

DB FEATURE

Environmental Audits For Real Estate Purchases: A Quick Trip Through The Mine Field

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Business is good. Sales are increasing every year. You're adding employees, and the plant is running two shifts. You're out of space and have to move.

Eventually, you find an old manufacturing or industrial site that sat vacant for several years. It's perfect. You negotiate a purchase price, close the deal and move in.

You may have just bought yourself a major environmental liability.

Today, purchasing commercial real estate means more than just ensuring that the seller's title is clear. A purchaser must also assess and allocate the risk of potential environmental liabilities associated with commercial industrial, or agricultural property being acquired. Environmental statutes like CERCLA (the Federal Comprehensive Environmental Response, Compensation and Liability Act) contain liability provisions that indirectly impose a burden on purchasers of real estate to conduct all appropriate inquiries into the previous ownership and use of the property under consideration. Feigning ignorance about contamination that exists on a piece of commercial property — or arguing that you did not cause the contamination — is not enough to absolve a landowner of liability under CERCLA.

Accordingly, an environmental assessment is important to realtors, purchasers, tenants, lenders and attorneys who want to know that the properties in which they have an interest are free from environmental hazards. As the purchaser, you should take the appropriate steps to determine whether environmental hazards exist. A Phase I Environmental Assessment ("Phase I") or due diligence review, through inquiry and assessment, effectively reduces risk and avoids acquiring interests in environmentally "impaired" properties. The Phase I provides an objective, independent and professional opinion of what potential environmental risks are associated with the property. This assessment is usually performed by a reputable environmental engineering consultant. Your attorney, not you, should hire the consultant. This way, if litigation ever develops, your Phase I results can be kept confidential under the attorney work product doctrine, if you so choose.

A Phase I gathers historical information regarding the property from the EPA, DER,

local planning commission, other federal, state or local agencies, historical records of the property, reports, permits or maps. Records are scanned for any environmental history associated with the property such as spills, past hazardous activities and state or federal CERCLA (or "Superfund") sites located near (usually within one mile) the property. The hydrogeologic make-up of the property (soil, depth and ground water flow directions) is also examined.

A physical inspection of the property is another aspect of a Phase I. During the inspection, the environmental consultant reviews the operations occurring on the property. He or she also conducts employee interviews to glean information about practices in dealing with hazardous or toxic materials. Buildings are assessed for asbestos and PCBs. The consultant also studies: fuels stored on the property including type, classification and quantity, and hazardous materials and/or waste stored or used at the site; current as well as past waste disposal practices; obvious spill or leak areas; and the existence of on-site wells or borings on the property.

After a thorough review of the site, a written report is submitted to your attorney by the environmental consultant. If the Phase I report indicates the possibility of environmental contamination, a Phase II Environmental Assessment ("Phase II") is necessary. A Phase II requires a more detailed review of the property and includes analysis of soil and water samples taken from the property itself. This review will either resolve any uncertainty concerning environmental liability or quantify the extent of such liability. The results of Phase I and Phase II environmental assessments are often used in negotiating the final price or terms of a contract of sale for property. The objective in negotiation is to allocate the risk for environmental liability between the parties. There are alternative ways to accomplish this.

Warranties

By including warranties in the agreement of sale, the seller may represent that the seller's records of hazardous and toxic materials used on the property are complete and accurate; that environmental permits are in place and freely transferable; and that there are no outstanding notices of

violations or enforcement actions involving the property. If possible, these warranties should extend beyond the final closing date of the sale agreement. However, in most cases, the seller will resist either including warranties in the first place or allowing them to extend beyond the final closing date of the agreement. This is a negotiating point to be worked out between the parties.

Indemnification

Indemnification clauses shift the risk from the purchaser back to the seller. The seller of the property indemnifies the purchaser for any clean-up costs incurred. Indemnification agreements will not reduce the liability of the prospective purchaser with regard to environmental statutes like CERCLA, but will provide a basis for recovery against the seller. Indemnification agreements can include establishing a bond or escrow account for prospective clean-up costs.

A word of caution: an indemnification agreement is only as good as the financial stability of the seller. When negotiating such indemnification agreements, the prospective purchaser must carefully consider the financial viability and long-term prospects of the seller. (This is where requiring a bond or escrow account makes good sense.)

Insurance

One way to protect yourself from environmental liability is through "First Party Pollution Cleanup/Environmental Remediation Insurance." The seller pays for the coverage. The purchaser is the insured or "First Party." This type of coverage, however, is only for a limited period of time. Further, this coverage only covers clean-up costs that are required to comply with a government mandate to clean-up the property. Of course, the seller will balk at providing such insurance because the premiums are expensive. If such coverage is acquired, make sure that defense costs and third party liability coverage (for damages to other property) are specifically provided for in the policy. Lenders will also want to be sure they are named as additional insurers. While this type of insurance is expensive and limited in its duration, it provides a higher degree of certainty than an indemnification agreement that funds will be available if needed for environmental clean-up.

Creativity is a must in negotiating environmental issues in real estate transactions. For instance, to avoid the necessity of insurance, indemnities or warranties, you may want the seller to remediate the site by removing hazardous waste and nonhazardous waste requiring a removal permit. The purchase price can be adjusted to reflect the

environmental hazards. Or you can ask the seller to delete contaminated land from the sale.

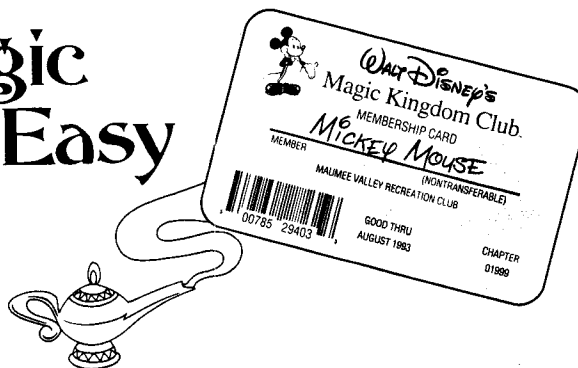
The purchase of commercial real estate is a mine field for the unwary. A purchaser of commercial real estate should seek assistance of an attorney knowledgeable in environmental law to assist with the environmental portions of the sales agreement. **EB**



Editor's Note: Rhoda Shear Neft and R. Damien Schorr are members of the firm of J.D. Hull & Associates, P.C. The firm practices in Pittsburgh and Washington, D.C. in the areas of environmental law, natural resources law, commercial litigation, general business, taxation, estate planning, white collar criminal law, administrative law, appellate practice and lobbying. An earlier version of this article appeared in the March 22, 1995 issue of the Pittsburgh Legal Journal.

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