisions in the purchase agreement such as limitations on environmental liability agreed to by the parties. The lawyer should also obtain indemnification from the seller, holding the purchaser harmless for any and all acts of the seller and all previous owners of the property. Keep in mind that the seller (assuming it generated the hazardous waste) will always be liable under CERCLA. The seller cannot contract away its liability. The purchase agreement should expressly define the scope of representations and warranties obtained from the seller so that the intended benefit is not inadvertently lost. The lawyer must provide that the indemnifications and representations survive the closing for a long period. The closing should be conditioned upon the satisfactory results of an environmental audit.

Since the purchaser is not continuing the seller's operations (the purchaser anticipates developing the real estate), the contract ought to require the seller to contact all licensing and regulatory agencies to cancel all of the seller's operating licenses and permits and to give notice of the sale and of the fact that the purchaser is not continuing the seller's operations.²⁵ This may shift the burden of environmental liabilities to the seller because it will have the effect of raising any "red herrings."

In addition to providing for protective clauses and requirements in the purchase agreement, the lawyer must address additional considerations which may not flow from the purchase agreement. Such considerations may address whether the intended use of the property will be affected by the existence of the contamination. Also to be considered is the possibility of excising the contaminated portions of the premises from the transaction. If the contaminated portions of the premises are excised, is it still possible for the purchaser to complete the transaction and realize his anticipated benefits? All of the indemnifications and representations and warranties that the astute lawyer places in the purchase agreement will not amount to much if the seller does not have a deep enough pocket to stand behind its warranties. The lawyer must ascertain whether the seller is wealthy enough to back up the warranties and indemnifications found in the purchase agreement. This may be accomplished by requiring a bond guaranteeing payment or a demand letter of credit. Furthermore, the lawyer must address whether there are any potential adverse public relation costs involved in perhaps constructing a retail shopping center or apartment complex on a hazardous waste site.

The lawyer can also minimize CERCLA liability in a situation where

²⁵ *Id.* at 13.

the purchaser has already entered into a contract with the seller and then enlists the services of the lawyer to draft the paperwork. The lawyer can conduct an appropriate inquiry so that the purchaser may qualify under the narrow "Innocent Landowners" exception under SARA. If the situation is such that an appropriate inquiry is not feasible at that time, perhaps the parties may be able to fall under the *de minimus* settlement provided for under SARA. Again, that limited exception would only arise when the EPA has found the purchaser liable for cleanup costs.

If there are predecessor owners other than the seller who disposed of hazardous wastes, an attempt should be made to contract with them to pay for cleanup costs. Predecessor owners are still liable for cleanup costs. Perhaps the purchaser can obtain an indemnification from a predecessor owner with a "deep pocket." The lawyer should also determine if the seller disclosed its knowledge of the contamination to the purchaser. If it did not disclose, it is still fully liable under CERCLA, and the lawyer may be able to use this as a bargaining tool with the seller in renegotiating a contract that the purchaser/client entered into without legal representation. The key here is to minimize the purchaser's liability where he has become an owner of the property.

If the lawyer believes that he is not able to sufficiently protect the client/purchaser under this situation, serious consideration must be given to walking away from the deal and voiding the contract. The lawyer and client must weigh the costs of voiding the contract versus the potential cleanup cost involved if the purchaser were to go forward and become an owner of the property.

IV. CONCLUSION

It is important that the lawyer work with the client from the initial step in acquiring real estate with potential environmental liability. The lawyer is a necessary player in the analysis of economic aspects, particularly where the legal aspects of the transaction may cost more than what the client had anticipated to realize from the transaction.

Often times the client does not notify the lawyer until after he has entered into a purchase agreement for the real estate. In this situation, he uses the lawyer merely to draw up the legal papers after the substance of the deal has been consummated. To minimize the problems of this situation, the lawyer must educate the client and make him aware of the potential pitfalls before the client makes that fatal first step without proper representation. The lawyer should adopt a total-services approach to servicing the needs of his clients. This approach encompasses the lawyer contacting the client before a problem arises. The contact may be in the form of sending a newsletter to those clients who may be potentially affected by recent legislation. Contact can also be made by conducting seminars for clients on the specific subject matter. The lawyer

may want to address the possibility of the client hiring an environmental specialist, particularly if the client anticipates encountering additional transactions that may have potential environmental liability.

In addition to the federal legislation on hazardous waste, there are a growing number of states which have enacted legislation, which in some instances is more burdensome than the federal legislation. Massachusetts, New Jersey and Tennessee, to name a few, have enacted superliens in which the state has superior priority over all other encumbrances on the owner's property. Pennsylvania, New Jersey and Connecticut require notification of any industrial establishment transfer. Although Ohio has not enacted legislation of this magnitude, the lawyer must educate himself as to the law in other states which have enacted such legislation. If Ohio is to enact legislation of this sort, it will most likely pattern it after other states' statutes. In this regard the lawyer may be able to anticipate environmental legislation and advise his client accordingly.

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