Session 204

# Limiting Liability in Business and Real Estate Transactions

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Session 204: LIMITING LIABILITY IN BUSINESS AND REAL ESTATE TRANSACTIONS



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# LIMITING ENVIRONMENTAL LIABILITY IN BUSINESS AND REAL ESTATE TRANSACTIONS

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I. Real estate transactions

a. Summary of liabilities relating to hazardous substances

1. Liability for cleanup of real property

The Federal model: The Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA" or "Superfund").

a) The owner and/or operator of a facility from which there is a release or threatened release

b) The former owner and/or operator of the facility at the time of disposal of the hazardous substances

c) The person who arranged for the disposal of hazardous substances

d) The person who transported the hazardous substances to the facility, if that person selected the facility

Defenses

Limited to where the release of threatened release and the resulting damages were caused solely by an act of God, an act of war, or an act or omission of a third party where the following conditions exist:

a) The person asserting the "third party defense" can show that he or she exercised due care with respect to the hazardous substances and took precautions against foreseeable acts or omissions of any such third party.

b) The "third party defense" does not apply if the third party is an employee or agent of the person asserting the defense, or if the third party is one whose act or

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omission occurs in connection with a contractual relationship with the person asserting the defense.

c) A document transferring title to real property is not deemed a "contractual relationship" where the transferee did not know of the disposal of hazardous substances on the property and he or she took, at the time of acquisition, all appropriate inquiry into he previous ownership and uses of the property. 42 U.S.C. §§\9607(b)(3),9601(35).

Other primary federal statutes:

Resources Conservation and Recovery Act ("RCRA"), 43 U.S.C. §§\6901 et seq. -Imposes corrective action requirements on permitted facilities. Also authorizes injunctions against owners, operators, generators and transporters to compel cleanups where solid or hazardous waste may present and imminent and substantial endangerment to public health or the environment.

Federal water Pollution Control Act ("FWPCA" or "Clean Water Act"), 33 U.S.C. §§\1251 et seq. - Authorizes government cleanup actions for discharges of hazardous substances and oil on navigable waters, and authorizes suit against the owner or operator of the source of the discharge.

Toxic Substances Control Act ("TSCA"), 15 U.S.C. §§\2601 et seq. - Imposes requirements for the management of in service PCBs. Establishes asbestos programs for schools and other public buildings.

Primary California statues:

California Superfund, Health & Safety Code §§\25300 et seq. - Imposes liability for the costs of responding to hazardous substance releases upon the same persons that are liable under federal Superfund, but contains provisions for allocation of costs.

Hazardous Waste Control Law, Health & Safety Code §§\25100 et seq. - Authorizes the Department of Toxic Substances Control to order owners, operators, transporters, generators and handlers of hazardous waste to undertake

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cleanup actions where violation of waste disposal law has occurred, and, in certain circumstances, authorizes the government to conduct the cleanup itself and recover its costs against such persons.

Porter-Cologne Water Quality Control Act, Water Code §§\13000 et seq. - Authorizes regional water quality control boards to order dischargers (including property owners) to cleanup discharges of wastes (whether or not such wastes are "hazardous wastes") to surface and groundwaters that create or threaten to create pollution or nuisance.

2. Third party suits for personal and property damages

A purchaser of property which is the source of ground water contamination can be held liable for damages caused by contaminated ground water which continues to migrate offsite after closing.

Query whether purchaser can be held liable for damages caused by contaminated ground water that has migrated from upgradient lands into the property and then further migrated to downgradient properties.

3. Protection for construction workers and future occupants

Occupational safety and training laws may require special training for construction workers who may contact contaminated soils or ground water.

Vapor extraction or vapor barriers may be required in the foundation to prevent migration of volatile chemicals into the new building.

4. Treatment of contaminated ground water

If dewatering of excavations is necessary during construction, contaminated ground water will need to be treated by a temporary treatment system.

If long term dewatering is necessary due to the depth of the basement or foundation, construction of a permanent treatment system may be necessary to meet NPDES permit requirements.

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5. Ability to obtain financing

   Lenders may not be willing to provide loans for the purchase of contaminated properties, and may not be willing to accept such properties as collateral on loans.

6. Decline in property value

   Owners of properties that have been contaminated by others often sue, contending that the existence of the contamination significantly lowers property value.

   A recent suit in Santa Clara Valley suggests that the presence of ground water contamination within one mile of property may diminish the value of the property.

7. Obligation to close or upgrade underground storage facilities

   Both the federal government and California have laws requiring that existing underground tanks be upgraded with monitoring systems and other spill protections. Both programs require abandoned tanks to be sealed in place or removed. Sampling is required at the time of closure or removal to ensure that spills have not occurred. 40 C.F.R. Part 280; Health & Safety Code §§\25280 et seq.

8. Restrictions on construction or sale until sampling and cleanup are performed

   "Hazardous waste property" and "border zone property" law, Health & Safety Code §§\25220 et seq. -Requires notice to the Department of Toxic Substances Control if certain types of construction are planned within one year on land on which there is probable cause to believe that there has been a significant disposal of hazardous waste, or on land within 2000 feet of a significant disposal of hazardous waste.

   Maher Act, San Francisco Public Works Code, Article 20 - Applicants for building permits for excavations of more than 50 cu. yds. of soil in designated areas of the city must (1) prepare site history and (2) sample the soil for wide range of hazardous wastes. Site mitigation required before permit may issue.

   "ECRA" laws (e.g. Environmental Cleanup Responsibility Act (ECRA), adopted by New Jersey) - Requires the seller of an

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industrial facility to secure from the state either a declaration that the facility is clean or approval of a cleanup plan.

9. Warning and disclosure requirements

Proposition 65 - Any person who exposes any individual to a chemical listed by the state as a carcinogen or reproductive toxin must give a "clear and reasonable" warning to that individual.

10. Disclosure of releases of hazardous substances:

Health & Safety Code §\25359.7 - "Any owner of nonresidential real property who knows, or has reasonable cause to believe, that any release of hazardous substance has come to be located on or beneath that real property shall, prior to the sale, lease, or rental of the real property by that owner, give written notice of that condition to the buyer, leases or renter of the real property," (Similar provisions applicable to lessees and renters.)

Broker's duty to conduct visual inspection, Civil Code §\2079 - applicable to residential real property comprising one to four units.

Real Estate Transfer Disclosure Statement, Civil Code §\1102.6 - Seller must state whether it is aware of any substances, materials or products which may be an environmental hazard.

Common law disclosure obligations - Intentional misrepresentation and negligent misrepresentation.

11. Asbestos investigation and warning requirements:

Good faith effort required to determine if asbestos is present before undertaking asbestos-related work. Cal. Labor Code §\6501.9

OSHA regulations require testing and notice where there is possibility of low concentrations of airborne asbestos. 8 Cal. Code of Regulations §\5208; see also Cal. Labor Code §§\6503.5, 6501.5.

The owner (defined to include lessees) of any building constructed prior to 1979 must provide notice to his or her

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employees, contractors, lessees and other co-owners of the existence of asbestos-containing materials. Cal. Health & Safety Code §§\25915 et seq.

Notice to air districts and EPA required before certain demolition and renovation projects involving asbestos containing construction materials. See 40 C.F.R. §\61.145; Bay Area Air Quality Management District, Reg. 11, Rule 2.

12. Permits and submissions to environmental agencies

Federal, state, and local laws may require permits for air emissions, for storage of hazardous substances, and for discharges of pollutants. Permits may not be transferable, and permit applications or notices necessary to transfer or reissue permits may be required prior to closing to ensure that a facility can operate immediately after closing.

13. Other hazardous material issues: lead, radon, water quality, electromagnetic fields, sick building syndrome (e.g., ventilation, formaldehyde)

b. Other environmental liabilities

1. Wetlands

2. Endangered species (Appendix A)

3. Land use issues (NEPA, CEQA)

c. Role of inhouse counsel

1. Scope range of potential liabilities

2. Scope due diligence (see I.d.1. below)

3. Contracts with environmental consultants

4. Develop structural options in view of information generated during due diligence

5. Develop procedural options for cooperation between parties and for dispute resolution

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6. Comprehensive contract provisions regarding potential liabilities

7. Process for contract management and future legal problems

    a) Tracking of obligations
    b) Periodic checks
    c) Reporting to government agencies

8. Establish privileges where appropriate (Appendix B)

d. Contractual mechanisms to limit liability

1. Environmental assessments

    a) Factors determining scope of assessment

        1) Structure of transaction
        2) Whether compliance with environmental laws as well as potential liabilities due to releases will be covered
        3) Level of materiality
        4) Cost
        5) Statutory standards for due diligence (42 USC 9601(35)(B))

    b) Confidentiality and timing

        1) Buyer and seller should agree in advance regarding government agency contacts, the confidentiality of the assessment, and reporting obligations if a release is discovered
        2) Purchase agreement should cover assessment
        3) Consider phasing assessment with stages of transaction
        4) Establish attorney client relationship early
        5) Make requests for government records early

2. Structural options

    a) Lease versus ownership
    b) Asset purchase versus stock purchase
    c) Surface easements
    d) Parcel divisions
    e) Establish new corporation for problem property
    f) Option to purchase

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3. Representations and warranties – should specifically address environmental conditions; avoid general reps and warranties. Consider following issues:

    1) Possession of permits necessary to operate
    2) Compliance with all applicable laws
    3) No pending or threatened litigation, administrative proceedings, or investigations
    4) Condition of property, facilities and subsurface with respect to specific environmental conditions
    5) Knowledge group
    6) Survival period of reps and warranties
    7) Conditions due to third parties
    8) Matters of record or that could be discovered through due diligence

4. Indemnification provisions – Issues:

    1) No protection against government action
    2) Need solvent indemnitor
    3) Past liabilities
    4) Financial assurances
    5) Administrative and injunctive actions
    6) Cost thresholds
    7) Control of defense and remediation
    8) Time limitation for claims

5. Conditions to closing

6. Escrow accounts

7. Letters of credit

e. Government mechanisms to limit liability – See III

II. Acquisition of operations

a. Determine adequacy of environmental management systems (Appendix C)

b. Audits

1. Waste systems
2. OSHA records

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3. Environmental recordkeeping
4. Hazardous material storage systems
5. Hazardous material handling
6. Operational permits

c. Create bright line between exposures occurring under past and new ownership

III. Government Approaches to Liability in Transactions

a. Roles, Responsibilities & Capabilities of Environmental Protection Agencies

b. Historical Paradigm- Laws of Unintended Consequence?

1. CERCLA & RCRA: Crises Beget Crisis Management

2. Greenfield Demise & Hazardous Waste Museums

c. Reevaluation and Readjustment of Environmental Protection Tools: Information, Structure & Resolution

1. CERCLIS meets Due Diligence

2. Cleaning Up Cleanups

a) Considering Land Use in Remedy Selection

b) Remedy Guidance & Review

c) NPL Deletions, Partial Deletions & Clarifications

3. Liability Issues

a) Lender & Fiduciary Liability Changes

b) Comfort & Cold Comfort Letters

c) Settlements

1) Prospective Purchaser Agreements & Consent Decrees

(i) Scope & Limitations

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(ii) Settlement Cost

(iii) Successor Benefits

2) De Minimis & De Micromis Settlements (Owner & Generator)

3) State of the Law on Successor Liability

4. Resolving Issues Uncovered in Due Diligence

1) Incentives for Self-Policing: The Audit Policy

2) The Level Playing Field: Components of EPA Penalties & the Benefit of Non-Compliance

3) Confidentiality

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## Appendix A

### Federal Endangered Species Act ("FESA")

A. Basic Mechanisms

1. Prohibits "taking" of an endangered species
2. Requires federal agencies to undertake "consultation" process to ensure that actions they authorize or fund are not likely to jeopardize the existence of any listed species or result in the adverse modification of any designated critical habitat.
3. Administered by U.S. Fish & Wildlife Service (Dept of Interior) and National Marine Fisheries Service (Dept of Commerce)

Note: focus has shifted from direct taking (eg., trapping) to indirect taking by habitat destruction.

B. Definitions

1. Endangered species - "any species which is in danger of extinction throughout all or a significant portion of its range".

2. Threatened species - "any species which is likely to become an endangered species within the foreseeable future throughout all or a significant portion of its range."

C. Listing - substantive grounds

F&W can list a species as endangered or threatened on the basis of any one of the following five factors:

1. The present or threatened destruction, modification, or curtailment of its habitat or range;
2. Over-utilization for commercial, recreational, scientific or educational purposes;
3. Disease or predation;
4. Inadequacy of existing regulatory mechanisms;
5. Other natural or man-made factors affecting its continued existance.

Determination made "solely on the basis of the best scientific and commercial data available.

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D. Listing - process

1. Petition by F&W or by any "interested person" - must provide "information sufficient to indicate that addition to, or removal from, the list may be warranted and, thus, that a status review of the species should be conducted.
2. Review of species' status

    a. 12 month period unless listing on emergency basis
    b. Ends with decision that action is warranted, not warranted or precluded

3. Judicial review under arbitrary and capricious standard

E. Consultation process (Section 7)

1. Applicable only where project involves a federal agency
2. Four steps (absent emergent circumstances)

    a. Lead agency asks if any proposed or listed species is in the area of the proposed action;
    b. Lead agency conducts biological assessment re whether the action is likely to jeopardize the species' existence or adversely modify a critical habitat. If so, consultation with F&W is required.
    c. F&W prepares a biological opinion identifying the effects and suggesting alternatives to avoid adverse impacts.
    d. If no alternative, the lead agency cannot permit project unless the Endangered Species Committee (God Squad) grants an exemption. Exemption allowed if the benefits of the action "clearly outweigh the benefits of each considered alternative course of action [consistent with conserving the species.]"

Note: As practical matter, private party applying for permit or other action from federal agency must prepare study identifying presence or absence of a listed species.

F. Taking prohibition (Section 9)

1. Direct takings (wound or kill) and indirect takings (harm or harass) prohibited

    a. Indirect harm cases

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1) Sierra Club v. Lyng - Decline of woodpecker population ranging from 22% to 76% on lands managed by US Forest Service in less than 10 years constitutes taking.
2) Sweet Home - Habitat modification must actually kill or injure wildlife by significantly impairing essential behavioral patterns such as breeding, feeding or sheltering.

2. Section 10 "incidental takings" permit

a. F&W may issue where it finds that (1) applicant mitigated impacts of taking to maximum extent practicable, (2) adequate funding for the plan will be provided, and (3) the taking will not appreciably reduce the likelihood of survival and recovery of the species.
b. Prospective permittee must submit habitat conservation plan specifying (a) likely impacts from the taking, (b) steps to mitigate impacts, (c) funding to implement mitigation, (d) alternatives to the taking, (e) reasons for not adopting alternatives, and (f) other measures that F&W may require.

Note: generally takes a year to get a permit.

**California Endangered Species Act**

A. Basics

1. Modeled after the federal law.
2. Administered by the Fish and Game Commission ("Commission") and the Department of Fish and Game ("Department")

B. Listing process

1. "Interested person" submits petition to Commission, and DFG evaluates whether the petitioned action "may be warranted" (Creates "candidate species").
2. DFG has 12 months to provide the Commission with a written report indicating whether, based on the best scientific information available to DFG, listing the species as endangered or threatened is in fact warranted.
3. Commission makes final determination whether to list.

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C. Consultation process

1. State agencies must consult with DFG and obtain written determination before taking action that could jeopardize the continued existence of a listed species. If DFG finds project is "likely to jeopardize" the species, DFG must determined reasonable and prudent alternatives.
2. Project can be approved notwithstanding DFG determination if:

   a Specific economic, social or other conditions make alternatives infeasible, and
   b. Reasonable mitigation and enhancement measures are added to the project, and
   c. The lead agency finds that the benefits of the original project (with mitigation and enhancement) "clearly outweigh" the benefits of the alternatives, and
   d. The lead agency finds that it has not made an irreversible commitment of resources to the original project that forecloses its ability to implement the alternative.

D. "Take" prohibition

1. May not apply to indirect takings
2. Prohibition extends to candidate species as well as listed species

E. Coordination - Permission for incidental take of federal and state listed species may require both Section 10(a) permit from F&G and Section 2081 agreement from DFG

F. California Natural Community Conservation Planning (NCCP)

1. Basics

   a. Alternative to singles species approach
   b. Purpose to create land use plans for long term protection of designated habitats while allowing appropriate growth, ie., to prevent listing
   c. Voluntary program requiring collaboration of interests
   d. Does not constitute exemption from CESA or CEQA

2. Process

   a. NCCP can be developed by anyone pursuant to agreement with DFG or by local, state or federal agency.
   b. Still must obtain Section 10 or 2081 permit

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## Appendix B

## Protecting Audits

Prior to conducting audits, mechanisms need to be in place to determine whether it is appropriate to conduct certain audits under an attorney-client or other applicable privilege.

A. Generally: Protection is difficult, so, to the extent possible, written reports should be kept factual and impartial. If document indicates problem, also indicate in same or follow up report that problem has been solved. Include positive conduct.

B. The attorney-client privilege - elements

1. The holder of the privilege is a client.

2. The communication is made to an attorney or subordinate who is acting as a lawyer regarding the communication.

3. The communication relates to a fact of which the attorney was informed by the client, without the presence of strangers, for the purpose of securing a legal opinion, legal services, or assistance in legal proceedings.

4. The communication is not for the purpose of committing a crime or tort.

5. The privilege has not been waived.

C. The attorney-client privilege - applied to audits
Upjohn Co. v United States, 449 U.S. 383 (1981)

1. Upjohn's general counsel, with the assistance of outside counsel, conducted an investigation of alleged payments to foreign governments. Written questionnaires sent to company managers. Mangers instructed by the company to keep the investigation confidential and not to discuss it with anyone other than Upjohn employees who might be helpful in providing the requested information. Court upheld privilege regarding the questionnaires, memoranda and notes of in-house and outside counsel. Factors:

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a. Communications made by employees to counsel, acting as counsel, at the direction of corporate superiors in order to secure legal advice from counsel.

b. Information not available from upper echelon management was needed to supply a basis for legal advice.

c. The communications concerned matters within the scope of the employees' duties.

d. The employees were aware that they were being questioned so that the corporation could obtain legal advice.

e. Pursuant to explicit instructions of the Chairman of the Board, the communications were considered "confidential" when made and had been kept confidential by the company.

f. The underlying facts were otherwise available to the government, which had the opportunity and resources to interview the same employees.

2. US v Chevron USA, 1989 WL 121616 (ED Pa, 1989) -Civil penalty action under Clean Air Act for violations of benzene emissions standards. In this case, the government sought disclosure of audit follow-up reports prepared by Chevron's Philadelphia refinery to show that it had corrected problems noted in a company audit. Chevron contended that the privilege applied to the reports because the team that had performed the audit included one of Chevron's environmental attorneys. The court rejected Chevron's claim, however, on the grounds that Chevron had not produced evidence showing that (1) the attorney was participating in a legal, rather than management, capacity; and (2) the company's primary purpose in conducting the audit was to obtain legal advice.

3. In re Grand Jury, 147 FRD 82 (ED Penn. 1992) - Subpoena issued by grand jury to environmental consultant in investigation of alleged violation of hazardous waste laws. Company asserts that its counsel, which was hired to defend the company in administrative proceedings, hired consultant and that the consultants work is protected by the attorney client privilege and as work product. Court finds that the work consisted of preparing a waste management plan that would achieve regulatory compliance for the company's waste disposal practices, not to aid the attorneys in providing legal advice. In support of its decision, the court noted

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that the consultants had met with company officials without the attorney present, that company personnel and the consultant had met with government without the attorney present, and that the attorney's billing records did not show charges for time spent consulting regarding the matter.

4. US Postal Service v. Phelps Dodge Refining Corp., 852 F. Supp. 156 (EDNY 1994) - Documents produced by outside scientific consultants who prepared remediation plan are not privileged although communicated to in-house attorney. First, plan not prepared to assist attorneys in providing legal advice. Second, factual data gathered by consultants is not privileged because it does not come through client confidences. "There are few, if any, conceivable circumstances where a scientist or engineer employed to gather data should be considered an agent within the scope of the privilege since the information collected will generally be factual, obtained from sources other than the client.

   Draft documents with in-house counsel's notes are privileged if they contain information a client considered but decided not to include in the final version. If information included in the final version, then disclosure to third parties constituted waiver of privilege.

   Internal corporate communications that were circulated to attorneys and non-attorneys are not privileged because their dominant purpose was not to obtain legal advice, i.e., they would have been created even if the attorney had not been included as a recipient

5. Olen Properties Corp. v. Sheldahl, Inc., 1994 WL 212135, 24 Env. Law Rptr. 20936 (CD Cal. 1994) - Environmental audit prepared by non-attorney is privileged when it is prepared at the direction of counsel to assist counsel in evaluating the corporation's compliance with relevant laws and regulations.

Notes prepared by non-attorney are subject to work product protection because they were prepared to assist counsel in defending specific claims.

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## Appendix C

## Policies and Guidelines Establishing Frameworks for EHS Management Systems

A. Federal Policies

1. In December 1995, EPA issued a policy commonly known as the "Audit Policy" ("Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations," 60 Fed. Reg. 66706 (December 22, 1995). This policy sets forth nine criteria EPA will apply in resolving environmental violations that have been voluntarily discovered and disclosed to the Agency and are promptly corrected (the nine criteria are: Discovery of the Violation Through an Environmental Audit or Due Diligence; Voluntary Discovery; Prompt Disclosure; Discovery and Disclosure Independent of Government or Third Party Plaintiff; Correction and Remediation; Prevent Recurrence; No Repeat Violations; Other Violations Excluded (regarding serious harm or endangerment); and Cooperation). Disclosures that meet the criteria will not be recommended for criminal prosecution, but would be subject to a lessened penalty. Companies that discover the violation through an environmental auditing or systematic compliance management are subject to a penalty equivalent to the economic benefit the violator realized by non-compliance (the "economic benefit" component), if this benefit is substantial. Companies that discover the violation through some other means are subject to a penalty equivalent to the economic benefit plus 25% of the penalty that would otherwise apply (the "gravity" component).

2. Department of Justice Guidance: In July 1991, the Department issued an enforcement policy designed to encourage self-auditing, self-policing and voluntary disclosure of environmental violations. The policy lists certain criteria for internal compliance systems that will be considered mitigating factors in deciding whether to proceed with criminal enforcement.

3. Federal Sentencing Guidelines: These guidelines, adopted at the end of 1991, provide that the penalty or sentence imposed for a crime will be substantially reduced if the defendant company has a "effective" audit and compliance program meeting specific criteria. Although the current guidelines are not directly applicable to environmental crimes, most of the criteria are likely to be included in new guidelines for sentencing in environmental cases. Draft guidelines for environmental crimes were issued in February 1993, but these are on hold.

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B. Federal Sentencing Guidelines: Elements of "Effective" Compliance Programs

1. Corporate standards and procedures: A corporate code of conduct that sets forth specific standards regarding environmental, health and safety compliance must be developed that is designed to address specific problems known to management. The standards should include audit program objectives, and should address the scope, committed resources and frequency of audits. The standard should also make clear conduct that is prohibited and outside employees' scope of work. The standards should be part of the basic training of all employees

2. High-level responsibility: A specific high-level person or persons should have responsibility to ensure that compliance with environmental, health and safety laws and the corporate code of conduct is occurring. A reporting system should be designed such that each officer and upper level manager receives reports on the matters within his or her authority.

3. Maintaining staff integrity: The system should be designed so that persons who have a propensity to disregard regulatory or corporate requirements are not provided significant discretionary authority over regulated operations.

4. Effective communication: Mechanisms must be put in place to document that standards and procedures are effectively communicated to employees.

5. Auditing system: A system must be established to detect violations and to allow employees to report violations without fear of retribution. In decentralized companies, the audit function sometimes is divided into two components: compliance audits, which are detailed audits of operations performed locally; and program audits, which are corporate evaluations of each region's management commitment, staffing and communications. Corporations also may perform periodic evaluations of the audit processes themselves.

6. Consistent enforcement: Appropriate and consistent disciplinary standards must be enforced.

7. Meaningful follow-through: If a violation of legal or corporate requirements is detected, a mechanism is needed for prompt correction, identification of root causes of the problem, and

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systemic changes to prevent future violations. Failure to detect violations also should be considered a failure to meet standards. The follow-through mechanism should include specific procedures for prompt preparation of written reports setting forth audit findings, corrective actions, and schedules for implementation.

C. Other Guidelines

1. ISO 9000 Quality Management Standards/ISO 14000 Environmental Quality Standards.

   a. Privately developed by companies seeking to ensure preferred status.

   b. Designed to assure buyers that supplier has "quality management" incorporated into its work processes, so that "continuous improvement" can be expected.

   c. Elements of ISO 14000 series (partially completed)

      1) Environmental management systems
      2) Environmental auditing
      3) Environmental assessment of sites and entities
      4) Environmental labels and declarations
      5) Environmental performance evaluation
      6) Life-cycle assessment of products and production processes
      7) Environmental aspects in product standards

2. CMA Responsible Care Program

   a. Community communication program
   b. May include upgrading of safety and health protections

3. Economics

   a. 3M - Process modification to reduce pollution

   b. ARCO - Voluntary, prompt cleanup is less costly than regulatory driven, later cleanup

4. Continuous quality improvement

   a. Diverse teams that evaluate work processes

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b. "Environmental Quality Management: A Framework for Pollution Prevention" (1993) - Industry/EDF discussion of demonstration projects involving QM/pollution prevention

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## Exhibit A

### Phase 1 Environmental Assessment

Scope of Work

A Phase 1 Environmental Assessment is a qualitative report designed to identify requirements for additional investigation. Testing of suspect materials is generally not completed in this phase of investigation. All reports submitted for review must be dated and signed by the preparer and an authorized signatory of the Consultant. Though the format of the Phase 1 Environmental Assessment is left to the discretion of the preparer, the following information must be included in the report or an explanation provided as to why it was not included:

1. Site identification.

2. Site and improvement description.

3. City, county and state under whose jurisdiction the project falls. Identify any applicable "Superlien" laws.

4. Current and proposed property use.

5. Inspection of the site and all improvements to identify signs of contamination or improper storage, handling, use or disposal of Hazardous Materials. The site inspection should also note evidence of soil staining, surface spills, odors, liquid breakouts, debris dumping, dead vegetation, containers or drums, etc. Other physical features, such as topography, surface soil characteristics, and surface water flow will be noted during the walk-through.

6. Historical ownership and use of the property dating back to when the property was unimproved, and including any agricultural uses which may have involved pesticides and other hazardous materials. This investigation must include review and analysis of:

* Available historical aerial photographs dating back 50 years to identify historical land use patterns, construction or destruction of buildings, the existence of ponds and disposal areas or other indications of potential environmental contamination. Sanborn maps will be reviewed, if available, to identify past land uses.

* "Chain of title" documents for the past 50 years, evaluating uses by lessees, licensees and easement holders of record. The Chain of Title Report will be ordered by Clients's legal department, at Client's cost, and forwarded to Consultant for additional review and comment.

* Identification of previous owners and operators.

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* Identification of the nature, purpose and handling of any Hazardous Materials used in the past.

7. Review of all applicable regulatory agency files, including without limitation, the National Priorities List (NPL), CERCLIS, State Regional Water Quality Control Board's Hazardous Substances Container Information, Office of Planning and Research Hazardous Materials Sites list, Regional Water Quality Control Board records, and local agency records such as those held by health, building, zoning, planning, sewer, water, fire, environmental and other departments, records that would have information on or have an interest in the property and neighboring sites (collectively, the "Lists").

8. In the event that the Lists review reveals a possible contamination source, a qualified employee or engineer of Consultant shall travel to the agency in question and review the file to determine the nature of the contamination source, the possible direction of flow, the extent of the contamination, the status of any remediation actions, the status of any governmental approvals, etc. (the "Follow-up Work"). If appropriate, Consultant's employee may thereafter contact the agency by telephone to resolve any ambiguities revealed in the agency's files. Client shall pay for customary and reasonable costs incurred in connection with the Follow-up Work.

9. Current ownership and use of the property including any current generation, use, disposal, treatment, storage or emission of any Hazardous Materials. If Hazardous Materials are used on the site, check for evidence of leaks or spills and the potential for future leaks or spills, provide an evaluation of handling practices and investigate for information indicating that the property may not be in compliance with environmental regulations.

10. Evaluation of pending, current or past environmental permits, licenses, E.P.A. numbers, registrations and violations that are in the public record. Review of regular or one-time environmental notifications, registrations, reports, plans, etc. filed with governmental agencies. Any information indicating that additional permits, licenses or registrations may be required or that there may be some noncompliance with existing permits, licenses or registrations must be submitted in conjunction with this review.

11. Past generation, use, disposal, treatment, storage or emissions of Hazardous Materials on or from the property. Any information uncovered in the course of investigation, that there may have been leaks, spills or regulatory violation in the past.

12. An evaluation of the regulatory compliance status of any off-site hazardous waste disposal facility used by the owner or any tenants.

13. Any information and/or observations regarding present or past inspections, investigations, claims, agency actions or litigations relating to hazardous materials. Any information or investigations, claims, actions or litigation relating to safety in the work place.

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14. Existing hydro-geological information, including direction of groundwater flow, water table levels, perched water layers, regional contamination and impact on sources of drinking water, possible contamination of groundwater from the subject or other sources.

15. Any existing information obtained from soils reports including organic vapor concentrations.

16. Information obtained in review of previous asbestos surveys, environmental studies or reports.

17. Information regarding properties within 2,000 linear feet and any potential environmental hazards there as well as present and historical land uses, including authorized or unauthorized toxic dumping or use as an unofficial community dumping ground. If the Property is for a hospital site within California, determine if it is within a "border zone", as defined by law.

18. Any sites within 2,000 linear feet on the "national priority list" under the federal superfund statute or on similar federal, state or local lists of contaminated sites.

19. Above ground or underground tanks, pipes, sumps or surface impoundments on the property or on adjacent properties, as that information is available. Including information on age, construction and content of the tanks, etc. and any information that there may have been leaks, spills or precision test failures.

20. Information and/or observations regarding surface and/or subsurface drainage, sewers, on-site waste-water disposal and septic systems, and storm system run-off, sources of drinking water in the area and location of nearest wells and surface water.

21. The location of existing on-site or nearby utilities, wet or dry transformers or other equipment containing PCBs, and the level of PCBs contained in such equipment. Information and/or observations on the presence of PCB's.

22. Any other information obtained in the course of the investigation and site visit regarding past, present or future environmental contamination incidents or risks on or emanating from the property.

23. Comments on the likely presence of/necessity of testing for radon or electro-magnetic contamination.

24. Concluding statements evaluating the significance of concerns identified in the course of investigations and providing recommendations regarding additional testing or remediation should specify the objective to be accomplished, activities to be conducted, the approximate cost and required time.

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25. The Phase I Environmental Assessment must provide the following exhibits:

* A Statement of Independence.

* A site plan indicating approximate locations of any hazardous material use, storage, treatment or disposal facilities and any areas with visible signs of potential contamination, soil discoloration, decaying vegetation, etc.

* A list of source materials and copies of any other relevant reports which have been reviewed.

* A list of agencies visited and personnel interviewed in this investigation.

* Any outside consultants' reports or conclusions used or referenced in the Phase I Assessment.

* Any other exhibits specifically requested by the client.

26. The term "Hazardous Material", as used herein, includes any toxic, hazardous, or similarly designated substances, materials or wastes, as defined by any applicable federal, state or local law, including, but not limited to, those substances, materials or wastes listed in the United States Department of Transportation Hazardous Materials Table (49 CFR 172.101) or defined by the Environmental Protection Agency as hazardous substances (40 CFR Part 302) and in any and all amendments thereto, or under the environmental laws and regulations of the State of California, including the California Environmental Protection Agency. The term "Hazardous Material" also includes naturally occurring asbestos; petroleum, including crude oil or any fraction thereof; natural gas; natural gas liquids; liquefied natural gas; or synthetic gas usable for fuel.

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# ADDRESSING ENVIRONMENTAL LIABILITIES THROUGH PUBLIC AND PRIVATE CONTRACTS – PATHWAY OR MAZE?

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Almost twenty years after the passage of the Superfund law and the implementation of comprehensive regulation of underground storage tanks under the Resource Conservation and Recovery Act, most corporate counsel have become sensitive to the risks that "hazardous waste" or other regulated wastes or materials may pose in the context of the purchase or sale of a business or of real property, or in the on-going operation of a business. Various techniques have evolved in an effort to restrict, reallocate, control or apportion these liabilities. Most of these efforts and exercises center around contractual limitations, be those contracts with environmental consultants to determine the extent of any contamination, contracts with engineers or other consultants to effect a remediation to the contamination, contracts with private parties to establish the circumstances under which those parties will accept or assume responsibilities for the assessment or cleanup of contamination, or (more recently) "contracts" with governmental agencies to establish the circumstances under which those agencies are willing to provide a private party some protection from environmental liabilities that might otherwise ensue.

Certainly in the first category would be the environmental site assessment process which has come to be known by the quasi-acronym of "phase one" or "phase two". The

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American Society of Testing and Materials (ASTM) standard for a Phase I Environmental Assessment of real property has become a standard "checklist" item for most commercial transactions — particularly if institutional lending is involved. However, the ASTM assessment does not identify many other environmental risks that may be lurking in developed or unimproved property: asbestos, indoor air quality issues, lead paint, elevated radon levels, wetlands, endangered species, electromagnetic fields, etc. The practitioner must be sensitive to these issues so that the client is appropriately advised and protected against reasonably discernable environmental risks.

The buyer's attorney should be particularly sensitive to these issues when it negotiates the scope of work with the consultant for the so-called "Phase 1" assessment of the property. Unless the scope of work is specifically tailored for the transaction and negotiated with the consultant, the buyer is likely to get only an assessment of risks that the ASTM audit would identify; primarily "hazardous waste" or "hazardous materials" discharges or readily observable conditions around the property. In this context the buyer should consider the end use to which it intends to put the property. The concerns for a hospital, for example, are likely to be much different than for a residential community with children or for a manufacturing plant. For example, for a hospital building, the pre-purchase assessment would likely include most of the more "exotic" issues including asbestos, radon, general indoor air quality parameters (carbon dioxide, carbon monoxide, particulate, bacteria/fungal growth (particularly in air handling units)), etc.

To the extent that the buyer is relying primarily on its consultant to help identify environmental risks (as opposed to representations and warranties of the seller) it is critical that the buyer have a consultant conversant with the buyer's business, intended

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use and risk sensitivity that is able to provide appropriate assessment services and technical advice regarding various environmental concerns. The buyer should not be afraid to engage more than one firm if necessary to obtain an appropriate level of expertise and sophistication to evaluate different potential environmental concerns at that the property or the buyer's intended use pose.

## I. GENERAL DRAFTING CONSIDERATIONS

As a general matter, buyer and seller have numerous drafting "tools" to incorporate into a contract to identify and shift the risk of environmental conditions: (1) seller representations, warranties and disclosure of known conditions; (2) buyer's rights and obligation to undertake pre-closing investigation of the Property; (3) the use of "as is" clauses; (4) the use of release and indemnification provisions; and (5) environmental liability insurance coverage (which is covered in much greater detail below). Although many of these "environmental conditions" pose a risk to a potential buyer, they are not always governed by explicit regulatory standards. As a result, standard forms of contractual representation, warranty, and indemnification provisions, which often are phrased in terms of violations of regulatory standards, may not be sufficient to highlight all potential areas of concern. The seller will need to carefully consider its disclosure obligations under federal and state law as well as common law. While seller disclosure of known hidden defects is certainly the majority rule in residential transactions, there continues to be an erosion of the standard of *caveat emptor* in the commercial

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transaction. This is a matter of state law and the standards continue to evolve in many jurisdictions, suggesting greater disclosure obligations by the seller.

Even where a transaction is intended to be treated with an "as is" approach and seemingly to be governed by *caveat emptor*, the seller should be careful to consider: (1) whether particular environmental conditions should be disclosed to avoid to possibility of future claims by the buyer; or (2) whether other seemingly innocuous general representations or warranties might later allow the buyer to craft an argument that there has been a breach of a representation or warranty, or a fraudulent misrepresentation by the seller, thereby opening the seller to potential causes of action for damages, recession, indemnification, etc.

The objective of this analysis is to provide the corporate counsel with an overview of the most common non-"waste-related" environmental conditions that may be encountered in improved or unimproved real estate and to provide sample contract language to identify issues and to allocate or the risks in a purchase and sale context.

A. Representations and Warranties of Seller

A standard form of representation and warranty from seller regarding the compliance of a property "with laws" or "no violation of laws on the property" will not help a buyer identify a wide range of physical or environmental conditions for which there is are not enforceable standards but which may pose a risk nonetheless; for example, the presence of elevated radon levels or asbestos that is being properly managed in place, poor air quality due to inadequate building design or maintenance, the presence of wetlands or endangered species on-site, or comparable conditions. The seller may

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wish to take the initial cue on the scope of representations and warranties from the buyer since, unless prompted by the seller, the buyer's concerns may be focused only on traditional "waste-related" issues and may not extend to these "exotics." Conversely, the buyer may seek to identify these risks by specific representations and warranties from the Seller, comprehensive due diligence by the Buyer, or a combination of the two. Contaminant-specific forms are provided in following sections of this paper. A broader buyer-oriented form of seller representation and warranty as to the condition of the property and compliance with law is set forth on Form A.

While it may be important for seller to disclose known environmental conditions to the buyer, either because it is required by law, prudent given the circumstances of the transaction or requested by the buyer, the seller generally has obtained its knowledge of environmental conditions from third parties (engineers, consultants, governmental agencies, predecessors in title or prior prospective purchasers). Buyer will not generally be in privity with those parties. Therefore, when providing information from such sources to the buyer, the seller must exercise care to avoid assumption of responsibility for inaccuracies that may be present in third party work product. See Form C(c), (long form disclosure, in context of complete due diligence) and Form B (short form disclosure), and Form G (disclosure relating to ACM).

**FORM A: "BUYER-ORIENTED" SELLER SUPPLEMENTAL REPRESENTATION REGARDING "NON-REGULATED" ENVIRONMENTAL CONDITIONS**

> Except as set forth on Exhibit ____, Seller has no knowledge of and shall have no knowledge as of the Closing Date of: (1) any conditions on or about the Property that could result in or otherwise give rise to any governmental or private party claim or action for damages or injunctive relief arising from alleged personal injury, property or natural resource damages of any kind, or which otherwise would reasonably be expected to result in a adverse impact on Buyer's intended development of the Property; or (2) any material physical or mechanical defects

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on the Property or the improvements thereon, including without limitation, the plumbing, heating, air conditioning and ventilation systems, emergency power generation and electrical systems.

**FORM B: SHORT FORM DISCLOSURE OF KNOWN CONDITIONS**

**Seller's Disclosure of Environmental Reports.** On or about the Effective Date, Seller has provided Buyer with a copy of that certain reports listed on Exhibit ___ attached hereto (referred to as the "Seller's Environmental Reports"). Buyer acknowledges that Seller's Environmental Reports were not prepared by Seller and are provided to Buyer for informational purposes only and without representation or warranty by Seller as to the completeness or accuracy of matters set forth therein, it being agreed that Buyer shall make its own determination of the environmental condition of the Property pursuant to Section __ of this Contract.

B. Buyer's Due Diligence

Buyer should insure that its right of entry onto the property during the due diligence period is broad enough in scope and long enough in duration to allow investigation of all relevant considerations. Form C provides Buyer with a broad right of access that should be sufficient to address most issues.

As a general matter, reporting and notification obligations under state law are imposed on the owner, operator, or other "responsible person" relating to the property. Therefore, considering the reporting obligations to which it may be subject, the seller should carefully consider whether or not it wishes to obtain a copy of any buyer environmental due diligence report, particularly in the event that the transaction fails to close; the seller may wish to specify in the contract that buyer must keep the results of its due diligence confidential (unless and until it closes the transaction). Of course, as more buyers (and their lenders) become savvy in evaluating environmental risks, the likelihood that a subsequent buyer will not discover the mutual condition(s) decreases, and any benefit that seller might otherwise gain by "avoiding knowledge" may diminish. Since

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the buyer's inspection reports arguably forms a baseline description of site conditions, sellers may wish to obtain a copy in any case upon closing.

In performing its due diligence and establishing a baseline condition, the buyer may wish to consider later uses to which it is likely to put the report(s) and manage and structure the report(s) accordingly. For example, will there likely be a future major tenant on the property that will insist as a condition of leasing that the seller provide information on known environmental conditions? While it may not be possible in all cases to create a document during due diligence that can be used for a variety of future purposes, the buyer should consider the possibility and attempt to manage report preparation to meet future needs.

**FORM C: BUYER'S INVESTIGATION AND DUE DILIGENCE PERIOD**

> A. Buyer's Inspection Period. Buyer's inspection period shall commence on the Effective Date of this Agreement and shall continue through and including __ p.m. EST on _____, 199_ (the "Inspection Period"). During the Inspection Period, Buyer and its engineers, architects, environmental consultants and other agents shall be entitled to undertake physical inspections and other investigations of the Property and Buildings, including, without limitation: **(i) engineering studies, (ii) environmental tests and analysis (including without limitation testing for asbestos, radon, or other conditions or contaminants of concern relating to environmental, health or safety within the Building)**, (iii) soils tests, (iv) boundary and topographic surveys, (v) an investigation into the availability of all utility services to the Property in capacities sufficient to serve the improvements to be constructed and located upon the Property, (vi) an investigation into whether the improvements which Buyer contemplates developing and constructing upon the Property will comply with all applicable governmental laws and regulations, **(vii) [*optional for improved property:* an investigation into whether the Building complies with and is being operated in accordance with all applicable governmental laws and regulations, ASHRAE 62-1989, Ventilation Standard for Acceptable Indoor Air Quality and other generally accepted building management practices]**; (vii) review of architectural design matters, (viii) meeting with homeowners in the vicinity of the Property, (ix) meeting with applicable governmental officials to review plans, permits and specifications for the Property or Buildings that may be on file, (x) an investigation of matters relating to zoning and permitted land use matters as they relate to Buyer's intended uses for the Property, and such other matters as may be deemed by Buyer to be reasonably necessary in order for Buyer

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to generally evaluate the Property and determine the feasibility of Buyer's intended use and development of the Property.

B. Right of Access. For purposes of undertaking such physical inspections and investigations, Seller hereby grants to Buyer and its agents full right-of-entry on the Property and any part thereof during the Inspection Period and at any time prior to the closing, provided, however, any such inspections shall, if requested by Seller, be conducted in the presence of Seller or its designated representative. Buyer shall carry (and deliver written evidence thereof to Seller) not less than One Million Dollars ($1,000,000) comprehensive general liability insurance with contractual liability endorsement which insures Buyer's indemnity obligations hereunder and naming Seller as an additional insured, and Buyer agrees to indemnify, defend and hold Seller harmless from and against any loss, liability, cost, damage or expense (including, without limitation, attorneys' fees, accountants' fees, court costs and interest) resulting from such inspection and examination. All inspections shall occur at reasonable times agreed upon by Seller and Buyer and shall be conducted so as not to (i) unreasonably interfere with use of the Property by Seller or its tenants, or (ii) endanger or harm persons or property. Each such inspection shall be scheduled upon not less than one (1) business day prior notice to Seller of the proposed inspection date and time or as otherwise agreed by the parties.

[Option 1: Any written report regarding environmental, health or safety matters affecting the Property shall be considered preliminary, shall be furnished to Seller at the same time it is delivered to Buyer and such report may not be finalized without the consent of Seller. If Seller does not agree to a final version of any environmental report during the Inspection Period, Buyer may terminate this Contract as provided in sub-paragraph E of this Section, but in no event will such report be finalized or distributed by Buyer or the consultant preparing such report. Each consultant, engineer or agent performing inspections for or on behalf of Buyer shall agree in writing that any such report shall not be distributed without Seller's written consent, except to the extent required by applicable law.]

In the event that Buyer does not terminate this Contract at the end of the Inspection Period, then Buyer shall continue to have access to the Property (on the same basis as it had such access during the Inspection Period) until the Closing. Buyer shall restore and repair any damage to the Property or any part thereof caused as a result of the inspections performed by or for Buyer. Nothing in this Section __ shall be construed to imply that Buyer may seek an adjustment of the Purchase Price as a result of any matter discovered as part of any such inspection or examination. The provisions of this Section __, including indemnification, shall survive the Closing or any termination of this Contract.

C. Buyer shall, in connection with its investigation of the Property during the Inspection Period, inspect the Property for the presence of Hazardous Substances (as such term is defined below), Buyer hereby assuming full responsibility for such inspections. As used in this Contract, the term "Hazardous

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Substances" means any and all substances, materials and wastes which are or become regulated as hazardous or toxic under applicable local, state or federal law or which are classified as hazardous or toxic under local, state or federal laws or regulations, including, without limitation, (i) those substances included within the definitions of "hazardous substances," "hazardous materials," "toxic substances," "solid waste," "pollutant" or "contaminant" as such terms are defined by or listed in the Comprehensive Environmental Response Compensation and Liability Act of 1980 (42 U.S.C. § 9601 et seq.) ("CERCLA"), as amended by Superfund Amendments and Reauthorization Act of 1986 (Pub. L. 99-499 100 Stat. 1613) ("SARA"), the Hazardous Materials Transportation Act (49 U.S.C. § 1801 et seq.), the Resource Conservation and Recovery Act of 1976 (42 U.S.C. § 6901 et seq.) ("RCRA"), the Toxic Substance Control Act (15 U.S.C. § 2601 et seq.), the Federal Insecticide, Fungicide and Rodenticide Control Act (7 U.S.C. § 136 et seq.), the Occupational Safety and Health Act of 1970 (29 U.S.C. § 651 et seq.), the Emergency Planning and Community Right to Know Act of 1986 (42 U.S.C. § 11001 et seq.), the Hazardous and Solid Waste Amendments of 1984 (Public Law 86-616 Nov. 9, 1984), the Federal Clean Air Act (42 U.S.C. § 7401 et seq.), and in the regulations promulgated pursuant to such laws, all as amended, (ii) those substances listed in the United States Department of Transportation Table (49 CFR 172.101) or 40 CFR Part 302, both as amended, and (iii) any material, waste or substance which is (A) oil, gas or any petroleum or petroleum by-product, (B) asbestos, in any form, (C) polychlorinated biphenyls, (D) designated as a "hazardous substance" pursuant to Section 311 of the Clean Water Act (33 U.S.C. § 1251 et seq.), as amended, (E) flammable explosives, (F) radioactive material, and (G) radon.

D. Seller agrees that it shall, prior to commencement of the Inspection Period, deliver to Buyer all surveys, engineering drawings, plans, studies, reports and similar materials relating to the Subject Property which are in the possession or under the control of Seller (the "Seller Documentation"). SELLER MAKES NO REPRESENTATION OR WARRANTY AS TO THE TRUTH, ACCURACY OR COMPLETENESS OF ANY OF THE SELLER DOCUMENTATION. BUYER ACKNOWLEDGES AND AGREES THAT ANY RELIANCE BY BUYER ON OR USE OF SELLER DOCUMENTATION SHALL BE AT THE SOLE RISK OF BUYER, BUYER DISCLAIMS ANY INTENT TO RELY ON SELLER DOCUMENTATION, AND BUYER AGREES THAT IT SHALL RELY SOLELY ON ITS OWN INDEPENDENTLY DEVELOPED OR VERIFIED INFORMATION.

E. In the event that the results of Buyer's inspections and investigations are, in Buyer's sole opinion and within Buyer's sole discretion, unacceptable to Buyer for any reason whatsoever, and Buyer so notifies Seller of that fact prior to the expiration of the Inspection Period, then, at Buyer's option, Buyer shall be entitled to terminate this Contract and direct the Escrow Agent to transfer the Earnest Money Deposit to Buyer. Upon such termination and transfer of the Earnest Money Deposit to the Buyer, this Contract and all rights and obligations of the parties hereunder shall cease and be null and void. In the event

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> of such termination, Buyer shall return the Property to Seller undamaged and in the same condition it was in as of the Effective Date. [Optional: In addition, Buyer will deliver to Seller, at no expense to Seller, all of the written materials and studies relating to the Subject Property which Buyer has received from Seller or obtained during its investigation and inspection of the Property.] If Buyer fails to send written notice of termination of this Contract prior to the expiration of the Inspection Period, Buyer's right to terminate this Contract pursuant to this Section __ shall automatically expire and be rendered null and void.

C. The Effect Of An "As-Is" Sale

Sellers frequently use the concept of an "As-Is" sale (or a sale as-is, except for specified representations and warranties) to attempt to cut off future causes of action that a buyer may have against the seller for all matters, including environmental conditions on the property. This issue has been addressed by a number of courts, and it is clear that a seller should not assume that an "As-Is" clause will insulate the seller from post-closing causes of action by the buyer resulting from environmental conditions on the property. Generally, such clauses are construed only to cut off only actions for breach of implied common law warranties by the seller, and do not operate to protect the beneficiaries of such clauses against other causes of action by the other party to the agreement, or against governmental enforcement by state or federal environmental agencies. To cover possible claims from the buyer, the seller should specifically incorporate a release from all post-closing liability in addition to the standard "As-Is" clause. See Forms D and E. To deal with possible governmental action, the seller will have to depend upon either coverage under an indemnity (discussed below), or upon evolving "new" forms of contractual protection such as agreements with the agencies that they will take no action against parties to the transaction, or contractual protection in the form of insurance.

**FORM D: BROAD FORM AS-IS CLAUSE WITH RELEASE**

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As Is Sale. Notwithstanding anything to the contrary contained in this contract, it is expressly understood and agreed that Buyer is purchasing the subject property "AS IS" and "WHERE IS" as of the Closing Date, and with all faults and defects, latent or otherwise, and that **Seller is making no representations or warranties, either express or implied, by operation of law or otherwise, with respect to the quality, physical condition or value of the Property, the presence or absence of conditions on or about the Property that could give rise to a claim for personal injury, property or natural resource damages, the presence of hazardous or toxic substances, materials of wastes, substances, contaminants, pollutants, contaminants on, under or about the Property**, or the income or expenses from or of the Property except for the limited representations, warranties and covenants set forth in Section __ hereof. Without limiting the foregoing, it is understood and agreed that Seller makes no warranty of habitability, suitability, merchantability or fitness for a particular purpose or any purpose. The provisions of this Section __ shall survive Closing. **From and after the Closing Date, Buyer shall forever release Seller from any and all manner of action or actions, cause or causes of action, suits, damages, claims, costs, expenses or any other manner of liability Buyer had, has, or hereafter may have upon or by reason of or in any manner resulting from Seller's ownership or sale of the Property or improvements and fixtures thereon to Buyer or any condition or fact or circumstances existing on or about the Property prior to Closing**.

## FORM E: AS-IS SALE OF IMPROVED COMMERCIAL PROPERTY WITH DISCLOSURE OF CERTAIN KNOWN CONDITIONS AND RELEASE BY BUYER

A. Property Conveyed "As Is". Other than as expressly set forth in this Agreement, Seller hereby specifically disclaims, and the Buyer hereby releases the Seller from, any warranty, guaranty or representation, oral or written, past, present or future, of, as to, or concerning (a) the nature and condition of the Property, including, without limitation, the water, soil and geology or any other matter affecting the stability, physical condition or integrity of the Real Property or the Improvements, and the suitability thereof and of the Property for any and all activities or uses which Buyer may elect to conduct thereon, and the existence of any Hazardous Materials (as defined below) thereon, (b) the compliance of the Property with any law, rule, regulation or ordinance to which the Property is or may be subject, (c) the condition of title to the Property or the nature and extent of any right-of-way, lease, license, reservation or contract, (d) the profitability or losses or expenses relating to the Property and the businesses conducted in connection therewith, (e) the value of the Property, (f) the existence, quality, nature or adequacy of any utility servicing the Property and, (g) the legal or tax consequences of this Agreement or the transactions contemplated hereby. Buyer acknowledges that Seller has not made an independent investigation or verification of the accuracy or completeness of any documents, studies, surveys, information or materials which were prepared by parties other than Seller and which will be provided, or made available, to Buyer, or the methods employed by the persons or entities which prepared such items.

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Buyer is an experienced and sophisticated buyer of commercial real estate projects such as the Property and will have had ample opportunity to make an independent investigation of the Property. Buyer acknowledges that, prior to the end of the Study Period, it will have a full and complete opportunity to conduct such investigations, examinations, inspections and analysis of the Property as Buyer, in its absolute discretion, may determine. Buyer expressly acknowledges that, in consideration of the agreements of Seller herein, and other than as expressly set forth in this Agreement, Seller makes no representations or warranties, express or implied, or arising by operation of law, including, but not limited to, any warranty of condition, habitability, merchantability, suitability or fitness for a particular purpose or otherwise.

B. Certain Reports. Seller has provided or will provide to Buyer within five (5) days of execution of this Agreement copies of certain reports that are in Seller's possession relating to the physical and environmental condition of the Property, which reports are listed on Exhibit __ hereto (collectively, the "Reports"). Buyer understands and acknowledges that the Reports and any other reports provided by or on behalf of Seller to Buyer are provided without any representation or warranty, express or implied, as to the completeness or accuracy of the facts, presumptions, conclusions or other matters contained therein or the methods employed by the persons or entities which prepared such reports. Buyer has been expressly advised by Seller to conduct an independent investigation and inspection of the Property utilizing experts as Buyer deems to be necessary for an independent assessment of all liability and risk with respect to the Property, Improvements or conditions thereon. Buyer shall rely only [*optional*: on Seller's representations and warranties contained in Section ____ herein, and] upon Buyer's own investigations and inquiries with respect to all such liability and risk including, without limitation, all liability and risk with respect to the presence of Hazardous Materials (as hereinafter defined) in, on or around the Property.

For purposes of this Agreement the term "Hazardous Materials" shall mean any substance which is or contains: (i) any "hazardous substance" as now or hereafter defined in Section 101(14) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (42 U.S.C. Section 9601 et seq.) or any regulations promulgated under CERCLA; (ii) any "hazardous waste" as now or hereafter defined in the Recourse Conservation and Recovery Act (42 U.S.C. Section 6901 et seq.) or regulations promulgated under RCRA; (iii) any substance regulated by the Toxic Substances Control Act (15 U.S.C. Section 2601 et. seq.); (iv) gasoline, diesel fuel or other petroleum hydrocarbons; (v) asbestos and asbestos containing materials, in any form, whether friable or nonfriable; (vi) polychlorinated biphenyls; (vii) radon gas; and (viii) any additional substances or materials which are now or hereafter classified or considered to be hazardous or toxic under "Environmental Requirements" (as hereinafter defined) or the common law, or any other applicable law related to the Property. Hazardous Materials shall include, without limitation, any substance, the presence of which on the Property: (A) requires reporting, investigation or remediation under Environmental Requirements; (B) causes or threatens to cause a nuisance on the Property or adjacent property or poses or threatens to pose a hazard to health or safety of persons on the Property or adjacent property; (C) which, if emanated or migrated from the Property, could constitute a trespass; or (D) could give rise to a claim for damages or

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injunctive relief resulting from personal injury, property or natural resources damages. For purposes of this Agreement, the term "Environmental Requirements" shall mean all laws, ordinances, statutes, codes, rules, regulations, agreements, judgments, orders and decrees now or hereafter enacted, promulgated, or amended, of the United States, the states, the counties, the cities or any other political subdivisions in which the Property is located and any other political subdivision, agency or instrumentality exercising jurisdiction over the owner of the Property, the Property or the use of the Property relating to pollution, the protection or regulation of human health, natural resources or the environment, or the emission, discharge, release or threatened release of pollutants, contaminants, chemicals or industrial, toxic or hazardous substances or waste or Hazardous Materials into the environment (including, without limitation, ambient air, surface water, ground water or land or soil).

D. Indemnification

The final and most obvious means of shifting the risk of environmental liabilities between the parties is an indemnification agreement. Contractual indemnities were one of the first techniques used to allocate environmental liabilities in corporate transactions. These contractual provisions generally were intended to be viewed as contractual commitments by an indemnitor to protect the indemnitee from specified environmental liabilities suffered the indemnitee. Because of the complex dynamic between purchase price, the parties knowledge of existing conditions (before and after buyer's due diligence), the risk posed by those conditions, the scope of seller's representations and warranties, the possible availability of environmental insurance to cover certain risks for the benefit of the parties, the scope and coverage of indemnification agreements generally are negotiated on a case by case basis. Form F contains a sample indemnification agreement.

There are at least six critical issues in negotiating indemnification agreements, in addition to matters which are very site-specific such as access and migration problems:

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(1) scope of the claims or matters that are covered by the indemnity; and the methods for implementing the indemnity protection (2) duration of the indemnification agreement; (3) cap on liability under the agreement; (4) the determination of who will indemnify whom (including consideration of possible cross-indemnification); (5) limits on the right of the indemnity to incur expenses, and the standards for related coverage and notice questions, and (6) mechanisms to ensure the security of the indemnification agreement.

As a starting point, and often as a part of the agreement's general indemnification provisions (as distinguished from specific environmental provisions), the parties will want to be indemnified for any breach of the other party's representations, covenants or warranties in the agreement. Beyond that, the parties may agree by contract to allocate various risks to either the seller or the buyer. Obviously, the party providing indemnification will wish to limit the scope, duration and maximum financial exposure to the other party. The beneficiary of the indemnity must recognize that the indemnification is implicitly limited by the financial strength of the indemnitor. For example, an indemnification from a single asset entity that is likely to be dissolved or under capitalized after closing will be of limited value to the indemnity. In those cases, the indemnification may need to be secured by a letter of credit, an escrow hold back arrangement or a guarantee by a parent or other better capitalized entity.

In limiting the duration of the indemnification agreement, the indemnitee needs to be sensitive to the particular types of claims that are likely to be raised, the context in which the claims might be raised and applicable statute of limitations relating to those claims, if any.

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Indemnification agreements have been utilized as a contractual technique for reallocation of environmental risk for a number of years. In the early years after the enactment of statutes such as CERCLA and RCRA, litigation centered around the legal effect of contractual indemnities, especially since many of these indemnification agreements had been drafted in years before the enactment of these statutes, and thus made no clear reference to them. With the passage of time, this issue has diminished in importance, since most indemnification agreements now are very specific (sometimes too specific) in the delineation of environmental statutes and regulations which are covered.

Moreover, even highly negotiated and well-drafted indemnification agreements have inherent limitations. One of these has already been noted – the limitation inherent in the financial viability of the indemnitor. In early years this led frequently to the inclusion of independent financial security in the form of letters of credit, escrow agreement or security interests. It now seems to be more often the case that environmental insurance is thought of as an equally available technique to deal with this potential security limitation.

Likewise, environmental insurance has operated to help cover another problem with indemnifications, namely the recognition that an indemnitee must usually pay out monies before an indemnification obligation will arise or before it is reimbursed. Sometimes issues like these are dealt with by requiring an indemnitor to perform cleanup or remediation work, but in circumstances where the indemnitor is divesting itself of a particular asset or division, this may not be feasible. Again, environmental insurance seems to have filled some – but not all – gaps in those circumstances.

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## FORM F: INDEMNIFICATION AGREEMENT.

1. INDEMNIFICATION

a. **Indemnification by Seller**. Seller and Parent Company agree that they will, jointly and severally, indemnify, defend, protect and hold harmless Buyer, its officers, shareholders, directors, agents, employees, successors and assigns at all times from and after the Closing Date, from and against all claims, losses, damages, actions, suits, proceedings, demands, assessments, adjustments, penalties, fines, costs and expenses whatsoever (including without limitation, reasonable attorneys' fees and expenses of assessment or remediation, claims by governmental agencies, third party claims of personal injury or property damage), incurred by or asserted against Buyer as a result of or incident to:

(i) any material breach of, material misrepresentation in, untruth in or inaccuracy in the representations and warranties by Seller set forth in this Agreement or in the Schedules, Exhibits or certificates attached to this Agreement or delivered pursuant to this Agreement;

(ii) nonfulfillment or nonperformance of any material agreement, covenant or condition on the part of Seller made in this Agreement and to be performed on after or before the Closing Date, including without limitation Seller's obligation to complete [*specify required actions such as:* fulfillment of obligations under governmental clean up settlement or order, removal of specified asbestos-containing building materials prior to Closing, or other actions identified by Buyer during due diligence period]; and

(iii) the environmental matters identified in Seller's Environmental Reports and more particularly described on Exhibit __.

b. **Indemnification by Buyer**. Buyer agrees that it will indemnify, defend, protect and hold harmless Seller, its officers, shareholders, directors, agents, employees, successors and assigns at all times from and after the Closing Date under this Agreement from and against all claims, losses, damages, actions, suits, proceedings, demands, assessments, adjustments, penalties, costs and expenses whatsoever (including without limitation, reasonable attorneys' fees and expenses of assessment or remediation, claims by governmental agencies, third party claims of personal injury or property damage), incurred by or asserted against Seller as a result of or incident to the presence of Petroleum Hydrocarbon Compounds as defined in Section __, on or about the soil, surface or groundwaters or ambient environment of the Property, including without limitation any such Hydrocarbon Compounds that may have been discharged or released on or about the Property prior to the date hereof, whether now known or discovered after the date hereof, it being the express agreement of the parties that the Seller shall have no liability of any kind or nature for any Hydrocarbon Compound contamination on or about the Property after the Closing Date.

c. **Procedures for Resolution of Claims for Indemnification**

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(i) **Notice of Possible Third Party Claims**. If any person entitled to be indemnified under this Agreement (the "Indemnitee") shall receive notice of assertion by any third party of any claim against the Indemnitee that, in the judgment of the Indemnitee, may result in the incurrence by the Indemnitee of damages for which the Indemnitee would be entitled to Indemnification pursuant to this Agreement, the Indemnitee shall promptly deliver to Indemnitor a written notice describing in reasonable detail such claim and Indemnitor may, at their option, assume the defense of the Indemnitee against such claim (including the employment of counsel, who shall be counsel satisfactory to the Indemnitee, and the payment of expenses). The Indemnitee shall have the right to employ separate counsel in any such action or claim to participate in the defense hereto but the fees and expenses of such counsel shall not be a the expense of Indemnitor unless: (i) Indemnitor shall have failed, within a reasonable time after having been notified by the Indemnitee of the existence of such claim as provided in the preceding sentence, to assume the defense of such claim and to employ counsel reasonably satisfactory to the Indemnitee, (ii) the employment of such counsel has been specifically authorized by Indemnitor or (iii) the named parties to any such action (including any impleaded parties) include both the Indemnitee and Indemnitor and the Indemnitee shall have been advised in writing by such counsel that there may be one or more legal defenses available to it which are different from or additional to those available to Indemnitor. Indemnitor shall not be liable to indemnify the Indemnitee for any settlement of any such action or claim effected without the consent of Indemnitor but if settled with the written consent of Indemnitor, or there be a final judgment not to appeal for the plaintiff in any such action, Indemnitor shall indemnify and hold harmless the Indemnitee from and against any loss or liability by reason of such settlement or judgment.

(ii) **Notice of Actual Claim**. If the Indemnitee shall incur any damages and shall consider that such Indemnitee is entitled to be indemnified against such damages by Indemnitor hereunder, such Indemnitee shall deliver a certificate signed by a representative of the Indemnitee (the "Certificate") to Indemnitor, which Certificate shall

(A) state that the Indemnitee has paid or properly accrued damages for which such Indemnitee is entitled to indemnification pursuant to this Agreement; and

(B) specify in reasonable detail such individual item of damage included in the amount so stated, the date such item was paid or properly accrued and the nature of the claim to which each such item is related and the computation of the amount to which such Indemnitee claims to be entitled hereunder.

(iii) **Notice of Objection**. In case Indemnitor shall object to the indemnification of the Indemnitee in respect of any claim or claims specified in any Certificate, Indemnitor shall, within 30 days after receipt by Indemnitor of such Certificate, deliver to the Indemnitee a written notice to such effect and Indemnitor and the Indemnitee shall, within the 30-day period beginning on the date of receipt by the Indemnitee of such written objection, attempt in good faith to agree upon the rights of the respective parties with respect to each of such claims to which Indemnitor shall have so

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objected. If the Indemnitee and Indemnitor shall succeed in reaching agreement on their respective rights with respect to any of such claims the Indemnitee and Indemnitor shall promptly prepare and sign a memorandum setting forth such agreement. Claims specified in any Certificate to which Indemnitor shall not object in writing and claims the validity and amount of which shall have been the subject of a final judicial determination in a proceeding involving the parties to this Agreement are hereinafter referred to, collectively, as "Agreed Claims". Any civil action brought on a claim which is not an Agreed Claim shall be brought in a court of competent jurisdiction in _____ County, Florida, to the jurisdiction and venue of which the parties agree.

(iv) **Payment of Agreed Claim**. Promptly after determination of the amount of any Agreed Claim: (i) Indemnitor shall pay to the Indemnitee in cash an amount equal to the Agreed Claim if the Indemnitee shall have previously paid the Agreed Claim or (ii) Indemnitor shall pay such amount necessary to satisfy the Agreed Claim directly to the holder of the Agreed Claim if the Indemnitee has not previously paid the Agreed Claim; provided, however, that in the event that the Indemnitee subsequently recovers any or all of the amount of the Agreed Claim from a party other than Indemnitor, the Indemnitee shall reimburse immediately to Indemnitor in cash an amount equal to the amount of such previously paid Agreed Claim which shall have been recovered.

d. **Termination of Indemnification**. The indemnification agreements set forth in paragraph 1(a)(i) and (iii) and 1(b) shall terminate _____ (__) years from the Closing Date. The indemnification agreements set forth in paragraph 1(a)(ii) shall expire _____ (_) years from the date of [insert basis for certification of completion of specified action].

e. **Cap on Seller's Environmental Liability under Indemnity**. Notwithstanding anything herein to the contrary, Seller's total combined liability pursuant to subparagraph (a) of this paragraph 1 shall not exceed the amount of _____ ($_____) (the "Cap"), and nothing herein shall be deemed to require Seller to indemnify and hold Buyer harmless pursuant to subparagraph (a) once the sum of Seller's expenditures pursuant to subparagraphs (a) in the aggregate exceed the Cap.

f. **Effect of Insurance**. The parties do not intend that either party act as an insurer or co-insurer; and in the event any claim is asserted against either party which is or may be insured against under any policy of title, liability, operations or other insurance, the Indemnitee shall tender the claim to the insurer and the Indemnitor's obligations hereunder shall be limited to the uninsured portion of such claim.

## II. GOVERNMENTAL MECHANISMS FOR CONTRACTUAL LIMITS TO ENVIRONMENTAL LIABILITY

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As noted in the discussion above, classically contractual efforts to reallocate environmental liabilities have dealt only with the parties to a particular transaction, be they sellers, purchasers, lenders, guarantors, tenants or the like. More recently, another very significant player in the arena of environmental liabilities – governmental agencies - has offered a new contractual mechanism to limit environmental liability. In recent years as a result of changes in governmental attitudes, and specifically as a result as the enactment of new governmental regulations and statutes, both the U.S. Environmental Protection Agency (at the federal level), and state and local environmental agencies, have adopted programs and techniques whereby some of the parties to a transaction which would otherwise incur potential liability can be assured, to some extent, that they will be protected from governmental or private claims seeking to assert that liability.

A. Changing Regulatory Philosophy

B. Regulatory Context.

## III. THE CHANGING NATURE AND ROLE OF ENVIRONMENTAL INSURANCE

One of the most significant developments in recent years with respect to controlling environmental risks is the changing evolution of insurance as a private contractual device to limit and quantify the extent and magnitude of environmental liabilities. In response to the growing demand for an ability to manage environmental risk, a limited (but increasing) number of insurance companies now issue liability policies offering protection against specified environmental risks. The largest of these companies are:

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- AIG Environmental (Commerce & Industry Insurance Company) ("AIG")
- ECS Incorporated/Reliance Insurance Company
- Zurich-American Insurance Company (Steadfast Insurance Company)
- Kemper Environmental

Perhaps because of the rate of growth in this area of insurance coverage – some have estimated it to be as high as 30 percent to 60 percent per year, smaller companies have also entered the market. These include:

- United Capital Insurance Company
- Seneca Environmental Management
- American Safety Insurance Group

Further, in the last few years, competition has become particularly fierce, resulting in changes to both the market strategy and the environmental insurance products being offered. Providers are more and more competing in both the pricing and product structure. For example, AIG, which has a menu of coverages to choose from in its pollution legal liability policy, reportedly has found the policy to be unwieldy in some circumstances, and as a result of the pressures of the marketplace it has reduced its menu of coverages from the eighteen it had in November of 1997 to fewer than ten. It has also streamlined its policy exclusions so that they all appear on one page.

Generally the best point for starting the negotiation, or even the evaluation of a possible use of an insurance contract to restrict or define environmental liabilities, is with

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a broker who specializes in environmental insurance. For any given transaction, such brokers are a wonderful source of current information about the coverage and terms available. Some such brokers – but far from an all-inclusive list – would be Twin Elms LLC, EPIC Insurance Services, Marsh Environmental Consulting and Willis Corroon Environmental Risk Management Services. The broker will work with the applicant, or with its risk manager and/or counsel, to define the specifications for coverage and the needed documentation. Those will then be provided to various underwriters who will then customarily issue the quotations that are described below in greater detail.

Due to the unique nature of each environmental risk, most often environmental liability insurance policies are written with the factual context of a particular insured's situation in mind. Therefore, at present there is no established ratings manual that determines the amount of the premium for a particular policy. Moreover, most of these policies are issued in an unregulated mode, so it usually is not possible to look to state insurance regulatory authorities for assurance as to the reasonableness of either coverage or premiums. Instead, the insurance companies carefully examine the application of each insured and seem to set the premium on a case by case basis.

### A. Available Types of Insurance Coverage

Types of coverage presently available generally fall into several categories. It should be taken into account, however, that frequently these categories are combined and the insurance product obtained represents a combination of several different types of coverage:

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- Pollution Legal Liability Insurance
- Property Transfer Liability Insurance
- Brownfields Restoration and Development Insurance
- "Cleanup Cost Cap", "Stop Loss Remediation", or "Stop Gap" Insurance
- Secured Creditor Impaired Property/Lenders Liability Insurance
- Contractors Pollution Liability and Errors and Omissions Insurance

Once it has been determined that insurance may play a role in a transaction, the costs, site testing requirement and coverage limits should be considered. Informed brokers in this area are becoming more and more indispensable since they can expedite negotiations with the underwriters, or between the underwriters and the technical consultants, to assess the magnitude of the insurance risk, which will affect the extent, scope and cost of environmental site assessment.

With most of these coverages, there does not seem to be a standard "industry" policy form, so the offering of a particular underwriter needs to be read and reviewed very closely. Some policies contain what has been termed by some a "chinese menu", whereby the insured party is able to choose different coverages at differing costs. There also seem to be significant variations in the ease of being able to read and quickly comprehend policy variations.

Each underwriter seems to have its own application form. However, all of these are intended to develop fundamental background information on the insured, the proposed transaction and (especially) the site and site conditions. The general practice seems to be for the issuance of a premium quotation ,with a binder or commitment issued

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only after further information is provided. The premium quotation, however, does afford an early opportunity for negotiation of both coverage and cost.

The final policy is issued after there has been a site assessment performed by a consultant approved or selected by the underwriter. With the exception of certain secured creditor policies, generally these assessments are not the equivalent of a phase II, and certainly never merely a phase I. Each underwriter seems to have its own testing and procedural requirements which the consultant must satisfy.

## B. Policy Terminology and Characteristics:

### 1. Claims Made vs. Occurrence Based Coverage

Even for those familiar with general insurance concepts, environmental insurance seems to have generated its own very confusing and often seemingly inconsistent terminology. One of the most important concepts to grasp are the circumstances under which a claim can be made With the exception of contractors pollution liability coverage, most of the foregoing types of insurance coverage are written on a claims made basis only. AIG and Kemper Environmental each offer contractors pollution liability coverage on an occurrence basis. In order for claims made coverage to apply, a claim must be made during the policy period, or any extended reporting period an insured may be able to purchase. As a result, in order for an insured to be protected with respect to an environmental risk, insurance coverage must continue to be renewed annually.

For example, assume that a discharge of a hazardous substance occurred in 1999 (that is covered under the policy) and that the discharge was not discovered until 2001.

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With a claims made policy, there would be no coverage under the 1999 policy for the event. Rather, it would be necessary for an insured to have a policy in effect in 2001 in order for there to be a possibility of coverage, since the trigger for coverage with this type of policy is a claim being made and reported during the policy period. With an occurrence based policy, the 1999 policy would apply, even if no policy were written in 2001, since the trigger for coverage under this type of policy is the occurrence, not the claim.

Some policies contain a limited term "extension of coverage" provision whereby if a notice of possible claim is given with specificity during the policy period, and the actual claim is then made against the insured within five (5) years of the end of the policy period, coverage is still available. However, such provisions should be closely scrutinized since the extended coverage may not be as broad as the existing coverage.

**2. Deductible and Minimum Premium Issues**. Environmental insurance will involve and require some type of deductible. In the negotiation of the deductible, one concept that should be pursued is a request for an "aggregate deductible" that would cover the life of the policy, rather than being responsible for the full deductible each time there might be a separate occurrence during the term of the policy. An insurer might be willing to offer an aggregate deductible if the insured party agrees to pay what is termed a "maintenance deductible", which is a smaller deductible priced so that the insured will not file smaller nuisance type claims.

Environmental policies also would generally incorporate a concept of "minimum earned premiums". The underwriter wants to earn and keep a high percentage of a one-time premium upon issuance of the policy, even if the insured party

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were to sell the property early in the life of the term. If the party to be insured expects to sell property within only a few years of the placement of coverage, in the negotiation of the policy there should be a designation of an amount of minimum earned premium, or as an alternative, there might be provisions made whereby a successor or assignee could obtain the benefit of the remaining policy term, with no (or minimal) premium charges.

**3. Parties Covered**. Questions have developed in connection with environmental insurance concerning the extent of coverage. While a basic policy will generally cover the property owner, it is often necessary specifically to schedule or to insure coverage for affiliates and for key personnel such as property managers. Similarly, if coverage is requested or expected for a lender or for existing or future tenants, that needs to be specified. Some underwriters will require that if coverage for future tenants is expected, tenants will be required to demonstrate a baseline condition, especially if the new tenant would operate with a differing process from an environmental standpoint.

**4. Triggers for Coverage**. Generally, environmental insurance policies have not provided a consistent or uniform definition of an event which would trigger coverage. In some instances, the mere discovery of a defined environmental problem would trigger an obligation to pay for remediation by the insurance company. In other instances, there is a specific requirement for a defined governmental action or governmental order. As with most other aspects of environmental insurance, the potential insured party must carefully read and negotiate policy definitions, making changes if needed.

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In particular, in those states which have procedures for consultant certification of cleanup, the "traditional" coverage which might require a governmental cleanup order would need to be amended so that a "claim" would also include an instruction, order or recommendation by the authorized consultant.

### C. Description of Available Insurance Coverage

**1. Pollution Legal Liability**. This policy, along with the Property Transfer Liability coverage described below, is intended to cover claims and costs arising from pollution conditions on, within or under covered locations (that is locations specifically listed in the policy) or emanating from covered locations. The contamination which is covered can be known or (less frequently) unknown, and can include releases that occur during the policy period. The coverage includes claims for clean up, as well as claims for bodily injury and property damage. Also included are defense costs; however, these costs will be deducted from, and are subject to, the policy limits. In addition, business interruption coverage, property value diminution and extra expense coverage are also available in certain instances.

There are certain frequent exclusions to this coverage, which generally include pre-existing conditions known to insured; dishonest, willful, intentional acts or omissions or deliberate, intentional or willful non-compliance with law or notices; contractual liability (unless scheduled in the policy); underground storage tanks (unless these are scheduled in the policy or are unknown); there also may be exclusion for specific contaminants such as asbestos, lead paint and radioactive materials.

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The term for these policies has traditionally been a 1-5 year term, although a longer term is preferred by most insured parties, and as a result of competition between underwriters in some instances this may be able to be obtained with a 10 year term.

**2. Property Transfer Liability Insurance**. This policy is closely related to the general Pollution Legal Liability and is designed to cover claims arising out of specifically listed real property for pre-existing unknown contamination and existing known contamination below reportable levels. This could include a situation such as contamination at a site, in excess of certain governmentally prescribed limits, being authorized with the permission of these governmental authorities. Those instances would also usually involve some type of land use restriction or institutional control on the property, and the placement of some type of physical impervious cap on the surface of the land to prevent any further liquid intrusion.

This type of coverage generally has been marketed towards the property transfer situation. This type of policy can insure the seller, the buyer, and the lender, and may be helpful in enabling a transaction to go forward. For this type of policy, again the term generally is 3-5 years. Applicants often request and can obtain a lesser term, but insurance companies object to writing for a lesser term. Insurance companies have, in certain instances, increased the coverage to a 10-year term; as with most environmental insurance, an insured may also be able to negotiate the term depending upon the circumstances.

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For both Pollution Legal Liability policies and Property Transfer policies, the insurance companies will generally require at a minimum, a Phase I audit and possibly a Phase II audit in order for the property to be insured.

**3. "Cleanup Cap" or "Stop Gap" Coverage**. This type of policy is designed to cover an increase in the costs of a known cleanup. An insured must have a government-approved cleanup plan in place, or a cleanup plan approved by the insurance company, but not yet approved by the government. Coverage arises when the cost to perform the work approved under such cleanup plan ultimately proves to be more than estimated by the consultant that prepared the plan. This type of insurance does not cover the cost to clean up any other contamination discovered during the course of the insured cleanup, although some underwriters have recently agreed to offer some extended coverage in this regard. Instead, the usual approach is for a combination of coverages to be proposed, whereby property transfer insurance or pollution legal liability insurance would be obtained, to cover this situation.

Coverage under a "cleanup cap" or "stop gap" type of policy ends (subject to the policy term) when the project is completed and the insured receives a No Further Action Letter or similar documentation from the applicable governmental authority having jurisdiction over the cleanup.

These types of policies will require a deductible, through a self insured retention, which is usually the estimate for the approved cleanup plus between 3 % and 10 % of such costs. Also, there can be a co-payment arrangement once the cleanup costs go beyond the self insured retention**.** The usual exclusions from coverage are that there is no

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coverage other than for the increase in cost of the specifically insured approved cleanup. This does not include legal costs incurred in negotiating with governmental authorities**.**

The term for these policies is negotiable, depending upon length of time for cleanup, but is usually a maximum of 10 years. The carriers maintain this is dependent upon their reinsurance contracts.

**4. Secured Creditor Impaired Property Insurance**. This is a recent product for financial institutions which was first introduced by AIG. It is presently being actively marketed to financial institutions. First Union Bank has an extensive program in place. The marketing approach is that the policy can be used in place of a Phase I audit, and the per property premium will be less than the cost to have a consultant prepare a Phase I audit. As part of the policy application, an environmental questionnaire is used in place of the audit. Also, AIG will perform a data base search and as long as there are no red flags, AIG will insure the property.

The policy is designed to cover that sum equal to the lesser of: (i) the loan balance due with respect to the real property that is found to be contaminated (in which case the company will indemnify the insured); or (ii) the cost to clean up such property (in which case the company will pay on behalf of the insured).

However, it should be noted that this coverage only applies: (i) when the secured creditor is faced with a loan in default during the policy period; (ii) when the primary collateral securing the loan is real property; (iii) when contamination is discovered during the term of the loan and the policy period; and (iv) the secured creditor has a perfected security interest in the real property. It should also be kept in mind that if the cleanup costs are less than the loan balance, the insured must have foreclosed on the property in

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order for the coverage to apply. However, AIG is now willing to write loan balance coverage only so that the financial institution is not forced to foreclose. Note that there is also coverage available under this policy for CERCLA and state lender liability claims as well as for third party claims for bodily injury and property damage.

The policy limits for this type of coverage is $1,000,000 and up. One underwriter has reported that its average limit is $35,000,000. The primary exclusions from coverage are that there is no coverage for known contamination, for asbestos or lead paint or naturally occurring radioactive materials, or if loan goes into default outside the policy period. The term for this type of coverage is up to 15 years.

One of the limitations of this type of coverage is that since a secured creditor can be named as additional insured under most other policies, this type of coverage may not be practical or cost effective, particularly since the property owner will not be insured under the policy and it is the only paying premium.

**5. Contractors Pollution Liability and Errors and Omissions Insurance**.

This coverage is designed to provide: (i) coverage for bodily injury and property damage (including cleanup of pollution conditions) arising out of covered operations performed by the insured contractor or consultant on a third party's real property; and (ii) for pollution arising out of professional services rendered by the insured contractor or consultant. As already noted, contractors pollution liability insurance is now available on an occurrence basis, which is a very important factor for a client to consider when retaining a contractor or consultant to perform environmentally related services.

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It is important for an environmental contractor or consultant to have appropriate contractors pollution liability coverage in place (containing sufficient policy limits and a limited deductible) prior to performing work on a client's real property. This type of coverage is designed to protect the property owner if, for example, the contractor accidentally pierces an underground storage tank during a tank excavation or causes a fracture or other means for the contamination to move from one aquifer to another during the course of drilling a groundwater monitoring well. There is also project specific coverage where the insurance company provides dedicated policy limits of liability for a particular project. This may be vital when the contractor is dealing with a large or complicated cleanup.

In contrast to contractor's pollution liability coverage, errors and omissions coverage, which is claims made coverage, is designed to cover events such as the failure of the consultant to detect contamination during a Phase I or Phase II audit, or negligent design of a remedial system.

The term for this coverage is usually one year, but the policy should be renewed during each year work is being performed at a site and, if claims made coverage, for an agreed upon number of years after performance of the work. In addition, it has been reported that there are three year policies being written for the environmental consultant or contractor and that there are ten year policies available for project sites. There is no coverage for intentional, willful or deliberate noncompliance with law.

### D. Factors Increasing theUse of Environmental Insurance

**1. Additional Security for Contractual Indemnity**. Environmental indemnities have become crucial tools in all types of commercial transactions, be it the

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purchase, sale or merger of a business or the purchase or sale of or real property, the leasing of real property or the financing of real property.

An important point to consider when examining the strength of an indemnity is that the indemnity is only as good as the financial strength of the person or entity that is giving the indemnity. So, for example, if the indemnity is being given by a company which does not have significant assets, it may be worthless when the need for indemnification arises.

Further, many sellers balk at giving an environmental indemnity on the basis that they do not want to leave an open long-term liability in place after the transaction is completed. Instead, in many instances a seller will provide a buyer with the opportunity to perform due diligence, or perhaps give an indemnity of limited duration, often for as little as one to three years. And even if a seller agrees to an indemnity, frequently the indemnity will have a threshold and a cap.

As decades of experience have shown, environmental problems tend to be insidious and in many instances years pass before damage becomes manifest. Therefore, a one to three year indemnity will likely not be very helpful to a buyer in a situation such as this.

A possible vehicle for providing a buyer, a landlord, or a financial institution with further comfort as to the strength of an environmental indemnity, or the limited term of an indemnity, may be some type of environmental liability policy which includes contractual liability coverage that specifically insures the indemnity.

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**2. Security When No Indemnity Given**. It is a rarity in a commercial net lease transaction where a landlord is willing to provide an indemnity to a tenant, particularly in the situation of a long-term net lease where the landlord has no presence on the property, and has for all intents and purposes turned the property over to the tenant. On the other hand, a tenant often does not want to be responsible for midnight dumpers or unknown environmental problems, whether located on the property or migrating to the property from an off-site location. Environmental liability insurance may be a possible compromise to protect both the landlord and the tenant, and even the landlord's mortgagee.

**3. Security Where Ongoing Manufacturing Operations**. Due to the plethora of environmental laws which subject a landlord to joint and several liability with its tenant, landlords tend to be reluctant to lease their properties to manufacturing facilities. Many landlords and tenants alike have witnessed the exodus of manufacturing operations from heavily regulated states to more business friendly states (which may no longer be so business friendly). One possible means of providing a landlord with protection in leasing a facility to a manufacturer would be to require the tenant to maintain environmental liability coverage, acceptable to the landlord, during the term of the lease and for an agreed upon period after the expiration of the lease. However, the landlord must always keep in mind that this insurance coverage will only be effective if insurance companies continue to write the coverage; if an insurance company is willing to continue to underwrite the risk of the tenant's operations; and if the tenant complies with the terms of the policy.

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**4.** **Additional Security for Loan**. Although lenders are offered a certain degree of protection in the available lender liability limitations under various federal and state laws, it remains difficult to convince a lender to loan against collateral consisting of real property on which manufacturing operations are conducted or even against "Brownfields" type property. A lender is always concerned about preserving the value of its collateral. It needs to know the value will be there should foreclosure become necessary, and that it will not be taking over property with an environmental problem which may ultimately result in liability to the lender or an inability of the lender to obtain full value from the collateral securing its loan. Lenders have been burned in the past by environmental liabilities and tend to be cautious with loans they believe present such a risk. A new insurance product may ultimately make the difference between the granting or denial of a loan. It is therefore something to be considered in order to complete the loan transaction.

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### E. Example of Policy Terms That Require Negotiation.

The needs of the insured and the transaction will dictate the terms of the policy that require negotiation, which in many instances will be numerous. The following provides some examples of policy terms that should be negotiated, but is by no means all inclusive. Keep in mind that negotiated revisions to the policy may result in an increase in the cost of the premium because the insurance company may perceive an increased risk in issuing the coverage on an insured's terms, rather than its own.

**1. Known Condition**. This defined term needs to be limited to conditions known by specifically identified individuals, such as the environmental manager of a company. An insured does not want to take the risk of an insurance company denying coverage of a claim because an employee, who is not in a position of authority, knows something about an environmental condition that has not been disclosed to upper management. Also, any concept of a reasonable expectation of a claim arising from a pollution condition should be deleted, if possible, to avoid future problems.

**2. Insured**. This defined term needs to include all the persons and entities that are intended to be named insureds, as opposed to additional insureds. For example, if the policy is intended to cover a seller for environmental issues that may be its responsibility and a buyer for environmental issues that may be its responsibility, make sure that the policy does just that. Beware of the situation where a party is named as an additional insured and is only covered for claims for which the other party is also responsible.

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**3.** **Property Damage**. Make sure this defined term includes diminution in value of real property. This potential cause of action should not slip through the cracks, particularly with third party claims.

**4.** **Underground Storage Tanks, Asbestos and Lead Paint**. The form policies generally exclude these environmental concerns from coverage. However, in most instances, an insured does not want the policy to contain exclusions such as these, particularly if an insured has no knowledge of an underground storage tank or if there is asbestos or lead paint discovered in the environment outside of a building or structure.

**5.** **Intentional Acts**. Be very careful of this dangerous broad exclusion which takes away coverage for any dishonest, willful, intentional or deliberate act or omission committed by or at the direction of the insured or any deliberate noncompliance with law or notices of violation or the like. At a minimum, an insured will need to limit this provision to the acts of certain specified individuals responsible for environmental affairs or officers of an insured. Further, the first part of this exclusion should be deleted in its entirety because it is ripe for a dispute. For example, what is a willful omission?

**6.** **Contractual Liability**. This exclusion needs to either be deleted or there needs to be a schedule of insured contracts added to the policy. For example, if an

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insured provides an environmental indemnity, whether to a buyer, lender or tenant, it wants this policy to support that indemnity.

**7.** **Cancellation**. Where there is more than one insured on a policy, the insurance company will look to deal through only one insured for items such as cancellation and non-renewal and the policy will contain a condition to that effect. It is crucial that the insurance company be required to give the other insureds under the policy notice of events such as these, so that the other insureds can continue the coverage if they so desire.

**8.** **Choice of Law/Choice of Forum**. Insurance companies attempt to use New York as the law and forum applicable to the policy. This is not surprising considering the fact that New York law heavily favors insurance companies and even affords statutory protections to these companies. Therefore, if the insurance company refuses to apply the law and forum requested by the insured, at a minimum the insured should consider having these conditions deleted from the policy.

**9.** **Arbitration**. There is another provision that may appear to be harmless but which is clearly designed to favor the insurance company. It requires that the results of the arbitration be final and non-appealable and, more importantly, that the only individuals who can serve as arbitrator are disinterested current or retired executives of fire or casualty insurance or reinsurance companies or Underwriters of Lloyds. How could this provision possibly result in a fair determination for the insured?

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**10.** **Other Insurance Provision**. These types of policies usually contain a provision that they are excess over any other available coverage, although recently there have been some revisions in the policies to make the coverage primary. Nevertheless, an insured does not want to be locked in a battle with the insurance company issuing environmental coverage as to whether its environmental insurance policy or some other policy applies, after it has spent a substantial premium purchasing the environmental insurance. Therefore, the burden should be on the insurance company issuing the environmental insurance policy to pay the claim and it should be the responsibility of that insurance company, not the insured to chase after whatever other insurance coverage it may deem. to be available.

**11.** **Notice**. Beware of the conditions of the notice provision of the policy. In many instances insurance companies have deleted the requirement for notice "as soon as practicable" and replaced it with "immediate" notice or even "prompt notice as a condition precedent to coverage". It is crucial that the insured minimizes the ability of an insurance company to deny coverage based on a defense of late notice.

**12.** **Subrogation**. Make sure the insurance company waives subrogation as to all insureds.

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**13.** **Severability**. If there is more than one insured with differing interests, make sure the policy contains a severability clause addressing their respective interests.

**14.** **No Assignment**. Be very careful of the condition in the policy prohibiting assignment of the policy, particularly in situations such as mergers. Also, while an insured may want to assign the policy to a new property owner, it may be more prudent to add that new property owner as an insured as well, so that the original insured continues to have protection.

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# EPA GUIDANCE AND POLICY DOCUMENT DIRECTORY

Prepared by: Arthur L. Haubenstock, Assistant Regional Counsel, U. S. Environmental Protection Agency, Region IX

## EPA Guidance and Policy on Brownfields, Superfund & the Audit Policy

These tables contain information culled from EPA and other federal government documents and web sites.
The electronic form of these tables contains hyperlinks to the referenced documents.
Copies of most of the listed guidance and policy documents are available at the following web addresses:

| | |
|---|---|
| Brownfields | www.epa.gov/brownfields/gdc.htm<br>www.epa.gov/brownfields/liab.htm |
| Superfund | www.epa.gov/superfund/pubs.htm |
| Superfund Redevelopment | www.epa.gov/superfund/programs/recycle/policy.htm |
| Audit Policy | es.epa.gov/oeca/auditpol.html<br>es.epa.gov/oeca/ore/apolguid.html |
| General EPA Publications | www.epa.gov/epahome/publications.htm |
| General U.S. Government Publications | www.access.gpo.gov/su_docs/aces/aces002.html |

## EPA Guidance and Policy on Brownfields & Superfund Redevelopment

| Title | Date | Description |
|---|---|---|
| Brownfield Tax Incentive: Fact Sheet | August 1997 | Fact Sheet on tax incentives to spur cleanup and redevelopment of brownfields provided by Subtitle E of the Taxpayer Relief Act of 1997. |
| Brownfields - Pollution Prevention and Waste Minimization | April 1997 | Fact sheet on EPA pollution prevention and waste minimization programs with application to the sustainable reuse of contaminated properties. |
| Community Reinvestment Act (CRA) | 1997 | The Community Reinvestment Act (CRA) establishes creative initiatives for economic development in low- and moderate-income urban neighborhoods while easing financial liability and regulatory burdens. |
| Guidance on Landowner Liability | June 6, 1989 | Guidance outlining EPA policy on landowner |

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| ***Under Section 107(a) of CERCLA, De minimis Settlements Under Section 112(g)(1)(B) of CERCLA, and Settlements With Prospective Purchasers of Contaminated Property.*** | | liability and settlement with de minimis landowners under CERCLA, including a brief (and partially outdated) discussion and policy statement concerning prospective purchasers. |
| ***Guidance on Settlements with Prospective Purchasers of Contaminated Property.*** | May 1995 | Revised 1989 guidance providing greater flexibility for prospective purchaser agreements (PPAs) and including model agreement. |
| ***Guidance on Federal Superfund Liens*** | September 22, 1987 | Discusses imposition of liens under Superfund law. See also ***supplemental guidance***. |
| ***Handbook of Tools for Managing Federal Superfund Liability Risks at Brownfields and Other Sites (hyperlink to web page listing each chapter)*** | November 1998 | Introduction to brownfields policies for parties interested in contaminated properties and compilation of EPA tools to encourage the cleanup and reuse of contaminated property and address liability barriers. |
| ***Interim Approaches for Regional Relations with State Voluntary Cleanup Programs.*** | November 14, 1996 | Guidance to facilitate regional/state negotiations on memoranda of agreement (MOAs) regarding state voluntary cleanup programs. |
| ***Land Use in the CERCLA Remedy Selection Process.*** | May 1995 | Land use directive promoting inclusion of realistic future land uses in remedy selection at National Priorities List (NPL) sites, including early discussion with local land use planning authorities, local officials, and the public. |
| ***Lender and Fiduciary Liability Amendments. [Asset Conservation,Lender Liability, and Deposit Insurance Protection Act of1996].*** | October 3, 1996 | Statutory codification of EPA Lender Liability rule providing qualified protection to lenders, trustees and other fiduciaries from liability under CERCLA and RCRA. |
| ***Policy on Interpreting CERCLA Provisions Addressing Lenders and Involuntary Acquisitions by Government Entities*** | June 30, 1997 | Provides guidance on application of Lender and Fiduciary Liability Amendments. |
| ***Policy on the Issuance of Comfort/Status Letters.*** | November 12, 1996 | Policy on issuing letters clarifying environmental status of potentially contaminated properties and indicating the likelihood of future EPA involvement, including model letters. |
| ***Policy Towards Landowners and Transferees of Federal Facilities.*** | June 13, 1997 | Policy addressing liability concerns of non-federal parties who acquire federal facility property and their transferees. |
| ***Policy Toward Owners of Property*** | July 3, 1995 | Policy addressing liability of owners of |

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| ***Containing Contaminated Aquifers.*** | | property containing contaminated groundwater tainted by source(s) outside their property. |
| ***Potential Insurance Products for Brownfields Cleanup and Redevelopment*** | April 1997 | Fact sheet summarizing results of EPA survey of environmental insurance options for brownfield activities. |
| ***Potential Insurance Products for Brownfields Cleanup and Redevelopment; Survey Results of Insurance Industry Products Available for Transference of Risk at Potentially Contaminated Property*** | June 1996 | Survey results of EPA survey of environmental insurance options for brownfield activities. |
| ***Quality Assurance Guidance for Conducting Brownfields Assessments*** | September 1998 | Guidance discussing quality assurance concepts and methodologies for identifying relevant data to determine environmental conditions. |
| ***Road Map to Understanding Innovative Technology Options for Brownfields Investigation and Cleanup.*** | June 1997 | Guidance identifying potential technology options available at site assessment, site investigation, remedy selection, and cleanup design and implementation phases of brownfield site characterization and cleanup. |
| ***Supplemental Guidance on Federal Superfund Liens*** | July 29, 1993 | Provides additional guidance on implementation of liens under Superfund law. |
| ***Targeted Brownfield Assessments*** | November 1998 | Fact Sheet on EPA program to provide assistance for environmental assessments for contaminated properties identified for redevelopment |
| ***Tool Kit of Information Resources for Brownfields Investigation and Cleanup.*** | June 1997 | Provides abstracts and access information for electronic databases and bulletin boards, newsletters, regulatory and policy guidance, and technical reports. |
| ***Tools for Managing Liability*** | July 1999 | Provides information concerning Superfund liability and mechanisms for ascertaining and resolving liability, including descriptions of comfort letters, prospective purchaser agreements, and statements of EPA liability policies |
| ***Using Supplemental Environmental Projects to Facilitate Brownfields Redevelopment*** | September 1998 | Guidance on using Supplemental Environmental Projects (SEPs) aimed at redeveloping contaminated sites to offset civil penalties. |

## General Superfund Law, Guidance and Policy Related to Redevelopment & Transactions

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| Title | Date | Description |
|---|---|---|
| ***The Alternative Dispute Resolution Fact Sheet.*** | May 1995 | Answers common questions on availability and use of Alternative Dispute Resolution (ADR) in EPA enforcement actions. |
| ***A Citizen's Guide to Understanding Presumptive Remedies.*** | October 1997 | A general overview of presumptive remedies under Superfund, with answers to commonly asked questions. |
| ***Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) 42 United States Code Annotated, Section 9601 et seq.*** | 1980 | The full Superfund law, including amendments. |
| ***Existing Ability to Pay Guidance and Models: Fact Sheet.*** | May 1995 | Describes EPA policies for considering a party's financial condition (ability to pay) in determining settlement amounts, including documents used by the EPA to assess and analyze financial information. |
| ***General Policy on Ability to Pay Determinations.*** | September 30, 1997 | Explains process and necessary components for ability to pay settlements in Superfund cases. |
| ***Guidance on Deferral of NPL Listing Determinations While States Oversee Response Actions.*** | May 3, 1995 | Provides criteria for deferring listing of contaminated site on the National Priorities List while undergoing state-lead remediation. |
| ***Guidance on Premium Payments in CERCLA Settlements.*** | November 17, 1988 | Describes discusses the purposes and calculation of premium payments in CERCLA settlements. |
| ***Methodology for Early De Minimis Waste Contributor Settlements under CERCLA section 122(g)(1)(A).*** | June 2, 1992 | Guidance promoting early consideration and facilitation of *de minimis* settlements under CERCLA section 122(g)(1)(A). |
| ***Model CERCLA Section 122(g)(4) De Minimis Contributor Consent Decree and Administrative Order on Consent.*** | December 7, 1995 | Model judicial and administrative CERCLA *de minimis* contributor settlements. |
| ***National Contingency Plan (40 C.F.R. Part 300).*** | | Implementing regulations for CERCLA and the Oil Pollution Act. The National Substances Pollution Contingency Plan, commonly called the National Contingency Plan (NCP), establishing a comprehensive, coordinated process for addressing releases of hazardous substances and oil spills. |
| ***The National Priorities List for Uncontrolled Hazardous Waste Sites;*** | November 24, 1997 | Interim final revision to the Agency's policy on placing RCRA-regulated federal facilities |

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| ***Listing and Deletion Policy for Federal Facilities.*** | | engaged in treatment, storage, or disposal of hazardous waste on the National Priorities list. |
| ***Partial Deletion of Sites Listed on the National Priorities List.*** | November 1, 1995 | Guidance for deletion of portions of sites from the NPL list prior to completion of site-wide remediation. |
| ***Policy for Municipality and Municipal Solid Waste CERCLA Settlements at NPL Co-Disposal Sites*** | February 5, 1998 | Discusses EPA general policy not to list generators and transporters of municipal solid waste as potentially responsible parties at NPL sites. |
| ***Policy Towards Owners of Residential Property at Superfund Sites.*** | July 3, 1991 | Discusses EPA general policy not to take enforcement actions against owners of residential property who cooperate in cleanup activities and who do not cause a release or threat of release of hazardous substances. |
| ***Presumptive Remedies: Policy and Procedures.*** | September 1993 | Discusses use of presumptive remedies (preferred cleanup methodologies) for common categories of sites, streamlining remedy selection process. |
| ***Presumptive Remedies: Site Characterization and Technology Selection for CERCLA Sites with Volatile Organic Compounds in Soil.*** | January 19, 1993 | Fact sheet outlining presumptive remedies for soils contaminated by volatile organic compounds. |
| ***Presumptive Response Strategy and Ex-Situ Treatment Technologies for Contaminated Groundwater at CERCLA Sites.*** | October 1996 | Guidance discussing use of site-specific remedial objectives as the focus of the remedy selection process for contaminated groundwater. |
| ***Presumptive Remedy for CERCLA Municipal Landfill Sites.*** | September 1993 | Establishes containment as the presumptive remedy for CERCLA municipal landfill sites and discusses streamlining principles related to remedial investigations/feasibility studies risk assessment. |
| ***Procedures for Partial Deletions at NPL Sites.*** | April 30, 1996 | Discusses procedures to delete portions of contaminated sites from the NPL prior to completion of site-wide remediation. |
| ***Revised De Micromis Guidance: Fact Sheet.*** | June 4, 1996 | Describes EPA policy to provide complete settlements for contributors of very small volumes of hazardous substances, including reference documents of interest to such parties. |
| ***Revised Guidance on CERCLA Settlements with De Micromis Waste Contributors.*** | June 3, 1996 | EPA policy to provide complete settlements for contributors of very small volumes of hazardous substances, including presumptive volumetric thresholds. |
| ***Rules of Thumb for Superfund Remedy*** | October 2, | Summarizes remedy selection guidance and |

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| ***Selection.*** | 1995 | describes primary elements of process. |
| ***Soil Screening Guidance: Fact Sheet.*** | June 1996 | Discusses methodologies to determine levels of soil contamination, and efforts to standardize and accelerate the evaluation and cleanup of contaminated soils at NPL sites where future residential land use is anticipated. |
| ***Standardizing the De Minimis Premium.*** | July 7, 1995 | Discusses components of premium for *de minimis* settlements, criteria for adjusting premia, and national experience with premia. |
| ***Streamlined Approach for Settlements With De Minimis Waste Contributors under CERCLA Section 122(g)(1)(A).*** | June 30, 1993 | Encourages expedited *de minimis* settlements, including discussion of site information necessary before such settlements should be considered. |
| ***This Is Superfund - A Citizen's Guide to EPA's Superfund Program.*** | | Introduces basic issues regarding the Superfund program, including include how Superfund sites are discovered, and who pays for and is involved in cleanups. Defines key terms for understanding the Superfund Program, such as potentially responsible parties (PRPs) and National Priorities List (NPL). |

| **EPA Audit Policy and Guidance** | | |
|---|---|---|
| **Title** | **Date** | **Description** |
| ***Audit Policy Interpretive Guidance*** | January 15, 1997 | Interpretation of key audit policy issues in question and answer format. |
| ***Audit Policy Update*** | Spring 1999 | Information on implementation of Audit Policy; Y2K policy; and proposed Audit Policy revisions |
| ***Confidentiality of Information Received Under Agency's Self-Disclosure Policy*** | | Policy on confidential treatment of information disclosed under the Audit Policy |
| ***Implementation of the Environmental Protection Agency's Self-Policing Policy for Disclosures Involving Potential Criminal Violations; Memorandum*** | October 1, 1997 | Guidance on application of audit policy to potentially criminal acts. |
| ***Incentives for Self-Policing: Discover Disclosure, Correction and Preventio Violations; Notice [Final Audit Polic*** | December 22, 1995 | Final policy, intended to encourage regulated entities to voluntarily discover, and disclose and correct violations of environmental requirements. |

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| | | |
|---|---|---|
| ***Policy on Compliance Incentives for Small Businesses*** | May 10, 1996 | Final policy, intended to promote environmental compliance among small businesses by providing incentives to participate in compliance assistance programs or to conduct environmental audits and to promptly correct violations |
| ***Y2K Enforcement Policy*** | November 30, 1998 | Enforcement policy designed to encourage prompt testing of computer-related equipment to ensure that environmental compliance is not impaired by the Y2K computer bug. |

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# Summary: Legislative Protection of Environmental Audits: The Federal "Incentive" Policy and State Environmental Audit Privilege and Immunity Legislation

Prepared by: Tomme R. Young, President, MERIT Enterprises, and co-author, *Managing Environmental Risk: Real Estate and Business Transactions* (West Group,1999)

Privileges and other protections for environmental audits are contained in state legislation and federal administrative documents. Although there is great variety among these documents, in all, the primary objective is to provide incentive to regulated companies and individuals to conduct regular voluntary environmental self-audits.

## A. US EPA Environmental Audit Policy Guidance Document

*Incentive for Self-Policing: Discovery, Disclosure, Correction, and Preventive Violations Final Policy Statement,* 60 Fed. Reg. 66706 (Dec. 22, 1995, effective Jan. 22, 1996, herein cited as "Policy").

### 1. Benefits Offered

This is **not a self-auditing <u>privilege</u>**, only a guidance relating to EPA's exercise of its administrative powers in the event of a violation. EPA has styled it "an incentive." As such, it provides that, if the violation is discovered in an audit or similar activity, and the violator reports it and complies with the other stated conditions, EPA will *<u>consider</u>* whether it is appropriate, under the enunciated policy, to reduce penalties and grant the violator other protections.

### 2. Outline of "Incentive" Requirements

The policy's limitations are limited, to ensure that the criminally or negligently culpable do not evade responsibility for the results of their actions.

a) "Audit" and "Due Diligence"

The Policy recognizes two levels of environmental self-evaluation: "environmental audit" and environmental "due diligence,"[1] both of which qualify for the same penalty reductions –

- *Environmental audit:* "a systematic, documented, periodic, and objective review by regulated entities of facility operations and practices related to meeting environmental requirements."[2]

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[1] The company may be called upon to document that their actions meet the definition of "due diligence." (Policy at I.E.1.)

[2] This definition was originally adopted as part of the EPA's 1986 policy on environmental auditing, and is specifically imported here from that document, suggesting that the 1986 audit policy will be the basis for determining whether a company has a program of RVSA.

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- *Due diligence:* "systematic efforts. . . to prevent, detect, and correct violations" must include:
  - (a) Intra-company environmental protocols;
  - (b) Designation of a person responsible for compliance at each facility/operation monitoring and auditing, performance evaluations, and internal "whistle-blower" protections);
  - (c) Communication of the program to all employees;
  - (d) Internal incentives and disciplinary mechanisms; and
  - (e) Procedures to ensure that violations are promptly corrected, and will not reoccur in future.

**Incentives (protections and benefits available)**

The policy does not offer immunity from administrative penalty, civil or criminal action, or discovery and use of documents. More limited protections are offered in three areas: penalty reduction, initiation of criminal prosecution, and access to reports of the company's RVSAs.

**b) Penalty reduction**

Penalty reduction is limited to:

- 100% reduction in gravity-based penalties associated with a self-reported violation, which meets all policy conditions. (Policy, ¶ II.C.1)
- If the entity does not meet all conditions (lacking an "environmental audit" or "due diligence" program), a 75% reduction may be available. (Policy, ¶ II.C.2.)

In another document, EPA also offers to negotiate reduction in other penalties if the entity undertakes a "supplemental environmental project." (*Supplemental Environmental Project Policy* (May 1, 1998).)

**c) No recommendation on criminal prosecution**

The Agency states that it will continue to decline to recommend criminal prosecution (by the Department of Justice or other prosecuting authority office) for self-policing entities that satisfy policy conditions. (Policy, ¶ II.C.3.) (Exceptions are discussed below.)

**d) No requests for audit reports**

For qualifying entities, EPA will not request or use an environmental audit report for the purposes of commencing civil or criminal investigation (The agency may still utilize its basic information powers if it has independent reason to believe that a violation has occurred. (Policy, ¶ II.C.4.)

Applies only to "environmental audit reports" and specifically excludes "the data obtained in the course of the environmental audit," and testimonial evidence concerning the audit and the audit process. (Policy, ¶ II.B.)

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**e) Limitations on Incentive Provisions**

These benefits are limited by two provisions regarding the rights retained by EPA with regard to violations.

## Economic Gain

EPA will still be entitled to disgorge economic benefits resulting from the company's noncompliance – to "level the playing field" and ensure that violators do not prosper by their violations. (Policy, ¶ II.E.)

## Criminal Prosecutions Still Permitted

The assurance that EPA will not recommend criminal charges is limited in certain situations. Prosecution will still be recommended wherever:

- ♦ the violation involves concealment (or approval) of environmental violations by management;
- ♦ the violation demonstrates conscious involvement in, or willful blindness to, the violations by managers or officials in the company;
- ♦ there is evidence of criminal acts by individual managers or employees.

## Conditions of Qualification for Incentives

The Policy identifies nine separate conditions – six direct, and three which are limitations on the use of the policy.

**f) Systematic Discovery**

The policy only applies to violations that were discovered through application of a systematic program of environmental compliance review, *i.e.* –

(i) an environmental audit; or

(ii) an objective, documented, systematic procedure evidencing due diligence regarding environmental compliance

The company must provide "accurate and complete documentation . . . as to how it exercises due diligence to prevent, detect, and correct violations according to the criteria for due diligence." (Policy, ¶ II.D.1)

**g) Voluntary Discovery**

The RVSA that discovers the violation must be "voluntarily," – that is, not mandatory by statute, regulation, permit (including NPDES and air emissions permits), judicial or administrative order, or consent agreement. (Policy, ¶ II.D.2.) The existence of mandatory reporting obligations does not by itself mean that a company's audit or diligence was not "voluntary" for purposes of this condition.

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**h) Prompt Reporting**

The violation must be reported to EPA in writing within 10 days (unless a shorter period applies) after it is discovered that the violation has occurred, *or may have occurred*. (Policy, ¶ II.D.3.)

**i) Correction and Remediation**

The company must correct that violation within 60 days, (unless limited provisions for extension apply), and must certify that fact in writing. It must also make specified efforts to remedy any environmental or human harm resulting from the violation. (Policy, ¶ II.D.5.) Where correction of the violation will require the company to apply for a permit from federal or state authorities, the EPA will make reasonable efforts to secure timely decision on the permit application. (Policy, ¶ I.E.4.)

**j) Prevention of Recurrence of Violation in Future**

The company must commit in writing to take preventive steps regarding future violations. One recommended mechanism for this is improvement of the company's environmental auditing or due diligence program. (Policy, ¶ II.D.6, *further discussed in* ¶ I.E.5.)

**k) Cooperation**

The company must cooperate with EPA, which means, at a minimum, "providing all requested documents and access to employees," as well as assistance in investigation of the violation itself, disclosure problems, and any environmental consequences. (Policy, ¶ II.D.9)

**l) Other Conditions – Limitations on the Availability of the Policy**

The three remaining conditions limit the availability of the policy, providing objective mechanisms for determining whether the audit and report were truly voluntary,

## "Independent" Discovery and Disclosure

The discovery and disclosure can not be motivated by the imminence of government or third-party legal action or investigation. It must occur before:

(a) notice of, or the commencement of a government inspection, investigation or request for information;

(b) notice of a citizen suit;

(b) the filing of a third-party complaint;

(c) any report by a "whistleblower" employee; or

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(d) awareness of the imminence of the discovery of the violation by a regulatory agency.

(Policy, ¶ II.D.4.)

### Specific Types of Violations Excluded

The policy will not apply to violations that have resulted in:

- "serious actual harm,"
- "imminent and substantial endangerment to human health or the environment,"
- a violation of the specific terms of an order, or consent agreement.

(Policy, ¶ II.D.8.)

### No Protection for Repeat Violators

A "bright line" test applies to determine if the company is a repeat violator to whom the policy does not apply:

- similar violations at the same facility within the three years prior to the current violation, or
- a pattern of violations by the facility or it's parent organization over the past five years.

(Policy, ¶ II.D.7.)

**Protection of information**

Confidentiality and privilege is not a priority (or even much of a consideration) under the policy. Several provisions mandate various types of government and public access to the audit and related information. For example:

- The company's qualification for penalty mitigation may be conditioned on the public availability of the company's due diligence efforts. This provision was specifically added to ensure that environmental groups and other members of the public be able to judge the adequacy of compliance management systems. (Policy, ¶ I.E.1.)
- One possible condition of penalty mitigation is a publicly available description of the company's due diligence efforts. (Policy, ¶ II.D.1.)
- For violations requiring relatively long remediation periods, the required written agreement, administrative consent order, or judicial consent decree must be publicly available. (Policy, ¶ II.D.5.) This provision is emphatically intended to create and reinforce public accountability for the company's commitments. (Policy, ¶ I.E.4.)

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- EPA will recognize both FOIA requests, and its own mandate to make compliance agreements publicly available. (Subject to basic regulations regarding Confidential Business Information. 40 C.F.R. Part 2.) (I.E.2)

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B. State Environmental Audit Privilege Legislation

25 states currently[3] have enacted some form of privilege for companies conducting RVSAs. (*See,* Alaska Stat. §§ 09.25.450, *et seq.*; Ark. Code Ann. § 8-1-303; Colo. Rev. Stat. § 13-90-107(j); Idaho Code § 9-340; Ind. Code § 13-10-3-3; Ky. Rev. Stat. § 224.01-0401; Mich. Stat. Ann. §§ 13A.14801 *et seq.*; Miss. Code Ann. § 40-2-71; Mont. Code Ann. §§ 75-1-1201 *et seq.*; Neb. Legis. 395; Nev. Rev. Stat. § 445C.010, *et seq.*; N.H. Rev. Stat. Ann. §§ 147-E:1 *et seq.*; Ohio Stat. §§ 3745,70, *et seq.*; Or. Rev. Stat. § 468.963;[4] R.I. Stat. § 42-17.8-1, *et seq.*; S.C. Code §§ 48-57-10 *et seq.*; S.D. Codified Laws, §§ 1-40-33 *et seq.*; Tex. Rev. Civ. Stat. Ann. art. 4447cc; Utah Code Ann. § 19-7-104; Va. Code Ann. § 10.1-1198; Wyo. Stat. § 35-11-1105.)

1. Effect of EPA Policy on State Privilege Legislation

Many of the state environmental audit privilege laws were enacted prior to the publication of the EPA Policy—several before the initiation of the federal process of developing that policy. (Policy ¶ II.F, 26 Envtl. L. Rep. 35639, 35634). In one provision, the EPA Policy addresses the existence of state environmental privilege laws, and states its position regarding them, noting in particular that it will:

a. encourage the adoption of state policies that reflect the incentives and conditions outlined in this policy.

b. "firmly oppose any statutory environmental audit privileges that shield evidence of environmental violations," and

c. oppose any immunities in cases of

   i. criminal conduct,

   ii. serious threats or actual harm to health and the environment,

   iii. non-complying companies gaining an economic advantage over their competitors through their non-compliance, or

   iv. repeated failure to comply with federal law.

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[3] As of mid-1998.

[4] **Oregon** was the first state to pass privilege legislation, in 1993, and has been the basis on which numerous other states' laws were drafted. Less than seven years having passed since this first enactment, evaluation of the effectiveness of these laws is still ongoing.

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The Agency reserves its right to take action "if necessary to protect public health or the environment by enforcing against any violations of federal law."

2. Digest of State Law Provisions

The variation among the various states' environmental audit privilege provisions is instructive on many points. The following are general notes comparing these various laws with regard to their coverage and limitations.[5] (References here are only to specific provisions in legislation, concepts or provisions that are implied at law, or applicable based on other statutes not referred to below):

1. Definition: What is "an audit" for purposes of the privilege?

   Under a typical definition, an "audit" must be both "internal" and "comprehensive," designed to identify and prevent non-compliance and to improve compliance with applicable environmental regulations. – **Colorado, Indiana, Kentucky, Oregon**

   Both internal audits and those conducted by independent contractors are specifically included – **Iowa**

   To qualify, an audit must be designed to (1) produce systematic, documented and objective results, (2) identify and prevent noncompliance, and (3) improve compliance – **Nevada**

   Audit must also be designed to identify "historical. . . noncompliance" – **Iowa**

   Audit must be prepared pursuant to a specific written directive to review compliance with an environmental requirement or requirements – **Nebraska**

   For purposes of the privilege, "audit" may include either a facility audit or an audit of environmental management systems – **Indiana, Iowa** (also may be an audit of a particular activity), **Kentucky**

   Audited facility, system or activity must be regulated under state or federal environmental laws, rules or permit conditions – **Iowa**

2. Breadth of privilege – protected materials: What information, evidence, records and other information are protected by the privilege?

   For these purposes, "audit" includes all audit materials that are developed for the purpose of the auditing process (including, in addition to the final report, all field notes, observations, draft

[5] Apart from this note, this outline will not discuss or allude to the (sometimes complex) procedural requirements for asserting the privilege. Owing to the fact that most exceptions to the privilege are based on the contents of the audit materials themselves, elaborate provisions must be made regarding protection of and surrender of the documents to officials (who may not review them in advance of the final decision on privilege) prior to resolution of the issue of whether a privilege may be asserted, and punishment for official violations of these provisions.

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reports, photographs, etc.) – **Alaska, Colorado, Indiana, Kentucky, Minnesota, Mississippi, Nebraska, New Hampshire, Oregon, South Carolina, Texas**

Privilege does not cover machinery and equipment maintenance records – **Michigan**

Privilege does not cover industrial pretreatment monitoring results required *or used* by a Publicly-owned Treatment Works (POTW) – **Michigan**

To be privileged, all such audits must be labeled "Environmental Audit Report: Privileged Information." – **Colorado, Iowa, Oregon**

For the audit to be privileged, the company must have provided a notice to state and municipal authorities that it is conducting an audit – **Alaska**

Includes a testimonial privilege (applicable to persons involved in the performance of the audit) – **Colorado, Ohio** (persons possessing information within the privilege precluded from testimony), **Texas** (limited testimonial privilege, includes the person to whom audit results were disclosed and the custodian of the audit, even if these persons did not participate in conducting the audit)

Includes the contents of communications between or among the facility owner, the employees or contractors of the owner, as necessary, in good faith to the conduct of the audit – **Ohio** (communicating party must have been notified that the conversation was a part of the audit)

3. Breadth of privilege – proceedings: Does the privilege apply to all types of proceedings?

   Applies to any civil, criminal and administrative proceedings, and unless an exception is shown (below) – **Arkansas, Colorado, Idaho, Indiana, Kentucky, Mississippi, New Hampshire, Ohio, Oregon, Texas, Wyoming**

   Applies only to civil and administrative proceedings. No privilege in criminal proceedings – **Alaska, Iowa**

   Applies to civil and administrative proceedings, or enforcement proceedings under local ordinances – **Nebraska**

   Applies to use by public officials against the party in any administrative hearing or judicial action – **Montana**

   Applies to all administrative proceedings and civil actions, except those commenced by the environmental regulatory agency – **Nevada** (special request by the agency required)

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Applies only to requests by the state Department of Environment and Natural Resources (audits otherwise subject to discovery according to the rules of civil and criminal procedure) – **South Dakota**

Includes immunity from imposition of administrative penalties, initiation of prosecution for violations, provided the company voluntarily self-reported the violations – **Alaska, Colorado, Iowa, Michigan** (including only fines based on negligent acts or omissions), **Montana, Nebraska** (violator who complies will "generally not be liable for civil penalties"), **New Hampshire** (violator must show that it has taken appropriate measures to avoid future violations), **Ohio, Rhode Island** (immunity only from "gravity based penalties" and civil or criminal prosecution for such violations), **South Carolina, South Dakota** (immunity does not apply to willful violations, violations evidencing a pattern, repeat violations, etc. Violation must be reported in writing within 30 days of discovery)

Includes a presumption of non-liability for such penalties (rebuttable by a showing that (1) violation was willful, (2) violation resulted in serious actual damage to public health, (3) offender realized a significant economic benefit as a result of the violation, or (4) the audit and report were initiated after the commencement of government investigation or proceedings) – **Nevada**

Specifically includes administrative enforcement actions – **Arkansas**

Government agencies may not request, review, or otherwise use an audit report during an agency inspection of a regulated facility or operation – **Alaska, Texas**

So long as a violation discovered in the course of an audit is properly reported to the appropriate officials, such officials may not request a copy of the audit report – **Montana**

If reporting requirements are met, officials may not request or use the contents of the audit report as a regular means of investigation or as a basis for initiating administrative, civil or criminal action – **Rhode Island**

4. Breadth of privilege: How is the privilege asserted? To what extent does it override general discovery authority?

   Asserting party must prove all elements of the privilege, including prompt initiation of any necessary remedial action, diligent pursuit of same thereafter – **Arkansas**

   Privilege may be waived – **New Hampshire**

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Owner of the facility or property is the holder of the privilege – **Ohio**

Audits are not exempt from normal discovery, but if the privilege is successfully asserted, they may not be admissible in evidence – **Kansas**

Audits are not exempt from normal discovery, but their use by state officials is restricted – **Montana**

5. Exceptions to and limitations of the privilege: On what basis may the privilege be withdrawn (in whole or in part)?

   Statutory exceptions to the privilege *do not* apply to audits performed prior to enactment of the privilege statute (1994); such audits are categorically privileged – **Indiana**

   Discovery of audit reports and associated materials may be compelled if any of these bases for exception can be proven: (*see especially,* **Colorado, Kentucky, New Hampshire, Oregon, Wyoming,** however, some or all of the elements listed below appear in virtually all state environmental privilege statutes)

   - fraudulent purpose behind assertion of the privilege
   - material not subject to the privilege (*e.g.* not created for the purpose of the audit, and not otherwise privileged)
   - the material evidences or illustrates a violation of state or federal environmental law, as to which prompt correction efforts were not undertaken[6]
   - (only as to criminal cases) the material is relevant to the allegation of a breach of state criminal environmental provisions, upon a showing of compelling need for the material.

   Privilege does not apply where the party asserting the privilege does not have a system to assure compliance with environmental laws – **Kansas**

   No privilege where the self-audit and/or reporting were undertaken to avoid disclosure of information in a proceeding that was underway or where the person/company had reason to suspect that a government inspection or audit was imminent – **Kansas, New Hampshire, Rhode Island, Utah**

   An exception may be granted where substantial resources may be necessary to achieve compliance – **Utah**

[6] In some statutes (*e.g.*, **Arkansas, Indiana, Ohio**) the burden of proving the exception (normally on the person/entity seeking the material) is shifted to the person asserting the privilege, with regard to the showing that remedial efforts were promptly and diligently undertaken.

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No privilege where the information is obtained through a source independent of the audit – **Michigan, Utah**

In criminal proceedings, the court may require full or partial disclosure, if the district attorney or AG has need for the information and such information is not otherwise available – **Wyoming**

Compliance with specific requirements for detailed disclosure (including a significant amount of technical information, such as laboratory, equipment, monitoring and other test results) of violations is a prerequisite of all immunity and privilege – **Rhode Island**

6. Independence of the privilege: Is it tied to the applicability of the attorney-client and/or work product privileges?

   The involvement of an attorney is not required in order to assert the privilege – **Oregon, Colorado**

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