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Minimizing Exposure for Municipalities for Brownfields Liability

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Minimizing Exposure for Municipalities for Brownfield Liability

By definition, the redevelopment of Brownfield sites involves legal and technical obstacles. On the other hand, there are strong incentives to redevelop them: not only does it make sense to re-use properties than otherwise would lie fallow, those properties are often in locations that make them particularly valuable for redevelopment, near transportation, utilities, and industry. For that reason, they are particularly attractive to municipalities seeking to revitalize their urban cores. This paper discusses ways in which municipalities acquiring Brownfield properties may reduce their risk of exposure to liabilities associated with them. It first discusses environmental liabilities associated with Brownfields, as well as issues related to their development, and then suggests ways to address those issues.

Environmental Liabilities

A municipality seeking to acquire and develop a Brownfield property should consider liabilities associated with onsite conditions and how to manage them, as well as requirements associated with any planned development. The discussion below focuses on liabilities associated with onsite conditions and then provides a high level overview of issues relating to development.

Onsite Conditions—Problems of the Past

Superfund Liabilities

The term "Brownfield Site" means real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant. The definition was added to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. §§ 9601 et seq.), commonly known as CERCLA or Superfund, by Public Law 107-118 (H.R. 2869) - the "Small Business Liability Relief and Brownfields Revitalization Act" signed into law January 11, 2002. The so-called Brownfield Amendments of 2002 were intended to ameliorate some of the liability concerns that had resulted from the enactment of CERCLA in 1980.

Before CERCLA, environmental statutes generally regulated conduct prescriptively, providing for penalties for violations. In CERCLA, Congress created a new paradigm, imposing liability based not on a violation of law, but rather on a person's relationship to a site from which there has been a release or threat of release of a "hazardous substance."[1]

[1] Although Superfund broadly defines the term "hazardous substance," it excludes from that definition petroleum and petroleum products, and thus sites contaminated by gasoline and other petroleum products do not fall within its ambit.

Those liable under CERCLA, so-called potentially responsible parties or PRPs, include present owners and operators of a hazardous substance-contaminated site, owners and operators of the site at the time hazardous substances were disposed, transporters who selected the site, and generators of waste who arranged for disposal of their wastes at the site. 42 U.S.C. § 9601(14) (2002). CERCLA liability is strict, generally joint and several, and unlimited. See "Who's Liable Now? – New Federal Brownfields Legislation, p. 983, J. Civins and B. Phillippi (Texas Bar Journal Dec. 2002). It includes costs of investigation and remediation of contamination, as well as natural resource damages. In addition, there is no limit on the monetary exposure, which also bears no relationship to the value of the property being bought or sold. As a result, CERCLA presented a significant impediment to Brownfield development.

As originally enacted, CERCLA provided three limited defenses: (1) act of God; (2) act of war; or (3) act or omission of a third party. To claim one of these defenses, a PRP must show that the release or threat of release of hazardous substances and the resulting damages were caused solely by one or a combination of these three actors. 42 U.S.C. § 9607(b) (2002). Of these three original defenses, the most viable and frequently asserted was the third party defense.

To claim the third party defense, the defendant must show not only that the release or threat of release was caused solely by the act or omission of a third party, but also that: (1) the third party was not the defendant's employee or agent, or one whose act or omission occurred in connection with a contractual relationship, existing directly or indirectly, with the defendant; (2) the defendant exercised due care with respect to the hazardous substances; and (3) the defendant took precautions against the foreseeable acts or omissions of the third party and the consequences that could foreseeably result from the acts or omissions. Case law is split as to the contractual nexus necessary to preclude use of the third party defenses; some courts ignore the requirement that there be an act or omission "in connection with" a contractual relationship. See Civins, Mendoza, and Fernandez, "The Third Party and Transaction-Related Defenses of CERCLA," ABA SEER Environmental Litigation and Toxic Torts Committee Newsletter, (2005).

In 1986, Congress enacted the 1986 Superfund Amendments and Reauthorization Act ("SARA"), which created a new subset of the third party defense--the innocent landowner ("ILO") defense -- the first defense to focus on parties to a real estate transaction. Under this defense, even if the proscribed contractual relationship were present, the PRP nonetheless could take advantage of the third party defense if it could show that it acquired the property after disposal of the hazardous substances and that: (1) it is a government entity that acquired the facility by escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation; (2) it acquired the property by inheritance; or (3) it was an innocent purchaser, that it is, it did not know and had no reason to know that any hazardous

substances were disposed at the facility. 42 U.S.C. § 9607(b)(3) and § 9601(35)(A)(i).[2]

To show at the time of the acquisition that it "had no reason to know," the party must show that it conducted "all appropriate inquiry ("AAI") into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability." 42 U.S.C. § 9601(35)(B). The Brownfields Amendments required that EPA define standards and practices for AAI, to include: (1) results of an inquiry by an environmental professional; (2) interviews with past and present owners, operators and occupants; (3) reviews of historical sources of information; (4) searches for recorded environmental cleanup liens; (5) reviews of governmental and other records; (6) visual inspection of the site and adjacent properties; (7) specialized knowledge or experience of the PRP claiming the defense and commonly known or reasonably ascertainable information about the site; (8) the relationship of the purchase price to the value of uncontaminated property; and (9) the degree of obviousness of the presence or likely presence of contamination and the ability to detect the contamination by an appropriate investigation.

EPA subsequently promulgated regulations defining AAI, which are found at 40 CFR Part 312. In promulgating its regulations, EPA sanctioned the use of the ASTM E1527 Standard. That standard has undergone a number of revisions, the most recent of which—ASTM E1527-13—EPA approved. 78 Fed. Reg. 79319 (Dec. 30, 2013)

Of the three ILO defenses, only innocent purchasers are required to show lack of knowledge and AAI; importantly, government entities need only show that they acquired the property involuntarily or by eminent domain or condemnation and that they satisfied the other elements of the third party defense, that is, that they had no affiliation with the person whose act or omission caused the contamination, that they exercised due care with regard to the hazardous substances, and that they took precautions against foreseeable acts of third parties.

As noted, the Brownfields Amendments sought to ameliorate the harsh effects of CERCLA—by adding new defenses for prospective purchasers of Brownfields, specifically, the transaction-related defenses of bona fide prospective purchaser ("BFPP") and of contiguous landowner ("CLO"). These two defenses, together with the innocent purchaser defense, each require that AAI be performed. They also generally require a showing of no affiliation with a liable party.

To clarify what is necessary for each of their three transaction-related defenses, EPA published a Common Elements Guidance (the "Guidance"). Memorandum

[2] SARA placed the defense in a carve out from the definition of "contractual relationships," and defined contractual relationship to include land contracts, deeds, easements, leases or other instruments transferring title or possession, without addressing the nexus requirement. 42 U.S.C. § 9601(35).)

from S. Bromm, Office of Site Remediation and Enforcement, United States Environmental Protection Agency, "Interim Guidance Regarding Criteria Landowners Must Meet in Order to Qualify for Bona Fide Prospective Purchase, Contiguous Property Owner, or Innocent Landowner Limitations on CERCLA Liability" (March 6, 2003). As the Guidance explains, the common elements comprise both threshold criteria and continuing obligations for the three transaction-related defenses.

In addition to the threshold criteria, the common elements include a set of continuing obligations that the purchaser must satisfy to continue to qualify for the defenses. The continuing obligations consist of five specific requirements: (1) compliance with land use restrictions and not impeding institutional controls; (2) implementing reasonable steps with respect to hazardous substances on property to stop and prevent releases and prevent or limit exposure; (3) providing cooperation, assistance and access to persons authorized to conduct response actions; (4) compliance with information requests and subpoenas of EPA; and (5) providing legally required notices with respect to the discovery of hazardous substances.

Some of the elements of the continuing obligations are clear, such as complying with information requests and subpoenas, because there was a pre-existing statutory obligation regarding this element. But others, in particular the requirement to take "reasonable steps with respect to hazardous substances," leave wide discretion. Given the lack of case law regarding what is actually required under many of the continuing obligations, a landowner seeking to rely upon one of these three defenses is left with substantial uncertainty about what, if anything, it must do to comply. Moreover, the requirement raises the possibility that compliance could be quite costly.

The relationship among the various defenses and the elements of each are very confusing. The attached chart is helpful in clarifying both relationships and elements.

Other Environmental Liabilities

Onsite conditions may give rise to regulatory liabilities under environmental laws other than Superfund. These liabilities include potential costs to comply as well as fines and injunctive relief for noncompliance. Examples include:

- Section 7003 of RCRA, which imposes liability on, among others, owners and operators of contaminated property;
- National Emission Standards for Hazardous Air Pollutants ("NESHAPs") for asbestos pursuant to the CAA, which impose on building owners and operators significant regulatory requirements relating to building demolition or renovation and OSHA, which imposes requirements on

employers to create working conditions that prevent or regulate exposure to hazardous substance generally and asbestos in particular;

- the RCRA underground storage tank ("UST") program, which imposes significant regulatory requirements on present and past owners and operators of underground storage tanks, and the analogous state program, some of which also apply to above ground storage tanks as well as USTs;
- section 6(e) of TSCA, which is the statutory basis for EPA's program for polychlorinated biphenyl ("PCB") regulation;
- the Residential Lead-Based Paint Hazard Reduction Act of 1992, which imposes disclosure requirements relating to the presence of lead-based paint in housing units;
- lead in drinking water regulation, under the Safe Drinking Water Act; and
- vapor migration.

The presence of hazardous substances, asbestos, lead paint, lead in drink water, USTs, or PCBs, as well as radon and indoor air pollution including the presence of mold, and the potential for vapor intrusion affect property value and may give rise to liability under contract and tort theories. Common law actions may involve third parties, such as toxic tort litigation – brought by adjacent residents or property owners, invitees, or employees – or property damage, or diminution in value claims – brought by adjacent or possibly successive landowners.[3]

Development Issues

Onsite conditions affecting Brownfields may include not only conditions that the government is seeking to protect public health and the environment from, but also conditions that the government is seeking to protect. These "good" conditions may trigger environmental regulatory programs that may result in impediments to development.

Some of these programs directly restrict land use, e.g., section 404 of the Clean Water Act (CWA), which requires permitting as a prerequisite to the placement of dredged or fill materials in waters of the United States, and the Endangered Species Act, which may prohibit development that adversely affects endangered species. On the local level, many cities have watershed protection ordinances that significantly affect development. Other state and local programs may restrict the withdrawal of groundwater and its availability for developmental purposes. The

[3] Although CERCLA does not establish private causes of action in tort, it does establish an exception to state statutes of limitations for cases involving hazardous substances. CERCLA trumps more conservative state statutes of limitations, and establishes as the commencement date for the running of limitations the date the plaintiff knew or reasonably should have known that the hazardous substance involved caused or contributed to the personal injury or property damage. 42 U.S.C. § 9613(g)(1). The Sct. Supreme Court recently addressed this provision in *CTS Corp. v. Waldburger* (2014).

review required by these programs also may result in delay and in the exacting of regulatory concessions by agencies in exchange for necessary approvals.

Superfund and other programs relating to on-site conditions may create de facto and, in some instances, de jure restrictions on land use, *e.g*., prohibitions on the use of ground water or continuing obligations to monitor its quality. Both federal and state Superfund programs also empower the government to impose a lien on remediated sites to secure payment of governmental costs in dealing with the site.

Pollution programs may restrict land use indirectly. Under the Clean Air Act, certain types of construction of new sources of air contaminants may be restricted based on the air quality of the region in which the property is located. Restrictions on existing sources of air contaminants also may affect the viability of a particular use. Similarly, under the CWA, discharges into watercourses may be restricted because of water quality limitations, which affect the uses available for property with wastewater discharge needs.

Brownfield site developers should factor these programs into their planning. The regulatory requirements associated with these programs may create opportunities for delay and public involvement, as well as giving rise to additional costs.

Methods of Addressing Brownfields Related Issues

Environmental Due Diligence

By conducting an investigation, the purchaser can identify and manage potential liabilities. The seller can also benefit from the environmental investigation by determining if significant problems exist that would affect property value.

From the perspective of both a seller and a purchaser, on the one hand, and a lessor and lessee, on the other, an investigation is also beneficial for other reasons: for sellers, to prevent subsequent claims asserting pre-existing contamination or to address problems of which the seller may be unaware; for lessors and lessees, to establish a baseline to preclude later arguments by the other party that it has caused or contributed to on-site contamination. In addition, an environmental investigation satisfying AAI in accordance with 40 CFR Part 312 and/or ASTM E-1527-13, generally comprising what is commonly referred to as a Phase I, is a prerequisite to the purchaser taking advantage of the BFPP defense under Superfund.[4]

[4] AAI also is a prerequisite to the contiguous land owner defense and the innocent owner defense, neither of which are particularly useful. *See* "Third Party and Transaction-Related Defenses of CERCLA: an Overview," J. Civins, M. Mendoza and C. Fernandez, Environmental Litigation and Toxic Torts Subcommittee Newsletter, Vol. 7, No. 1, July 2005, Section of Environment, Energy and Natural Resources, American Bar Associations. With regard to each of these three transactional defenses, there are two other prerequisites to satisfy, that is, specified continuing obligations and "no affiliation."

From the purchaser's perspective, it may be helpful to be able to perform intrusive sampling, but from the seller's perspective, there are concerns with potential damages to the property, with liability for offsite disposal, and with the possibility of obtaining information that may adversely affect the value of the property and create regulatory obligations. An access agreement is especially important if intrusive sampling is to be performed.

The scope of the investigation depends on the nature of the property and the nature of the transaction. The objective of a Phase I is to identify recognized environmental conditions or RECs – the presence or potential presence of hazardous substances or petroleum and, often, to satisfy AAI.

A Phase I may raise questions as well as answer them. For example, the finding of a REC may identify a potential problem that will require follow up in the form of a Phase II. A Phase II involves intrusive sampling, e.g., of soil or ground water, to determine whether there is, in fact, a condition of concern and, if so, possibly its scope. Even further investigation may be necessary to quantify the value of the concern, e.g., the cost of remediation.

A Phase I and any follow-up Phase II will not address many other conditions that may also be relevant, *e.g.* , asbestos (in structures), lead based paint, lead in drinking water, radon, wetlands, endangered species, cultural resources, health and safety, indoor air quality, including mold, flooding, faulting, or stormwater runoff. To address these concerns, consideration should be given to expanding the scope of the Phase I.

For ongoing operations, the investigation should include a compliance audit to identify and be able to correct any ongoing noncompliance that could create liability for the purchaser beginning on day one. In Texas, for example, an audit performed under the Texas Environmental Health and Safety Audit Act,[5] even if performed post-closing, can give a purchaser immunity from administrative or civil penalties for identified violations provided its prerequisites are met, *e.g.*, providing notice of audit, disclosing violations, and reasonably promptly addressing them. For lessors, the opportunity to conduct periodic environmental assessments and audits is important to insure that on-site problems are not being created.

Deal Structure

A basic question in drafting an agreement relating to a real estate transaction is how to structure the transaction. Pertinent considerations include the structure of

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See "Superfund's Transactional Defenses and the No Affiliation Prerequisite," 239 Envtl. Due Diligence Guide (BNA) 231:2321, January 2012.

[5] Tex. Rev. Civ. Stat. Ann. Art. 4447cc.

the acquiring entity and the type of real estate transaction, e.g., purchase or lease/purchase option.

Basic corporate principles of liability should be carefully considered when purchasing a property. For example, because the costs associated with on-site contamination may far exceed the value of the property and because liability may attach solely by virtue of ownership, a prospective purchaser of property with environmental concerns should consider structuring the transaction to limit liability to the value of the investment by creating a corporation, limited partnership or other corporate entity to insulate the buyer from that liability.

Most real estate transactions are structured as asset purchases, where title to property passes from one entity to another. In general, the purchaser of assets does not acquire the liabilities of its seller unless he explicitly agrees to assume them.[6] On the other hand, if the real estate transaction is effected through the purchase of the company owning the real estate, the liability of the acquired company, as well as the environmental condition of its assets must be considered. These additional liabilities include both those associated with the acquired company's formerly owned or leased properties and those arising from the acquired company's past disposal practices, as well as past instances of environmental noncompliance. These types of liabilities can be particularly difficult to identify and quantify. Even where the parties are intending to avoid these risks through an asset purchase, attention should be paid to the possibility of successor liability, based on traditional and evolving theories, including de facto merger, mere continuation, or continuing business enterprise, and the transaction should be structured to minimize those indicia upon which courts have relied to impose successor liability.

An environmental issue need not be an insurmountable hurdle in a real estate transaction. In some cases, where the seller plans to transfer a contaminated property after undertaking cleanup, an option-purchase agreement may prove useful. From the purchaser's perspective, requiring cleanup as a precondition to transfer also causes the seller to be liable for any problems that arise as a result of off-site disposal of contaminated materials from the remediation. Another alternative for both seller and purchaser is the lease/purchase option. This option allows not only time to evaluate the property prior to assuming ownership and associated liabilities, but also access to the property for other uses that may not create liability.

Contract Provisions

Once the deal structure has been addressed, environmental risks are further managed through specific contractual provisions. For example, the parties need to be able to take the results of any environmental due diligence into account, e.g.,

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[6] *United States v. NCR Corp.*,2011 WL 6987813 (E.D. Wis., Dec. 19, 2011).

in terminating the agreement, in adjusting the purchase price or providing for an escrow or in otherwise modifying the structure or the provisions of the deal. Other provisions for managing environmental issues include definitions, reps and warranties, covenants, conditions of closing, post-closing obligations, indemnities, survival, and insurance.

Superfund Defenses

As noted, there are a number of defenses available under Superfund, with the caveat that these defenses will not protect from liability under other statutes or the common law. For municipalities that acquire by eminent domain or tax foreclosure, the ILO defense is available without performing AAI though it is prudent to perform it nevertheless – to understand the risks being acquired. For purchasers generally, the BFPP defense is available, predicated on, among other things, the performance of AAI, the purchaser having no affiliation with the party responsible for the contamination, and satisfaction of the continuing obligations.

Prospective Purchaser Agreements

Before the 2002 Brownfield Amendments, EPA would enter into so-called prospective purchaser agreements, contractually releasing a prospective purchaser from Superfund liabilities in exchange for commitments to satisfy certain obligations, which generally were consistent with the transactional defense continuing obligations. Since 2002, EPA is less inclined to enter into such agreements, because of the availability of the transactional defense, but, under certain circumstances, still will. See Memorandum from Barry Breen to Superfund Senior Policy Managers and Regional Counsels regarding BFPP and the New Amendments to CERCLA (May 31, 2002).

Brownfields cleanup and liability protection programs

Many states have Brownfields remediation programs that allow property owners to remediate to risk-based clean up levels and obtain state approvals of that clean up and, in some states, releases from liability. Other programs allow property owners to obtain state certification that they are not responsible for contamination, e.g., if it is from an offsite source. The required cleanup under these programs generally depends on whether there are to be institutional controls, e.g., restrictions on property use or use of groundwater for potable purposes, or engineering controls, e.g., maintenance of a cap. In general, properties with these types of controls do not need to be cleaned up as stringently as do properties intended for unrestricted use, e.g., residential as well as commercial and industrial.

Audit Immunity Statutes

As noted, some states have statutes that afford immunity for violations uncovered during a systematic audit. In these states, prospective purchasers as well as owners of properties with ongoing operations may obtain protection against fines and penalties. See A Guide to the Texas Environmental, Health, and Safety Audit Privilege Act, TCEQ Office of Legal Services--RG-173 (Revised Nov. 2013).

Insurance

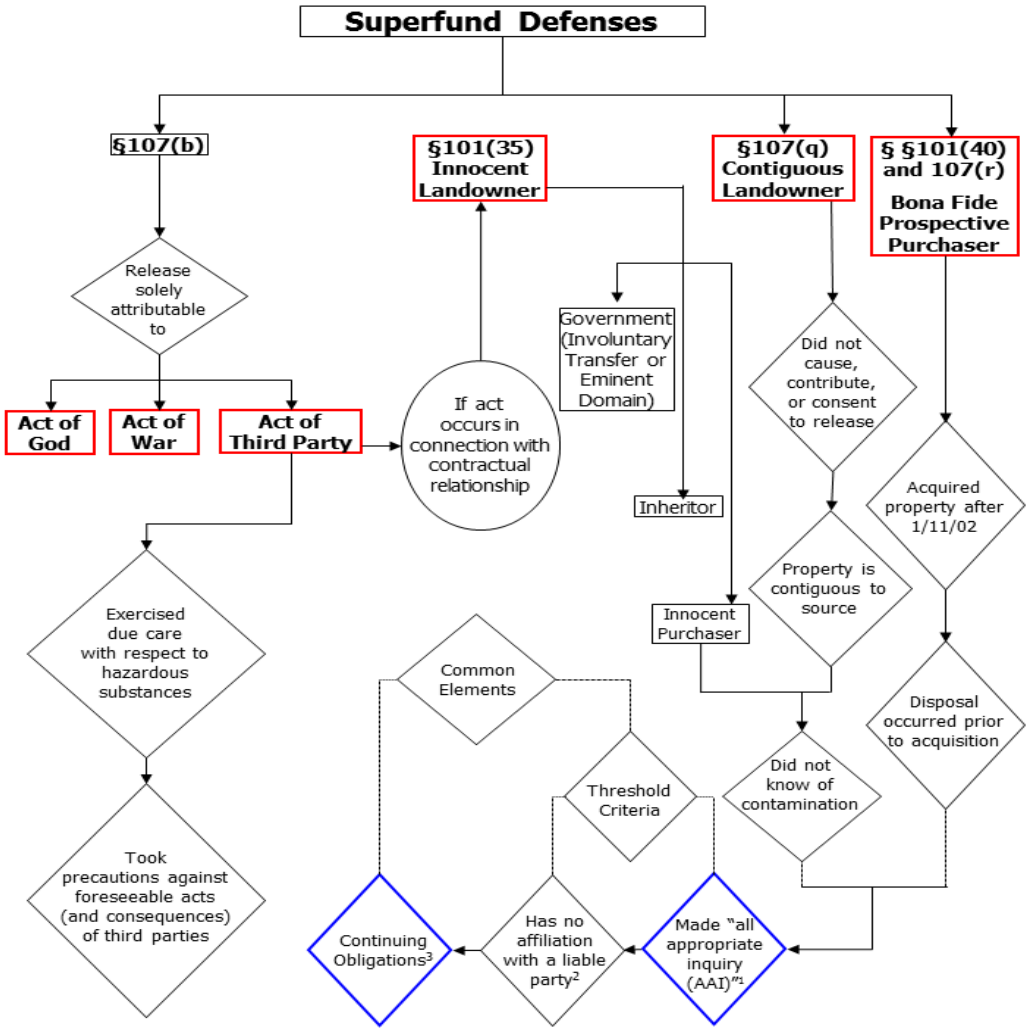
As noted in the other presentation in this panel, environmental insurance is available to mitigate risks associated with contamination. These policies may cover costs of investigation and remediation, as well as tort claims, and first party as well as third party claims. Cost cap coverage also is available for addressing risks associated with a cleanup being more costly than anticipated.

Liability Transfer

A number of companies are willing to negotiate liability transfers for contaminated properties, which is a viable option for quantifying risks associated with environmental cleanups. These policies may cover costs of investigation and remediation and first party as well as third party claims. Cost cap coverage also is available for addressing risks associated with a cleanup being more costly than anticipated.

Conclusion

Brownfield sites often are in locations that make them particularly valuable for redevelopment, near transportation, utilities, and industry. For that reason, they are particularly attractive to municipalities seeking to revitalize their urban cores. Although the fact that these properties have contamination poses obstacles to development, these obstacles can be made more manageable by the performance of appropriate due diligence and use of a number of contractual and extra-contractual risk management tools.



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1 *AAI equates to "had no reason to know." AAI rules are codified in 40 CFR Part 312, which are satisfied by ASTM E1527-05.*

2 *The no affiliation requirement applicable to contiguous land owners and bona fide prospective purchasers does not apply to innocent purchasers, but innocent purchasers do need to satisfy the contractual relationship test of the third party defense.*

3 *Continuing obligations include: (1) comply with land use restrictions and not impede institutional controls; (2) take reasonable steps regarding hazardous substances on property to stop and prevent releases and prevent or limit exposure; (3) cooperate and provide assistance and access to person authorized to conduct response; (4) cooperate and provide assistance and access to person authorized to conduct response; and (5) provide required notices with respect to the discovery of hazardous substances. See ASTM E2790-11.*

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