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Environmental Law Concerns in Real Estate Transactions

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ENVIRONMENTAL LAW CONCERNS IN REAL ESTATE TRANSACTIONS

by

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RECENT media attention and aggressive marketing by environmental professionals, publications, and conference sponsors have focused the attention of the real estate community on environmental concerns. Though subject to hyperbole, this publicity stems from concerns that are both real and often material to transactions involving the sale, lease, or mortgaging of real property. This Article provides an overview of environmental considerations relevant to real estate transactions and an analytical framework for evaluating those considerations.

I. OVERVIEW OF ENVIRONMENTAL LAWS

Environmental laws regulate human activities because of the actual or potential effect these activities have on the environment or on human health via the environment. For purposes of this Article, programs established by environmental statutes may be divided into three broad categories, based on their principle objectives: (1) Pollution Control; (2) Chemical Regulation; and (3) Environmental Review and Protection.

A. Types of Federal Environmental Programs

1. Pollution Control

Pollution programs generally seek to protect human health and welfare and the environment by prescriptively regulating the discharge of contaminants into various media. Examples of such programs are the Clean Air Act (CAA),[1] which regulates pollutant emissions to the air, the Clean Water Act (CWA),[2] which regulates pollutant discharges to water, and the Resource Conservation and Recovery Act of 1976 (RCRA),[3] as amended by the Haz-

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1. 42 U.S.C. §§ 7402-7462 (1988).
2. 33 U.S.C. §§ 1251-1387 (1988).
3. 42 U.S.C. §§ 6901-6992k (1988).

ardous and Solid Waste Amendments of 1984 (HSWA),[4] and the Underground Injection Control (UIC) program of the Safe Drinking Water Act (SDWA),[5] which regulate pollutant releases onto or under land. These programs establish permitting programs that require pre-construction or pre-operation environmental review, including public notice and the opportunity for an adjudicatory hearing.[6] To obtain these permits, owners or operators of proposed facilities generally must demonstrate compliance with both technology-based standards and standards relating to the quality of the ambient environment.[7] Issued permits contain not only substantive requirements, but administrative requirements as well, including testing, reporting, record-keeping, and authorization of inspections. To encourage compliance, these programs provide for substantial sanctions, both civil and criminal.[8]

A subcategory of pollution programs includes those that seek to alleviate problems resulting from past disposal practices. Included within this subcategory are the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA or Superfund),[9] as amended by the Superfund Amendments and Reauthorization Act of 1986 (SARA),[10] and section 7003 of RCRA.[11] Under both statutes, retroactive liability is imposed on specified parties.[12] CERCLA additionally establishes a comprehensive regulatory scheme to identify, investigate, and remediate problem sites.[13] To assist in the development of a data base, CERCLA also establishes prescriptive notification requirements for incidents and conditions of environmental contamination.[14]

2. *Chemical Regulation*

Chemical regulatory programs seek to protect public health and the environment by regulating the handling, use, manufacture, importation, and distribution of chemicals. These types of programs include: the Toxic Substances Control Act (TSCA),[15] the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA),[16] and the Emergency Planning and Community Right-to-Know Act (EPCRA)[17] of SARA. A related program is the drinking water program of the SDWA,[18] which imposes regulatory requirements

4. *Id.* §§ 6901, 6902, 6905, 6912, 6915-6917, 6921-6931, 6933, 6935-6939, 6941, 6943-6945, 6948, 6949a, 6956, 6962, 6972, 6973, 6976, 6979a, 6979b, 6982, 6984, 6991, 6991a-6991i.
5. *Id.* §§ 300h-1 to -5.
6. *Id.* §§ 7475(a)-(e), 6925(a)-(c), 300h-3(b)(1)-(3); 33 U.S.C. §§ 1341-1345 (1988).
7. *See* 42 U.S.C. §§ 7475(a)-(e), 6925(a)-(c), 300h-3(b)(1)-(3); 33 U.S.C. §§ 1341-1345 (1988).
8. *Id.* §§ 300h-2(b), 300h-3(c), 7413 (1988); 33 U.S.C. § 1319 (1988).
9. *Id.* §§ 9601-9657 (1988).
10. *Id.* §§ 9601-9675.
11. *Id.* § 6973.
12. *Id.* §§ 6991e, 9607(a).
13. *Id.* § 9621.
14. *Id.* § 9603(a), (c).
15. 15 U.S.C. §§ 2601-2671 (1988).
16. 7 U.S.C. §§ 136-136y (1988).
17. 42 U.S.C. §§ 11001-11050 (1988).
18. *Id.* §§ 300g-300j.

on the supply of potable water to the public.[19] These programs, too, contain substantial sanctions for noncompliance.[20]

3. *Environmental Review and Protection*

Environmental review and protection programs seek to protect the environment, or various segments of the environment, and human welfare generally through procedural and substantive environmental review requirements superimposed on other governmental programs as a prerequisite to federal activity. In these types of programs, the focus of environmental review may be broad or relatively narrow, with concern for a particular aspect of the environment. For example, the National Environmental Policy Act (NEPA)[21] generally requires consideration of a broad range of environmental impacts associated with various alternatives prior to taking federal action,[22] while the National Flood Insurance Program[23] seeks to restrict development in flood-prone areas. For a number of environmental review programs, the titles indicate their specific focus and objectives, for example, the Endangered Species Act,[24] the National Historic Preservation Act,[25] the Fish and Wildlife Coordination Act,[26] the Coastal Zone Management Act,[27] and the Wild and Scenic Rivers Act.[28]

B. Types of State Environmental Programs

1. *In General*

Many of the federal environmental programs have state analogs. In general, state environmental programs fall into categories similar to their federal counterparts. Some of these state programs seek to implement federal statutes that expressly provide for state assumption of responsibility. Prime examples are the federal pollution programs implemented by the United States Environmental Protection Agency (EPA), which provide for state assumption, contingent on federal guidelines being satisfied.[29] In states that have assumed responsibility for federal pollution programs, EPA involvement is limited to an oversight role. In states having programs that have not qualified, dual and parallel federal and state programs may exist. Texas, for example, has parallel waste water discharge permit programs: administered by the EPA, on the one hand, and by the Texas Water Commission, on the other.[30] Other state statutes may supplement federal programs and operate

19. *Id.*
20. *Id.* §§ 300g-3(b), 300h-2(b), 300i, 300j(e).
21. *Id.* §§ 4321-4370a.
22. *Id.* § 4332.
23. *Id.* §§ 4001-4104.
24. 16 U.S.C. §§ 1531-1544 (1988).
25. *Id.* § 470.
26. *Id.* §§ 661-666(c).
27. *Id.* §§ 1451-1464.
28. *Id.* §§ 1271-1282.
29. 33 U.S.C. §§ 1251, 1342, 1345 (1988); 42 U.S.C. §§ 300h-3001, 7402, 7410, 7470-7479, 7501-7508 (1988).
30. 33 U.S.C. § 1342 (1988); TEX. WATER CODE ANN. § 26.029 (Vernon 1988).

independently.

2. *Independent, Supplemental State Programs*

Though state pollution programs generally parallel their federal counterparts and supplant them upon state assumption, they also may supplement them, regulating activities not regulated by the federal programs. In Texas, the state has established its own program for the regulation of both industrial and municipal solid wastes,[31] in addition to having assumed responsibility for the federal hazardous waste program under RCRA. Many states have adopted their own Superfund programs that operate independently of the federal program, which, though providing for federal-state cooperation and coordination, does not provide for state assumption.[32] With respect to chemical regulatory programs, California has developed its own program, Proposition 65,[33] which is of significantly broader applicability than TSCA. TSCA itself does not provide for state assumption. As regards environmental review, many states have their own NEPA-type review programs.[34] New Jersey has developed an innovative environmental review program pursuant to its Environmental Cleanup and Responsibility Act (ECRA),[35] which prohibits certain property transfers without governmental approval.[36]

3. *State Administrative Procedures*

States implement their environmental programs in accordance with state administrative procedures. In Texas, for example, the Administrative Procedure and Texas Register Act (APTRA),[37] which applies to state pollution

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31. Act of June 14, 1989, ch. 678, § 1, 1989 Tex. Sess. Law Serv. 2612 (Vernon) (to be codified at TEX. HEALTH & SAFETY CODE § 361 (Vernon)), *as amended by* Act of June 14, 1989, ch. 583, § 1, 1989 Tex. Sess. Law Serv. 1921 (Vernon); Act of June 14, 1989, ch. 335, § 1, 1989 Tex. Sess. Law Serv. 1302 (Vernon); Act of June 14, 1989, ch. 536, § 3, 1989 Tex. Sess. Law Serv. 1755 (Vernon); Act of June 14, 1989, ch. 703, §§ 1-8, 1989 Tex. Sess. Law Serv. 3212 (Vernon); Act of June 14, 1989, ch. 639, § 5, 1989 Tex. Sess. Law Serv. 2120 (Vernon); Act of June 14, 1989, ch. 641, § 1, 1989 Tex. Sess. Law Serv. 2123 (Vernon); Act of June 14, 1989, ch. 400, § 1, 1989 Tex. Sess. Law Serv. 1542 (Vernon); Act of June 16, 1989, ch. 1143, §§ 3-8, 1989 Tex. Sess. Law Serv. 4721 (Vernon); Act of June 14, 1989, ch. 705, § 1, 1989 Tex. Sess. Law Serv. 3237 (Vernon).

32. *See, e.g.*, Carpenter-Presley-Tanner Hazardous Substance Account Act, CAL. HEALTH & SAFETY CODE §§ 25300-25386.6 (Deering 1988); Superfund Law, KAN. STAT. ANN. §§ 65-3452a to 3459 (1989); Environmental Response and Liability Act, MINN. STAT. ANN. §§ 115B.01-.24 (West 1988 & Supp. 1989); Spill Compensation and Control Act, N.J. STAT. ANN. §§ 58:10-23.11 to .34 (West 1982 & Supp. 1989); Act of June 14, 1989, ch. 678, § 1, 1989 Tex. Sess. Law Serv. 2646 (Vernon) (to be codified at TEX. HEALTH & SAFETY CODE §§ 361.181-.352 (Vernon)), *as amended by* Act of June 14, 1989, ch. 703, §§ 5-8, 1989 Tex. Sess. Law Serv. 3218 (Vernon).

33. Safe Drinking Water and Toxic Enforcement Act of 1986, CAL. HEALTH & SAFETY CODE §§ 25249.5-.73 (Deering 1988).

34. *See, e.g.*, Environmental Quality Assessment Act, CAL. HEALTH & SAFETY CODE §§ 25570-25570.4 (Deering 1988); Environmental Land and Water Management Act of 1972, FLA. STAT. ANN. §§ 380.012-.10 (West 1988 & Supp. 1989); Critical Areas Act, MINN. STAT. ANN. §§ 116G.01-.14 (West 1987); Land Use and Development Law, VT. STAT. ANN. tit.10, §§ 6001-6002 (1984 & Supp. 1989).

35. N.J. STAT. ANN. §§ 13:1K-6 to -13 (West Supp. 1989).

36. *Id.* § 13:1K-11.

37. TEX. REV. CIV. STAT. ANN. art. 6252-13a (Vernon Supp. 1989).

program permitting, establishes not only formal requirements for public notice and opportunity for a public hearing, but also procedures for the conduct of such hearings equivalent to those employed in civil litigation before a judge without a jury.[38] These hearings often are protracted, entailing significant discovery and detailed legal arguments.[39]

II. EFFECTS ON REAL ESTATE OF VARIOUS ENVIRONMENTAL PROGRAMS

A. Environmental Concerns In General

Parties to any real estate transaction should understand that environmental programs affect real estate in two significant ways: (1) they impose restrictions that affect the ability to use a property for a particular purpose, and (2) they create liabilities. For those engaged in real estate transactions generally, environmental concerns relate to potential land use restrictions and liabilities attributable to on-site conditions, which are predicated on a party's ownership or other involvement with property. For those intending new uses of property, an additional concern relates to the costs of attaining and maintaining environmental compliance for those uses. For those engaged in transactions involving not only real estate, but an ongoing business, further concerns include liabilities for prior activities that contributed to an off-site environmental or human health threat or that were in violation of an applicable environmental law. Whether liabilities for prior activities are transferred as a result of a transaction turns on whether that transaction involves the transfer of assets or of company ownership, as in a merger, either expressly or judicially inferred.[40]

To properly evaluate the relevance of environmental concerns to a transaction, it is necessary to understand the real property effects of the various environmental programs. The ways environmental programs are implemented determine how they affect real estate and real estate transactions. Specific liabilities and land use restrictions created by these programs are discussed below.

B. Specific Real Estate Effects of Environmental Programs

1. Programs Creating Liability

Prescriptive pollution programs and chemical regulatory programs are relevant in transactions involving ongoing businesses because they give rise to substantial liabilities for prior activities that were conducted in violation of an applicable requirement.[41] For transactions in which the development of a new business is contemplated, as well as transactions involving existing businesses, these two types of programs also are of concern because of the significant costs associated with attaining and maintaining compliance.

38. *Id.* art. 6252-13a, § 12.
39. *Id.* art. 6252-13a, §§ 13-14.
40. *See infra* text accompanying notes 145-155.
41. *See infra* text accompanying notes 219-238.

Under pollution programs, technical requirements significantly affect the feasibility and conditions of an existing or new use.[42] Pre-activity environmental review of new uses under pollution programs, including the potential for protracted public hearings, affects the amount of time and money required to implement those uses.[43]

Other pollution programs, as well as section 6(e) of TSCA,[44] are of concern to parties involved in real estate transactions because they create liabilities associated with on-site conditions.[45] Included in this category are: CERCLA[46]and section 7003 of RCRA,[47] which impose liability on, among others, owners and operators of property contaminated with hazardous substances; National Emission Standards for Hazardous Air Pollutants (NESHAPs) for asbestos pursuant to the CAA,[48] which impose on owners and operators of buildings containing asbestos significant regulatory requirements relating to the demolition or renovation of those buildings;[49] the underground storage tank (UST) program of RCRA, which imposes significant regulatory requirements on present and past owners and operators of underground storage tanks;[50] and section 6(e) of TSCA,[51] which is the statutory basis for EPA's program for the regulation of polychlorinated biphenyl (PCBs), that regulates PCBs in transformers, capacitors, and other equipment that might be found at an ongoing business or previously developed site.[52] For on-site conditions involving asbestos, PCBs, or hazardous substances that were stored in USTs, CERCLA provides an alternative basis for liability.[53]

The presence of hazardous substances, asbestos, USTs and PCBs, as well as radon and indoor air pollution, which, though subject to study, currently are not subject to regulation, may give rise to liability under the common law, specifically, under contractual and tortious theories of liability.[54] Common law actions may involve not only parties to the transaction, but third parties as well, such as toxic tort litigation brought by adjacent residents or property owners or by employees. The presence of these on-site conditions, of course, affects property value.

CERCLA is of concern not only because it creates liability for owners of property for on-site conditions,[55] but also because it creates liability for those acquiring ongoing businesses, or responsibility for former businesses,

42. *See, e.g.*, 33 U.S.C. § 1342 (1988); 42 U.S.C. §§ 300g-2, 6925, 7411, 7412 (1988).
43. *See, e.g.*, 40 C.F.R. §§ 60, 61, 122, 141-143, 270, 401-699 (1988).
44. 15 U.S.C. § 2606 (1988).
45. 40 C.F.R. §§ 61.140-.156 (1988); 53 Fed. Reg. 37,194 (1988) (to be codified at 40 C.F.R. §§ 280-281).
46. 42 U.S.C. §§ 9601-9675 (1988).
47. *Id.* § 6973.
48. 40 C.F.R. § 61(A), (M) (1988).
49. *Id.*
50. 53 Fed. Reg. 37,194 (1988) (to be codified at 40 C.F.R. §§ 280-281).
51. 15 U.S.C. § 2606 (1988).
52. 40 C.F.R. § 761 (1988).
53. 42 U.S.C. § 9607 (1988).
54. *See infra* text accompanying notes 92-99.
55. 42 U.S.C. § 9607(a) (1988).

that disposed of wastes at sites subject to, or potentially subject to, CERCLA investigative and remedial actions.[56] Under CERCLA, potentially responsible parties (PRPs) under section 107 include not only site owners and operators, but also certain transporters and generators, as well as others who arranged for disposal of wastes at the site.[57] Each of these PRPs may be subject to common law liability also.

2. *Programs Creating Land Use Restrictions*

Environmental review and protection programs are of concern in real estate transactions because of the restrictions they create on land use. Examples of such programs include the National Flood Insurance Program,[58] which restricts development in the flood plain, and the Endangered Species Act,[59] which restricts development in designated critical habitats of endangered species. The review required by these programs also may result in delay and in the exacting of regulatory concessions by agencies in exchange for necessary federal approval or concurrence.

Some pollution programs regulate land use directly. The SDWA,[60] for example, provides for the establishment of sole source aquifers,[61] such as the Edwards Aquifer in Texas.[62] Pursuant to that program, the Texas Water Commission has imposed certain land use restrictions in counties located atop the aquifer recharge area.[63] The recent amendments to the SDWA provide for the establishment of wellhead protection areas, which also will restrict land use.[64] Section 404 of the CWA,[65] though a pollution permit program, operates as a de facto wetlands preservation program by restricting development in wetlands areas. Courts have construed the CWA to apply not only to the placement of dredged materials into bodies of water, but also to the use of tractors to clear bottomland hardwoods.[66] CERCLA and other programs[67] relating to on-site conditions may create de facto and, in some instances, de jure restrictions on land use. Both federal and state Superfund programs also provide for the imposition of liens on government remediated sites to secure payment of governmental costs.[68]

On the local level, many cities have watershed protection ordinances that significantly affect development in some areas.[69] Other local programs re-

56. *Id.*
57. *Id.*
58. *Id.* §§ 4001-4104.
59. 16 U.S.C. §§ 1531-1544 (1988).
60. 42 U.S.C. §§ 300f to 300j-11 (1988).
61. *Id.* § 300h-6; 40 C.F.R. § 149 (1988).
62. TEX. WATER CODE ANN. § 26.046 (Vernon 1988).
63. TEX. REV. CIV. STAT. ANN. art. 31, § 313 (Vernon 1987).
64. 42 U.S.C. § 300h-7 (1988).
65. 33 U.S.C. § 1344 (1988).
66. Avoyelles Sportsmen's League, Inc. v. Marsh, 715 F.2d 897 (5th Cir. 1983).
67. 40 C.F.R. §§ 61, 264.117 (1988); 42 U.S.C. § 7411(e) (1988).
68. 42 U.S.C. § 9607(1) (1988); *see* Act of June 14, 1989, ch. 678, § 1 (to be codified at TEX. HEALTH & SAFETY CODE § 361.196).
69. *See* City of Austin v. Jamail, 662 S.W.2d 779 (Tex. App.—Austin 1983, writ dism'd); Royal Crest v. City of San Antonio, 520 S.W.2d 858 (Tex. Civ. App.—San Antonio 1975, writ

strict the withdrawal of groundwater and its availability for developmental purposes, as in the Harris-Galveston Coastal Subsidence District.[70] Water rights, a related area not within the scope of this Article, also may affect land use.

Several of the pollution programs restrict land use indirectly. Under the federal CAA,[71] certain types of construction of new sources of air contaminants may be restricted based on the air quality of the region in which the property is located.[72] Restrictions on existing sources of air contaminants also may affect the viability of a particular use. Similarly, under the CWA, discharges into watercourses may be restricted because of water quality limitations. This potential limitation affects the uses available for property with wastewater discharge needs.[73]

III. IDENTIFICATION OF ENVIRONMENTAL CONCERNS

A. Sources of Environmental Concerns

Environmental concerns include potential liabilities and land use restrictions. Environmental liabilities may arise under both common and statutory law.[74] Environmental land use restrictions are statutory-based.[75]

1. Statutory-based Environmental Concerns

There are five sources of statutory-based environmental liabilities. These sources include: (1) statute; (2) regulation; (3) permit; (4) administrative order; and (5) judicial order. The liabilities created by regulation, permit, and administrative order ultimately are statutory-based.

In some instances, statutory provisions are self-implementing and create immediate liability either for noncompliance, for example, hazardous substance site and release reporting requirements under CERCLA,[76] or for having had involvement in a site posing a threat to human health or the environment so as to qualify as a PRP under section 107 of CERCLA, irrespective of compliance.[77] In other instances, regulations are necessary to flesh out and implement statutory programs before liability can attach, as with NESHAPs under the CAA.[78]

Under the prescriptive pollution programs, a significant mechanism for achieving regulatory objectives is through permitting, pursuant to regula-

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ref'd n.r.e.); City of Austin Code tit. IX, ch. 13-15, art. 5, §§ 13-15-1 to -287 (1981); City of Del Rio Code of Ordinances § 49-712 (1987).

70. Act of Apr. 23, 1975, ch. 284, §§ 1-49, 1975 Tex. Sess. Law Serv. 672 (Vernon), *amended by* Act of June 15, 1977, ch. 557, §§ 24, 37, 1977 Tex. Sess. Law Serv. 1390 (Vernon) and Act of June 20, 1987, ch. 1107, §§ 19A-B, 36A, 1987 Tex. Sess. Law Serv. 3805 (Vernon).

71. 42 U.S.C. §§ 7402-7462 (1988).

72. *Id.* § 7407.

73. 33 U.S.C. § 1288 (1988).

74. *See* 42 U.S.C. §§ 6991e, 9607 (1988).

75. *See* 16 U.S.C. §§ 1531-1544, 470, 661-666 (1988).

76. 42 U.S.C. § 9603 (1988).

77. *Id.* § 9607.

78. 40 C.F.R. §§ 61.01-.252 (1988).

tions establishing procedural and substantive requirements. Examples of such permits include NPDES discharge permits[79] and section 404 dredge and fill permits[80] under the CWA, construction permits under the CAA,[81] UIC permits under the SDWA,[82] and hazardous waste treatment, storage, and disposal permits under RCRA.[83] These permits contain enforceable conditions, compliance with which may entail significant expenditures and violation of which may give rise to significant liabilities.[84]

Violations of statutes, regulations, and permits may lead to administrative or judicial orders that contain conditions,[85] the violation of which gives rise to additional liability. PRP liability under section 107 of CERCLA is imposed through administrative or judicial orders.[86] The violation of administrative orders may result in judicial orders. Land use restrictions generally result from regulations or from permits and may be included in either administrative or judicial orders.[87]

The costs of attaining and maintaining environmental compliance are substantial. To encourage compliance and to discourage noncompliance, environmental statutes contain significant sanctions. Civil sanctions include civil penalties and injunctive relief, compelling compliance or prohibiting continued noncompliance.[88] Criminal sanctions, available only if culpable intent is established, may be imposed on responsible individuals as well as on companies, and include fines and imprisonment.[89]

Under section 107 of CERCLA, liability generally arises not in the form of sanctions, but rather as costs of investigation and remediation of sites posing a threat to human health or the environment, costs associated with natural resource damage, and costs of required health assessments.[90] This liability may arise as a result of litigation brought not only by the government but by private parties as well, usually incident to litigation involving the real property transaction. Failure to comply with CERCLA administrative or judicial orders gives rise to further liability. For example, failure to comply without good cause with a section 106 order requiring remediation of a site gives rise to a penalty of three times the cost of remediation.[91]

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79. *Id.* §§ 122.1-.64.

80. 33 U.S.C. § 1344 (1988).

81. 40 C.F.R. §§ 60.1-.685 (1988).

82. *Id.* §§ 144.1-.55.

83. *Id.* §§ 270.1-.73.

84. 33 U.S.C. § 1319 (1988); 42 U.S.C. §§ 300g-3, 300h-1, 6928, 7413 (1988).

85. 33 U.S.C. § 1319(a)(2)(A), (B) (1988); 42 U.S.C. §§ 300g-3(c), 6928(a), 7413(a)(2)(A) (1988).

86. 42 U.S.C. § 9607 (1988).

87. *See, e.g.*, 40 C.F.R. §§ 264.1-.603 (1988); 53 Fed. Reg. 31,138 (1988) (to be codified at 40 C.F.R. §§ 264.1-.603); 54 Fed. Reg. 26,594 (1988) (to be codified at 40 C.F.R. §§ 264.1-.603).

88. 33 U.S.C. § 1319(d) (1988); 42 U.S.C. §§ 300h-2(b), 6928(g), 7413(c) (1988).

89. *See* 33 U.S.C. § 1319(c) (1988); 42 U.S.C. §§ 300h-2(b), 6928(d) (1988).

90. 42 U.S.C. § 9607 (1988).

91. *Id.* § 9607(c)(3).

2. Common Law Sources of Environmental Liability

a. Toxic Tort.

In addition to statute, environmental liabilities may arise under the common law. Persons associated with activities or conditions that have resulted in actual or threatened damages to human health or property may incur liability as a result of litigation under the common law. Sources of common law environmental liability include negligence, trespass, nuisance, and strict liability in tort.[92]

Toxic tort litigants may seek to join parties to a real estate transaction, based on their nexus to property.[93] Lawsuits have been brought not only against parties to transactions involving contaminated property, but also against parties to a transaction involving adjacent property.[94]

Toxic tort litigation often involves both statutory and common law claims. This type of litigation generally is brought by landowners or residents of adjacent properties, but also may be brought by their invitees, contractors, or employees, or by invitees, contractors, or employees of the person owning or operating the property on which the condition exists. Claims may include personal injury, damage to property, and diminution in property value.[95] Although CERCLA does not provide causes of action for toxic torts, SARA did create an exception to state statutes of limitation for hazardous substance cases. SARA established as the commencement date for the running of limitations the date plaintiff knew or reasonably should have known that the personal injury or property damage was caused or contributed to by the hazardous substance concerned.[96]

b. Contract Related Claims.

A related source of liability may arise as a result of the real property transaction. Causes of action may be brought by disgruntled parties to a transaction against others involved in that transaction. For instance, the seller, lender, broker, appraiser, or attorney may bring suit, based on: breach of contract, tortious theories such as fraud or negligent misrepresentation, or state deceptive trade practices acts.[97] This type of litigation also may involve claims based on nuisance and other common law environmental theo-

92. *See, e.g.*, Sterling v. Velsicol Chem. Corp., 647 F. Supp. 303, 311-20 (D. Tenn. 1986), *modified*, 855 F.2d 1188 (6th Cir. 1988).

93. *See* Tanglewood E. Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568, 1572-74 (5th Cir. 1988).

94. Powell v. Pulte Home Corp., No. 84-75865 (D. Tex. 1984). In this case, homeowners of properties adjacent to the Brio Superfund site sued the developer, asserting fraud. Following a jury trial that found for the plaintiffs, developers settled and were subrogated to the claims of the aggrieved homeowners against operators and generators. No opinion was issued. For a report of the case, see Dallas Morning News, Oct. 19, 1989, at 14A.

95. *See Sterling*, 647 F. Supp. at 306.

96. 42 U.S.C. § 9613(g)(1) (1988).

97. *See, e.g.*, Tanglewood E. Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568 (5th Cir. 1988); South Shore Bank v. Stuart Title Guar. Co., 688 F. Supp. 803 (D. Mass. 1988); United States v. Maryland Bank & Trust Co., 632 F. Supp. 573 (D. Md. 1986); United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,992 (E.D. Pa. 1985).

ries, as well as claims based on CERCLA.[98] Surprisingly, sellers also have brought CERCLA-based claims.[99]

B. The Environmental Audit

1. Areas of Inquiry

To identify various environmental concerns, an industry has arisen to conduct so-called environmental audits or surveys. Today most savvy sellers, purchasers, lessors, lessees, and lenders will not engage in a commercial or industrial real estate transaction without having had an environmental audit conducted by an environmental consultant.

a. On-site Conditions.

These audits typically focus on on-site conditions, though the scope may extend to conditions on adjacent properties that might affect the subject property. Environmental consultants generally describe environmental audits as being conducted in phases: Phase I, an on-site investigation, and review of pertinent documents, and Phase II, actual testing of soils, groundwater, surface water, or building components or air quality.

The Phase I investigation may involve review of: company and agency documents, historical aerial photographs, title reports identifying prior owners and environmental liens, and literature surveys, such as a computer-assisted search of current periodicals. The on-site investigation includes a walk-through and visual inspection looking for evidence of potential concerns, such as stressed vegetation or insulation suggesting the presence of asbestos; it also may include interviews with on-site personnel and adjacent residents or businesses. The Phase II investigation generally is triggered by Phase I findings, which are utilized to develop a tailored testing program.[100]

b. Environmental Compliance.

For ongoing businesses subject to environmental regulation, the audit should include an investigation of environmental compliance. A company typically performs a compliance audit to determine if its existing operations

98. Emhart Indus., Inc. v. Duracell Int'l, Inc., 665 F. Supp. 549 (M.D. Tenn. 1987), is typical. In that case, the purchaser brought a breach of contract suit against the seller. During the negotiations, the purchaser learned that PCBs had been used by the seller, resulting in contamination. The purchaser, therefore, insisted on contractual provisions allocating liability and guaranteeing the seller's promises. Although cleanup was effected, contaminants remaining on the site continued to discharge into a nearby river. Suit was brought based on breach of contract, fraud, negligent misrepresentation, and the state unfair trade practices act. The plaintiff also asserted a nuisance claim and a CERCLA claim. Although the court found a misrepresentation had been made, the contractual limitations on that tort claim had expired. *Id.* at 573. A statute similarly barred the nuisance action. The court, however, upheld the CERCLA claim of the buyer to recover cleanup costs. *Id.* at 574.

99. *See, e.g.*, Garb-Ko, Inc. v. Lansing-Lewis Servs., Inc., 167 Mich. App. 779, 423 N.W.2d 355 (1988) (seller sought to rescind sales contract for gas station and auto parts store after discovery of site contamination from underground storage tank leakage).

100. *See, e.g.*, Consulting Engineers Council of Metropolitan Washington, Guidelines for Environmental Site (1989).

are in compliance with applicable requirements by comparing those operations against a check list developed for that type of facility. This type of investigation is readily adaptable to, and often is conducted in conjunction with, an acquisition.

As noted, prior violations and liability for off-site disposal at problem sites should be of concern only when the purchaser will be standing in the shoes of the seller, through an actual or de facto merger or some other theory of successor liability. Ongoing violations are of concern regardless, however, because the purchaser will be liable if the violations have not been cured as of the date title is transferred or the purchaser begins operation. In that case, the purchaser, ab initio, will be operating in violation and, of course, will be responsible for its violations under statute as well as for compliance with applicable requirements, even though the condition may have been created by its predecessor.

For ongoing businesses and for intended new uses, the investigation should extend not only to existing regulatory requirements, but also to regulatory requirements scheduled to be implemented in the future. Individual facilities may have schedules of compliance, requiring that specific deadlines be achieved. In addition, pertinent requirements under regulations may become effective in phases. The audit should determine, therefore, not only whether the business is in compliance, but whether, and at what cost, it can continue to remain in compliance. Legislative and regulatory trends, therefore, also should be considered.

c. Land Use Restrictions.

Typically, environmental audits do not focus on land use restrictions. The type of investigation that considers these concerns sometimes is referred to as an environmental assessment. Air-quality-based or water-quality-based restrictions and the presence of wetlands, flood plain, endangered species, or historical or archeological sites identified in an environmental assessment may affect the ability to develop property for its intended use. For new uses, as well as for existing uses, these concerns should be addressed.

2. Content

For an environmental audit to be of value, it must produce usable results. The report, therefore, should be written in an understandable and useful manner. The report should not only identify environmental concerns, it should quantify the probability of their occurrence, which may include a range of possibilities, and it should discuss the range of costs associated with addressing each potential concern. The degree of certainty of these estimates also should be provided. Further, the report should identify the need for additional investigation and the types of investigation that might be useful or necessary to better quantify liabilities. The resulting report also can serve as an environmental baseline for subsequent operations on the site.

3. *Scope*

To ensure that an environmental audit does not overlook significant concerns and, at the same time, remains cost-effective, it must be scoped properly. To properly scope an environmental audit, the person designing the audit must focus on the nature of the transaction and the party for whom the investigation is being performed. Though each party to a real estate transaction has a common interest in knowing the pertinent facts, the legal ramifications of those facts differ for each party, especially in those transactions with potential CERCLA concerns. CERCLA's significance stems, in part, from the fact that the liabilities it creates may far exceed the value of the property. These liabilities may arise not only from on-site conditions[101] but, in transactions involving ongoing or former businesses, from off-site conditions as well.[102] An understanding of the way in which CERCLA creates liability, therefore, is essential to both real estate professionals and those involved in business acquisitions.

IV. SUPERFUND

CERCLA, as amended by SARA, is more commonly referred to as Superfund, after the hazardous waste trust fund that the law established to fund cleanup of sites posing a threat to human health or the environment.[103] In its implementation, CERCLA affects real estate and real estate transactions in a number of different ways. To assist real estate professionals, especially relevant concepts of CERCLA are discussed below.

A. Potentially Responsible Parties

Liabilities under CERCLA include costs of investigation, removal and remediation, natural resource damages and damage assessments, and required human health assessments associated with a facility from which there is a release, or a threatened release of a hazardous substance, which causes response costs to be incurred.[104] Potentially responsible parties, PRPs, liable for those costs under CERCLA include: (1) the present owner or operator of a facility; (2) the owner or operator of a facility at the time of disposal of hazardous substances; (3) any person who arranged for disposal or treatment, or who arranged with a transporter for transport for disposal or treatment, of hazardous substances at a facility; and (4) any person who accepted hazardous substances for transport to disposal or treatment facilities selected by that person.[105] The term "facility" includes buildings and any site where a hazardous substance has been deposited, stored, disposed of, placed, or otherwise came to be located.[106] The term "hazardous substance" is any

101. CERCLA is also a model for other related programs dealing with on-site conditions and may supplement claims based on those programs, for example, asbestos, PCBs, and USTs.
102. 42 U.S.C. §§ 6793(c), 9607(a) (1988).
103. 26 U.S.C. § 9507 (1988).
104. 42 U.S.C. § 9607(a)(4)(A)-(D) (1988).
105. *Id.* § 9607(a)(1)-(4).
106. *Id.* § 9601(9).

substance designated under other specified environmental statutes, but expressly excludes petroleum, natural gas, and related substances.[107]

The potential applicability of each of these four classes of PRPs is of concern in transactions involving ongoing businesses. Off-site disposal at problem sites, in particular, should be a significant concern in the acquisition of any business, because of potential liability as an arranger; the majority of the PRPs at most Superfund sites are generators. In real estate transactions, the first two categories, applicable to present and prior owners and operators, are of paramount concern.

Although the statutory language is somewhat ambiguous, referring, in one place, to present "owners *and* operators" and, in another, to persons who "owned *or* operated," the case law clearly establishes that Congress did not intend to require that a PRP be both an owner and an operator: either will suffice.[108] Courts, however, often fail to differentiate between the two terms, especially in cases involving shareholder-officers and lenders, and have created confusion in the case law.[109] Because of this confusion and liberal application of CERCLA to reach persons involved in real estate transactions, it is useful to focus separately on each of these two terms.

1. Owner

a. Present and Prior Owners.

Consistent with the statutory language, the courts have explained that present owners may be PRPs irrespective of whether the contamination was placed on-site prior to their acquisition.[110] For a present owner to be liable, it is unnecessary that disposal occurred during its ownership; ownership per se suffices.[111] Similarly, owners at the time of disposal also may be PRPs, irrespective of whether they have abandoned the facility.[112]

b. Interim Owners.

By its express terms, section 107 should not apply to interim owners of Superfund facilities.[113] In *Cadillac Fairview California, Inc. v. Dow Chemi-*

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107. *Id.* § 9601(14). Some state Superfund programs do apply to petroleum products, e.g., Texas.

108. United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 577-78 (D. Md. 1986). The definitional section of CERCLA defines the term "owner or operator," but provides little illumination, using the terms it is defining in the definition. 42 U.S.C. § 9601(20)(A) (1988).

109. *See infra* text accompanying notes 110-213.

110. *See* Tanglewood E. Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568, 1572 (5th Cir. 1988).

111. New York v. Shore Realty Corp., 759 F.2d 1032, 1044 (2d Cir. 1985).

112. Idaho v. Bunker Hill Co., 635 F. Supp. 665, 671 (D. Idaho 1986).

113. 42 U.S.C. § 9607(a) (1988):

> Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section (1) the owner and operator of a vessel or a facility, (2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of, . . . shall be liable . . . .

cal Co.[114] the court found an interim owner not to be a PRP under section 107.[115] On the other hand, in *United States v. Carolawn Co.*[116] the court refused to grant summary judgment and to dismiss from the lawsuit a company that had held legal title to a site for only one hour.[117] The decision, however, appeared to have been based on the fact that the defendant had transferred ownership to three of its employees rather than the fact of ownership.[118]

Some courts have suggested substantive bases for interim owner liability. In *Tanglewood East Homeowners v. Charles-Thomas, Inc.*[119] the owner's grading of soil containing hazardous substances was found to constitute treatment, creating potential liability for even an interim owner.[120] Some cases have suggested another factual basis for liability, based on the assumption that leaking of on-site contaminants constitutes disposal.[121] Other courts have rejected this position.[122] The expansion of CERCLA to reach passive interim owners based on leaking appears unwarranted. SARA does create an exception if the interim owner obtained and failed to disclose to the purchaser actual knowledge of a release or threatened release.[123] In that case, the interim owner may be held liable as a present owner.[124]

A similar issue involving interim owner liability arises under analogous provisions of section 7003 of RCRA.[125] This section authorizes the EPA to sue

> any person (including any past or present generator, past or present transporter, or past or present owner or operator of a treatment, storage, or disposal facility) who has contributed or who is contributing to [the] handling, storage, treatment, transportation or disposal [of any solid waste or hazardous waste that may present an imminent substantial endangerment to health or the environment].[126]

Although this provision applies to *any* past owner and, therefore, is broader than CERCLA in that regard, it is narrower than CERCLA in that it requires that owners, as well as others referenced in the provision, have contributed to the waste management that poses the threat. Whether passive ownership per se is adequate appears unlikely.

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114. 21 Env't Rep. Cas. (BNA) 1108 (C.D. Cal. 1984).
115. *Id.* at 1113.
116. 14 Envtl. L. Rep. (Envtl. L. Inst.) 20,698 (D.S.C. 1984).
117. *Id.* at 20,698-99.
118. *Id.* at 20,698.
119. 849 F.2d 1568 (5th Cir. 1988).
120. *Id.* at 1573.
121. *See* United States v. Conservation Chem. Co., 619 F. Supp. 162, 199-200 (D.C. Mo. 1985); Jones v. Inmont Corp., 584 F. Supp. 1425, 1437 (S.D. Ohio 1984).
122. *See* Ecodyne Corp. v. Shah, No. C-88-4813-JPV (N.D. Cal. Aug. 28, 1989); 4 Toxic L. Rep. 483 (Sept. 27, 1989).
123. 42 U.S.C. § 9601(35)(c) (1988).
124. *Id.*
125. *Id.* § 6973(a).
126. United States v. Conservation Chem. Co., 619 F. Supp. 162, 198 (W.D. Mo. 1985) (quoting 42 U.S.C. § 6973, as amended).

c. Lenders.

CERCLA clarifies that the term "owner" does not include a person who, without participating in the management of the facility, holds indicia of ownership primarily to protect a security interest in the facility.[127] In *United States v. Maryland Bank & Trust Co.*[128] the court found that a bank that had foreclosed and purchased property did so to protect its investment rather than its security interest and, therefore, was liable under CERCLA as an owner.[129] In *United States v. Mirabile*[130] the court suggested foreclosure, without operational involvement, would be inadequate to create liability.[131] Significantly, the bank in *Mirabile* had assigned its bid to the Mirabiles who accepted a sheriff's deed to the property. Though the bank physically secured the property and showed it to prospective purchasers, it never acquired legal title. Actual ownership, on the other hand, probably will give rise to section 107 liability, irrespective of whether the intent is to protect the value of the collateral.[132]

On April 25, 1989, Representative LaFalce introduced legislation, H.R. 2085,[133] designed to protect financial institutions from environmental liability when the institutions take title to foreclosed property or when they acquire contaminated property as trustee of an estate. The bill expressly would exclude from the CERCLA definition of owner or operator a financial institution that foreclosed on contaminated property or became a trustee.[134] At least one case has held a trustee liable as a site owner.[135]

d. Lessors/Lessees.

In a number of cases, courts have held lessors whose lessees created contamination liable as owners.[136] Liability is predicated on current ownership as well as ownership at the time of disposal.[137] As between the parties, a lessor may recover from its lessee who created the on-site contamination,[138] provided its lessee is solvent.

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127. 42 U.S.C. § 9601(20)(A) (1988).
128. 632 F. Supp. 573 (D. Md. 1986).
129. *Id.* at 579.
130. 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,994, 20,995 (E.D. Pa. 1985).
131. *Id.* at 20,996.
132. *See also* Tanglewood E. Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568, 1572 (5th Cir. 1988) (statute specifically imposes strict liability upon owners).
133. H.R. 2085, 101st Cong., 1st Sess. (1989).
134. *See* [Current Developments] 21 Env't Rep. Cas. (BNA) (May 5, 1989).
135. United States v. Burns, Hazardous Waste Litig. Rep. (Andrews Publication) 13,705, 13,705 (D.N.H. Sept. 12, 1988).
136. New York v. Shore Realty Corp., 759 F.2d 1032, 1045 (2d Cir. 1985) (owner responsible for unauthorized tenants); Versatile Metals, Inc. v. Union Corp., 693 F. Supp. 1563, 1563 (E.D. Pa. 1988) (owner and tenant jointly and severally liable); United States v. Argent, 21 Env't Rep. Cas. (BNA) 1354, 1355 (D.N.M. 1984) (owner responsible regardless of connection to tenant's business).
137. United States v. South Carolina Recycling & Disposal, Inc. (SCRDI), 653 F. Supp. 984, 987 (D.S.C. 1984), *aff'd sub nom.* United States v. Monsanto Co., 858 F.2d 160, 168 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 3156, 103 L. Ed. 2d 600 (1989).
138. Caldwell v. Gurley Ref. Co., 755 F.2d 645 (8th Cir. 1985).

In its June 6, 1989, Guidance on Landowner Liability under CERCLA,[139] the EPA in a footnote stated that: "The government has taken the position that 'owner' for the purposes of liability includes 'lessee.' "[140] The cases cited for that proposition,[141] however, do not extend as far as the government suggests. Basically, those cases involve situations in which the lessee either acted in a quasi-ownership capacity, for example, by subleasing the property,[142] or was involved as an operator because of its on-site activities.[143] If the government's position were correct, then the renter of an apartment conceivably could be held liable for pre-existing contamination of the property upon which the apartment building rests. That type of interest should not constitute ownership for purposes of CERCLA liability, especially since leases may establish only temporary relationships. Lessees should not be liable for on-site conditions that they do not create, presuming they do not exacerbate an existing problem. A long-term lease, such as ninety-nine years, however, could be construed to approach an ownership interest. One commentator has suggested that the analysis of whether a lease creates an ownership interest should be based on generally acceptable principles of accounting.[144]

e. Successor Corporations.

The EPA, in an internal agency memorandum (the Price Memorandum), asserted that successor corporations should be liable for actions of their predecessors.[145] The EPA argues for an expansion of successor liability beyond traditional corporate law doctrines. It suggests the appropriate test should be whether the new corporation continues substantially the same business operations as its predecessors.[146] This position draws heavily on analogy to products liability cases.

In *New Jersey Department of Environmental Protection v. Gloucester Environmental Management Services, Inc.*,[147] the court followed an approach similar to that urged by the EPA. In that case, the court denied a motion for summary judgment because factual issues existed concerning the relationship between the purchaser of a manufacturing plant and its predecessor,

139. 54 Fed. Reg. 34,235 (Aug. 18, 1989).

140. *Id.* at 34,238 n.10.

141. *SCRDI*, 653 F. Supp. at 984; United States v. Northernaire Plating Co., 670 F. Supp. 742, 747-48 (W.D. Mich. 1987).

142. *SCRDI*, 653 F. Supp. at 1003.

143. *Northernaire*, 670 F. Supp. at 748.

144. *See* Feder, *The Undefined Parameters of Lessee Liability Under CERCLA: The Trap for the Unwary Lender*, 19 ENVTL. L. 257, 267-69 (1988).

145. *See* Price, June 13, 1984, Memorandum, "Liability of Corporate Shareholders and Successor Corporations for Abandoned Sites Under CERCLA" [hereinafter Price Memorandum].

146. EPA notes four situations in which courts traditionally have imposed successor liability in asset transfers: (1) the purchasing corporation expressly or impliedly agrees to assume such obligations; (2) the transaction amounts to a de facto consolidation or merger; (3) the purchasing corporation is merely a continuation of the selling corporation; or (4) the transaction was fraudulently entered into in order to escape liability. *Id.* at 11.

147. 28 Env't Rep. Cas. (BNA) 1397 (D.N.J. 1988).

suggesting the possibility of successor liability for off-site contamination as a generator.[148] Other cases, however, have not followed the lead of the New Jersey court and have relied instead on the de facto merger doctrine.

In several cases, purchasers of assets have been found to have incurred CERCLA liability of their predecessors based on federal common law. In *Smith Land & Improvement Corp. v. Celotex Corp.*[149] the court generally found that the congressional intent in enacting CERCLA was to impose successor liability on a corporation that merged or consolidated with a PRP and suggested that a merger had occurred.[150] In *In re Alleged PCB Pollution of Acushnet River & New Bedford Harbor*[151] the court held a purchaser of assets liable for cleanup costs, based on a liberal application of the de facto merger doctrine, despite a disclaimer of liability in the acquisition document for the contamination giving rise to liability.[152] In *Louisiana-Pacific Corp. v. Asarco, Inc.*,[153] however, the court refused to find the purchaser of assets of a copper mill liable for CERCLA cleanup.[154] The court based its decision on the lack of showing that any exception to traditional corporate successor law existed.[155]

Case law with regard to successor liability under environmental statutes is evolving. In general, however, these cases suggest that any finding of successor liability in CERCLA actions likely will be based on traditional corporate law and not on novel theories of environmental liability. The existence of CERCLA claims, however, may be a significant consideration to the court in deciding whether successor liability should be imposed.

2. *Operator*

Courts have broadly construed the term "operator" to apply to a variety of persons who directly or indirectly are involved in waste management activities of the facility.[156] The EPA has aggressively argued for this construction of the term. In the Price Memorandum, the EPA argues not only for a liberal policy of successor liability, but also for a liberal policy of shareholder liability independent of, though related to, the doctrine of piercing the corporate veil.[157]

a. Officers, Employees, and Shareholders.

Consistent with the position espoused by EPA in the Price Memorandum, a number of courts have extended operator liability to individuals who were

148. *Id.* at 1400.
149. 851 F.2d 86 (3d Cir.), *cert. denied*, 109 S. Ct. 837, 102 L. Ed. 2d 969 (1988).
150. 851 F.2d at 91.
151. 29 Env't Rep. Cas. (BNA) 1723 (D. Mass. 1989).
152. *Id.* at 1726-30.
153. 29 Env't Rep. Cas. (BNA) 1450 (W.D. Wash. 1989).
154. *Id.* at 1453.
155. *Id.*
156. *See* New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985); United States v. Carolawn Co., 14 Envtl. L. Rep. (Envtl. L. Inst.) 20,699, 20,700 (D.S.C. 1984).
157. *See* Price Memorandum, *supra* note 145.

shareholder officers or managers.[158] Though noting the shareholder relationship, the pertinent consideration appears not to have been ownership, but rather the role of those individuals in the management of the company.[159] The pertinent inquiry resembles an aspect of the doctrine of piercing the corporate veil,[160] but focuses on the role of the shareholder in decision-making affecting hazardous waste management activities.

In *New York v. Shore Realty Corp.*[161] the Second Circuit Court of Appeals held a corporation's officer and stockholder liable for cleanup of a hazardous waste disposal site.[162] In placing direct liability upon the officer who made, directed, and controlled all corporate decisions and actions, the court pointed out that CERCLA defines "owner or operator" to mean "any person owning or operating" a facility, including individuals as well as corporations.[163] Noting that the statute excludes from the definition "a person, who, without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the facility," the court inferred that personal liability *did* exist for shareholders who *did* participate in the management of a facility.[164]

The Second Circuit Court of Appeals asserted that its reasoning followed that of other courts that have addressed the issue, citing as examples *United States v. Carolawn Co.*[165] and *United States v. Northeastern Pharmaceutical & Chemical Co. (NEPACCO).*[166] In *Carolawn* a district court applied the same reasoning in denying motions to dismiss a CERCLA action by individual defendants who were corporate officials.[167] The corporate officials were responsible for making the day-to-day operation decisions for the hazardous waste disposal business, and in addition, owned stock in the corporation and business site in an individual capacity for a short time.

In *NEPACCO* a federal district court applied this same reasoning as one of two alternate bases for imposing CERCLA liability on a vice president and major stockholder of a corporation.[168] The officer in question controlled the corporate business in several aspects. For instance, he supervised the chemical facility, arranged for the disposal and transport of the hazard-

158. New York v. Shore Realty Corp., 759 F.2d 1032, 1052 (2d Cir. 1985) (officer controlling corporate conduct liable for torts under New York law); United States v. Northeastern Pharm. & Chem. Co. (NEPACCO), 579 F. Supp. 823, 848 (W.D. Mo. 1984), *aff'd in part, rev'd in part and remanded*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987) (defendant active in management).

159. *Id.*

160. In environmental cases, courts may pay less respect to the corporate form than they would under the alter ego doctrine, disregarding corporate form "in the interest of public convenience, fairness, and equity." *See* Brookline v. Gorsuch, 667 F.2d 215, 221 (1st Cir. 1981).

161. 759 F.2d 1032 (2d Cir. 1985).

162. *Id.* at 1052.

163. *Id.* (quoting 42 U.S.C. §§ 9601(20)(A), (21) (1988)).

164. *Id.* (quoting 42 U.S.C. § 9601(20)(A) (1988)).

165. 14 Envtl. L. Rep. (Envtl. L. Inst.) 20,699 (D.S.C. 1984).

166. 579 F. Supp. 823, 847-48 (W.D. Mo. 1984), *aff'd in part, rev'd in part and remanded*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).

167. 14 Envtl. L. Rep. (Envtl. L. Inst.) at 20,700.

168. 579 F. Supp. at 847.

ous waste at the disposal site, and had direct knowledge and supervision of the contract for transportation and the ultimate disposal site. The officer also assisted in the selection of the disposal site by instructing the contractor on favorable disposal-site characteristics.

The court also placed liability upon the founder and president of the corporation, who was a major stockholder and who had supervised construction of the plant, even though it was not established that the president possessed prior direct knowledge of the plan to dispose of hazardous waste.[169] Importantly, the court noted that this individual stockholder, as president, had the capacity and general responsibility to control the disposal of hazardous wastes at the company plant.[170] Likewise, the president had the capacity to prevent and abate the damage caused by the disposal of hazardous wastes.[171]

These officer-shareholder cases have found individual liability for active control or management over hazardous waste decision-making. In *State v. Bunker Hill Co.*[172] a federal district court extended this reasoning to reach a parent corporation that controlled its subsidiary more indirectly through the corporate structure.[173] In that case Gulf Resources & Chemical Corporation (Gulf), relying on the Bunker Hill corporate entity, argued that the court did not have jurisdiction because Gulf was a nonresident corporation. Gulf also argued that it was not liable under CERCLA as an owner or operator. Gulf and Bunker Hill merged in May 1968, and Bunker Hill became the wholly owned subsidiary of Gulf. Gulf contended that the Bunker Hill facility was owned and operated by Bunker Hill, and not Gulf. The court found that Gulf's many contacts with the Bunker Hill facility as a parent corporation supported not only personal jurisdiction over Gulf, but also a conclusion that Gulf was an owner or operator for purposes of CERCLA liability.[174] Quoting *NEPACCO*[175] at length, the court held that the following test may be employed to determine when a parent corporation becomes an owner or operator with respect to a subsidiary's facilities: "The owner-operator of a vessel or a vacility [sic] has the capacity to make timely discovery of oil discharges. The owner-operator has power to direct the activities of persons who control the mechanisms causing the pollution. The owner-operator has the capacity to prevent and abate damages."[176]

Applying this test, the court found that Gulf was the owner-operator of the Bunker Hill facility.[177] The court determined that Gulf was not only in a position to be, and was, intimately familiar with hazardous waste disposal

169. *Id.* at 849.
170. *Id.*
171. *Id.*
172. 635 F. Supp. 665 (D. Idaho 1986).
173. *See also* Vermont v. Staco, Inc., 684 F. Supp. 822, 832 (D. Vt. 1988) (parent corporation, executive officers, and majority shareholders of company liable for Superfund costs).
174. 635 F. Supp. at 671.
175. 579 F. Supp. at 823 (W.D. Mo. 1984), *aff'd in part, rev'd in part and remanded*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).
176. 635 F. Supp. at 672 (quoting *NEPACCO*, 579 F. Supp. at 848-49, which in turn quotes Apex Oil Co. v. United States, 530 F.2d 1291, 1293 (8th Cir. 1976) (footnotes omitted)).
177. *Id.*

and releases at the Bunker Hill facility, but also that Gulf had the capacity to control such disposal and releases.[178] In addition, the court found that Gulf had the capacity, if not the absolute authority, to make decisions and implement actions and mechanisms that would have prevented the damage caused by the disposal and releases of hazardous wastes at the facility.[179]

While seeming to focus on the financial control of Bunker Hill by Gulf, the court was careful to note that courts must take care in applying the test so that a parent's normal activities with respect to its subsidiary do not automatically lead a court to determine that the parent corporation is an owner or operator.[180] The court found Gulf liable as an owner or operator under CERCLA because to hold otherwise would allow parent corporations to use the corporate veil in frustration of congressional purpose.[181] This decision blurs the distinction between an owner and an operator. Presumably the court premised Gulf's liability on Gulf's control of operations, rather than on its stock ownership. Other than the fact that stock ownership enabled Gulf to control decisions and become an operator, stock ownership should be irrelevant. The decision also is troubling because it focuses on the capacity of the parent to control the subsidiary as well as on the actual involvement of the parent in hazardous waste management activities of the subsidiary. In *Rockwell International Corp. v. IU International Corp.*[182] the court rejected such a test, explaining: "Mere ability to exercise control as a result of the financial relationship of the parties is insufficient for liability to attach. The entity must actually exercise control."[183]

In *United States v. Nicolet, Inc.*[184] the court, ruling federal common law applied, presumed to fashion a federal rule as to when the corporate veil can be pierced in a CERCLA case based on control of the management and operations of the subsidiary.[185] The court mistakenly relied on *State v. Bunker Hill Co.*[186] as support for its determination. The *Bunker Hill* court, however, based liability on the concept of operator liability under CERCLA, not on the piercing doctrine.[187] The *Nicolet* court confused these two related, but discrete, bases of liability. In *United States v. Kayser-Roth Corp.*[188] the court held the parent company of a defunct subsidiary liable under both theories of liability.

In *Joslyn Corp. v. T.L. James & Co.*[189] a district court declined to follow the trend towards expanding liability. The court refused to hold a parent

178. *Id.*
179. *Id.*
180. *Id.*
181. *Id.*
182. 702 F. Supp. 1384 (N.D. Ill. 1988).
183. *Id.* at 1390 (citations omitted).
184. 712 F. Supp. 1193 (E.D. Pa. 1989).
185. *Id.* at 1202-04.
186. 635 F. Supp. 665 (D. Idaho 1986).
187. *Id.* at 671-72.
188. 724 F. Supp. 15 (D.R.I. 1989). The piercing test applied by the court was the liberal, regulatory version, which provides that "a corporate entity may be disregarded in the interest of public convenience, fairness, and equity." *Id.* at 23.
189. 696 F. Supp. 222, 224-25 (W.D. La. 1988).

company liable, without piercing the corporate veil, for cleanup of a creosote plant operated by its wholly owned subsidiary.[190] The court based its decision on the belief that it was improper to ignore the corporate form without an express congressional directive.[191] That decision is on appeal.

b. Lenders.

As an alternative to owner liability, courts have suggested potential liability of a lender as an operator. In *United States v. Mirabile*[192] the court, though expressing its reservations, declined to dismiss a suit against a lender because of a factual issue as to whether the lender's involvement in the management of its borrower caused it to be an operator.[193] In *United States v. Nicolet, Inc.*[194] the government went so far as to assert that the mortgagee of the operator of a site is liable, but in that case, the mortgagee participated in the management and operational aspects of the facility.[195]

In *United States v. Fleet Factors Corp.*[196] a lender foreclosed on equipment, but not real property. Leaking drums were removed and while moving equipment, asbestos, a hazardous substance, was dislodged, creating fact issues as to whether Fleet, which authorized these activities, was an operator. The court focused on the so-called security interest exclusion, indicating that the holding of indicia of ownership to protect a security interest *with* participation in the management of the facility could give rise to liability.[197] The court seemed to suggest, correctly, that such liability is that of an operator rather than of an owner.[198] The case is on appeal.

c. Lessor/Lessee.

In *United States v. Northernaire Plating Co.*[199] the court held the lessee was an operator.[200] In that case, the defendant apparently operated a facility that may have contributed to or caused on-site contamination. In *South Carolina Recycling & Disposal, Inc. v. Searle (SCRDI)*[201] the court also held that the lessee was an operator.[202] As a practical matter, operator rather than owner liability should form the basis for lessee liability under CERCLA unless the lessee subleases the property or has an interest of such duration as to approach ownership.

190. *Id.* at 232.
191. *Id.* at 226.
192. 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,992 (E.D. Pa. 1985).
193. *Id.* at 20,994
194. 712 F. Supp. 1193 (E.D. Pa. 1989).
195. *Id.* at 1195.
196. 29 Env't Rep. Cas. (BNA) 1011 (S.D. Ga. 1988).
197. *Id.* at 1015-16.
198. *Id.*
199. 670 F. Supp. 742 (W.D. Mich. 1987).
200. *Id.* at 747.
201. 653 F. Supp. 984 (D.S.C. 1984).
202. *Id.* at 1002-04.

d. Other.

Because CERCLA imposes liability that is both strict and joint and several, both the government and private party plaintiffs have sought to expand its applicability. Plaintiffs, in these cases, have focused on the terms "operator" and "arranger."

In *United States v. Westinghouse Electric Corp.*[203] a generator involved in a CERCLA site at which it disposed of PCB materials filed a third-party complaint against a supplier of PCBs, seeking contribution. The court found the PCB supplier not liable because the supplier did not generate or dispose of any hazardous waste and did not contract for any disposal.[204] In *Edward Hines Lumber Co. v. Vulcan Materials Co.*[205] a former owner of a hazardous waste site sought recovery for contribution against a company that had previously built the wood treating facility that caused the contamination and that had supplied the chemicals. The court similarly declined to hold the supplier liable as an operator, analogizing to the concept of independent contract.[206] In *Prudential Insurance Co. of America v. United States Gypsum*[207] the court refused to hold a manufacturer of asbestos liable to a building owner under CERCLA because the manufacturer had not disposed of asbestos.[208]

On the other hand, the court in *United States v. Aceto Agricultural Chemicals Corp.*[209] held a pesticide manufacturer liable as an arranger for the cleanup of wastes produced by its formulator.[210] In *Ametek, Inc. v. Pioneer Salt & Chemical Co.*[211] the court suggested that a chemicals supplier that unloaded and possibly spilled chemicals at a site might be a PRP as an operator.[212] The *Ametek* court noted that courts have focused on the degree of control exercised over a facility in construing the term "operator."[213] These cases typify a trend towards expanding liability under CERCLA to persons not customarily considered to be PRPs.

B. Liens

Under CERCLA, cleanup costs incurred by environmental agencies give rise to liens on the affected real property.[214] Under section 107(l) of CERCLA, the lien arises at the time costs are incurred, but must be perfected, and is subject to prior perfected security interests under applicable state

203. 22 Env't Rep. Cas. (BNA) 1230 (S.D. Ind. 1983).
204. *Id.* at 1233.
205. 685 F. Supp. 651 (N.D. Ill.), *aff'd*, 861 F.2d 155 (7th Cir. 1988).
206. *Id.* at 657-58.
207. 711 F. Supp. 1244 (D.N.J. 1989).
208. *Id.* at 1255.
209. 872 F.2d 1373 (8th Cir. 1989).
210. *Id.* at 1384.
211. 709 F. Supp. 556 (E.D. Pa. 1988), *aff'd in part, rev'd in part and remanded on other grounds*, 872 F.2d 1373 (8th Cir. 1989).
212. *Id.* at 559-60.
213. *Id.* at 559.
214. 42 U.S.C. § 9607(l) (1988).

law.[215] The lien may be entered without opportunity for a hearing.[216] In a number of states, environmental liens are Superliens, taking priority over all pre-existing liens, with the possible exception of tax liens.[217] The Superlien statutes in some cases also authorize the imposition of liens on other property, real or personal, but these liens do not take priority over prior recorded liens.[218]

C. *Causes of Action Under Superfund*

Superfund litigation against PRPs may be brought by the government or by private parties.[219] Often, private party Superfund litigation is incident to litigation involving the real estate transaction. A key distinction between governmental and private party litigants relates to the ability of a PRP to contract away liability. Section 107(e) allows parties to allocate CERCLA liabilities among themselves, but renders ineffective any agreement to transfer such liabilities with respect to the government.[220]

Unlike private litigants, the government can issue an order requiring a PRP to take action at any site posing a threat.[221] The EPA may bring action in federal court to enforce its orders and seek penalties of up to $25,000 per day for willful violations or failure or refusal to comply with any government order.[222] In the alternative, the EPA may clean up the site itself and seek costs under section 107(a) and punitive damages under section 107(c)(3) of three times the cost if failure to comply was without sufficient cause.[223] The EPA also may ask a federal court to issue an injunction under section 106.[224] CERCLA, as amended by SARA, provides for the establishment of a hazardous waste trust fund or a "Superfund" to pay for cleanup of sites posing a threat to human health or the environment.[225] The government, and, under limited circumstances, private parties may take advantage of the fund.[226]

The government, through the EPA, is authorized to tap the fund for up to $2 million to deal with an immediate concern at any site from which there is a release or substantial threat of release of a hazardous substance into the

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215. *Id.*
216. *Id.* § 9607(l)(3).
217. *See, e.g.*, ARK. STAT. ANN. §§ 8-7-417, 8-7-516 (1987); CONN. GEN. STAT. ANN. § 22a-452a (West Supp. 1988); MASS GEN. LAWS ANN. ch. 21E, § 13 (West Supp. 1988); ME. REV. CIV. STAT. ANN. tit. 38, § 1371 (Supp. 1987); N.H. REV. STAT. ANN. § 147-B:10-b (1987); N.J. STAT. ANN. § 58:10-23.11f(f) (West Supp. 1988); TENN. CODE ANN. § 68-46-209 (1987).
218. *See, e.g.*, ME. REV. CIV. STAT. ANN. tit. 38, § 1371 (Supp. 1987); MASS. GEN. LAWS ANN. ch. 21E, § 13 (West Supp. 1988); N.H. REV. STAT. ANN. § 147-B:10-b (1987); N.J. STAT. ANN. § 58:10-23.11f(f) (West Supp. 1988).
219. 42 U.S.C. §§ 9604, 9696 (1988).
220. *Id.* § 9607(e).
221. *Id.* § 9606(a).
222. *Id.* § 9606(b).
223. *Id.* §§ 9607(a), 9607(c)(3).
224. *Id.* § 9606(a).
225. *Id.* § 9611(a).
226. *Id.* § 9611(a), (b).

environment, *or* of any pollutant that poses a risk to public health or welfare or the environment.[227] The government also may tap the fund for a full-scale investigative and remediation program, but the site first must be listed on the National Priority List (NPL), an appendix to the National Contingency Plan, the regulations that guide EPA in its implementation of CERCLA.[228] Under section 107, EPA is authorized to recover its response costs from PRPs.[229]

Though private parties also may request reimbursement from the fund, as a practical matter, private parties who incur response costs are more likely to recover their costs from PRPs. Private parties may seek recovery against a PRP either in a suit for contribution, brought by a PRP under sections 107(a)(3) and 113(f), or in a private cause of action under section 107(a)(4)(B), brought by any person who has incurred response costs.[230]

A distinction exists between private and governmental reimbursement action in that the government has the burden of establishing only that it incurred costs not inconsistent with the NCP while a private party affirmatively must establish that its costs were consistent with the NCP.[231] In *Amland Properties Corp. v. Aluminum Co. of America (ALCOA)*[232] and in *Versatile Metals, Inc. v. Union Corp.*[233] the courts denied recovery against prior owners because NCP procedural requirements were not satisfied. Other courts, however, have been more lenient, suggesting that substantial compliance will suffice.[234]

With regard to both lawsuits for reimbursement and those involving governmental orders, plaintiffs must establish that the defendant is a PRP.[235] No need exists to establish that the PRP contributed in any way to the release in order to establish a prima facie case.[236] The standard of liability is strict, meaning that culpable intent and compliance with the law are irrelevant. Liability also is joint and several, meaning that any PRP may be sued for the entire cost.[237] SARA expressly ratified case law authorizing PRPs to seek contribution from other PRPs.[238]

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227. *Id.* § 9604(a), (c).

228. *Id.* § 9605; 40 C.F.R. § 300 (1988); *see also* the proposed revised National Contingency Plan at 53 Fed. Reg. 51,394 (1988).

229. 42 U.S.C. § 9607(a) (1988).

230. *Id.* §§ 9607(a)(3), (a)(4)(B), 9613(f).

231. *Id.* § 9607(a)(4)(B).

232. 711 F. Supp. 784, 796 (D.N.J. 1989).

233. 693 F. Supp. 1563, 1581-83 (E.D. Pa. 1988). In this case, the court noted the purchaser was not precluded from seeking recovery under tort. *Id.* at 1582.

234. *See* NL Indus. v. Kaplan, 792 F.2d 896 (9th Cir. 1986); Wickland Oil Terminals v. Asarco, Inc., 792 F.2d 887 (9th Cir. 1986).

235. 42 U.S.C. § 9607(a), (b) (1988).

236. *Id.* § 9603(f)(1).

237. *See, e.g.*, State v. Bunker Hill Co., 635 F. Supp. 665, 676 (D. Idaho 1986); State v. Asarco, Inc., 608 F. Supp. 1484, 1489 (D. Colo. 1985); United States v. Chem-Dyne Corp., 572 F. Supp. 802, 805-08 (S.D. Ohio 1983).

238. 42 U.S.C. § 9613(f) (1988).

D. Apportionment

The federal statute contains no guidance for apportionment of liability among PRPs. The statute does provide, however, for the EPA to conduct a nonbinding preliminary allocation of responsibility.[239] For guidance, courts have looked to the legislative history of CERCLA, specifically the Gore Amendment.[240] Though not enacted, that amendment contains a number of factors that courts have taken into account in allocating responsibility among PRPs.[241]

Under CERCLA, joint and several liability may be avoided if it can be demonstrated that the release or threatened release is divisible.[242] Federal case law suggests that joint and several liability also may be inappropriate if there is another rational basis for allocating liability.[243] For example, joint and several liability may be inappropriate if each of the PRPs disposed of the same types of waste and the relative volumes are known.[244]

E. Statutory Defenses

1. Overview

Though under CERCLA liability is strict, there are several affirmative statutory defenses.[245] To escape liability, a PRP must establish by a preponderance of the evidence that the release or threat of release of hazardous substances and the resulting damages were caused solely by an act of God, an act of war, an act or omission of a third party, or any combination of these causes.[246] Of these defenses, the most viable is the third-party defense. PRPs seeking to take advantage of this defense, however, have a difficult burden.

2. Elements of Third-Party Defense

To take advantage of the third-party defense, a PRP must establish: (1) the release or threat of release and resulting damages were caused solely by the third party; (2) the third party was not (a) the PRP's employee, (b) the PRP's agent, or (c) one whose act or omission occurred in connection with a contractual relationship with the PRP; (3) the PRP exercised due care with respect to the hazardous substance taking into consideration the characteristics of the material, in light of all relevant facts and circumstances; and (4)

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239. *Id.* § 9622(e)(3).

240. *See* Allied Corp. v. Acme Solvents Reclaiming, Inc., 691 F. Supp. 1100, 1116 (N.D. Ill. 1988).

241. *See* United States v. A & F Materials Co., 578 F. Supp. 1249, 1256 (S.D. Ill. 1984).

242. *See* United States v. Miami Drum Servs., Inc., 25 Env't Rep. Cas. (BNA) 1469, 1475 (S.D. Fla. 1986).

243. *See* United States v. Tyson, Hazardous Waste Litig. Rep. (Andrews Publication) 12,983 (E.D. Pa. 1988); O'Neil v. Picillo, 682 F. Supp. 706, 724-26 (D.R.I. 1988), *aff'd*, 883 F.2d 176 (1st Cir. 1989); United States v. Ottati & Goss, Inc., 630 F. Supp. 1361, 1395-96 (D.N.H. 1985) (citing RESTATEMENT (SECOND) OF TORTS §§ 433A, 433B, 875, 881 (1976)), *modified*, 24 Env't Rep. Cas. (BNA) 1152 (D.N.H. 1986).

244. *See Ottati*, 630 F. Supp. at 1396.

245. *See* 42 U.S.C. § 9607(b) (1988).

246. *Id.*

the PRP took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions.[247] Of these elements of proof, the most difficult have been sole causation and the lack of a contractual relationship.

3. *Contractual Relationship*

The pertinent language concerning the lack of a contractual relationship is unclear. Arguably this provision applies only if the contractual relationship existed at the time the release occurred. Stated alternatively, the third-party defense should not be vitiated by a contract if the act or omission causing the release did not occur in connection with any contractual relationship.

Unfortunately from the PRP's perspective, courts have chosen not to focus on the nuances of that provision and have held PRPs liable if any contractual relationship existed with the third party.[248] As a consequence, lessors, as owners, have been held liable for actions of their lessees, and lenders, as operators, for the actions of their borrowers.[249]

4. *Innocent-Purchaser Defense*

To ameliorate the harsh effects of the contractual bar, CERCLA was amended to add the so-called innocent-purchaser defense. SARA added to CERCLA a new section, 101(35)(A),[250] that clarified that the term contractual relationship in section 107(b)(3)[251] includes instruments transferring title or possession to real property,[252] but added an exemption. This exemption applies if the real property on which the facility is located was acquired by the PRP after the disposal or placement of the hazardous substance and one of the following conditions is satisfied: (1) at the time of acquisition, the PRP did not know and had no reason to know that any hazardous substance was disposed of at the facility; (2) the PRP is a governmental entity that involuntarily or through the exercise of eminent domain acquired the property; or (3) the PRP acquired the facility by inheritance or bequest.[253]

To avail itself of the innocent-purchaser defense, a PRP must demonstrate that it made all appropriate inquiry into the previous ownership and uses of the property, consistent with good commercial and customary practice in an effort to minimize liability.[254] In making its determination, the court is instructed to consider: (1) any knowledge or experience on the part of the PRP; (2) the relationship of the purchase price to the value of the property if

247. *See* New York v. Shore Realty Corp., 759 F.2d 1032, 1048 (2d Cir. 1985).
248. United States v. Pacific Hide & Fur Depot, Inc., 716 F. Supp. 1341 (D. Idaho 1989); *see infra* text accompanying notes 177-178.
249. For a discussion of lessor, lessee, and lender liability as operators, see *supra* text accompanying notes 136-144 and 199-202.
250. 42 U.S.C. § 9601(35)(A) (1988).
251. *Id.* § 9601(35)(A)-(C).
252. *Id.*
253. *Id.* § 9601(35)(A).
254. *Id.* § 9601(35)(B).

uncontaminated; (3) commonly known or reasonably ascertainable information about the property; (4) the obviousness of the presence or likely presence of contamination at the property; and (5) the ability to detect such contamination by appropriate inspection.[255]

The legislative history of SARA indicates that the duty to inquire to qualify as an innocent purchaser is to be judged as of the time of acquisition.[256] Purchasers are to be held to a high standard regarding inspection and must have made a reasonable inquiry into all circumstances in light of best business and land transfer principles.[257] Those engaged in commercial transactions are to be held to a higher standard than those engaged in private or residential transactions.[258] As a consequence, prospective purchasers have a strong incentive to make a reasonable investigation so that they may take advantage of the section 107(b)(3) defense if subsequently they should discover that the property is contaminated.

A lessor whose lessee creates contamination by definition cannot be an innocent purchaser because it is a current owner and, therefore, can never take advantage of the third-party defense.[259] As a practical matter, a lending institution that forecloses and takes title to contaminated property also will be hard-pressed to take advantage of the innocent-purchaser defense, because of the due diligence requirement, if the contamination occurred during the period of the loan. If, however, the contamination were pre-existing, then the defense should be potentially available.

It is important to note that the innocent-purchaser provision and the requirement of due diligence do not apply when the PRP is not in privity of contract with the person responsible for the contamination.[260] Subsequent purchasers need show only that the release was solely caused by a third party, that they exercised due care with respect to the materials, and that they took precaution against foreseeable acts.[261] In *United States v. Pacific Hide & Fur Depot, Inc.*,[262] however, the court suggested that any contract involving real property triggers the innocent-purchaser requirements.[263] The statute, however, indicates that the contract must be with the party causing the contamination.[264] As noted, if an owner of property obtained actual knowledge of the release or threatened release of a hazardous substance at the facility when that person owned the property and subsequently transferred ownership without disclosing that knowledge, that person is

255. *Id.*
256. H.R. CONF. REP. No. 962, 99th Cong., 2d Sess. 186, 186-88, *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 3279, 3280-81.
257. *Id.*
258. *Id.*
259. *See* State v. Time Oil Co., 687 F. Supp. 589 (W.D. Wash. 1988), *discussed at* 1988 Hazardous Waste Litig. Rep. (Andrews Publication) 12,869 (July 4, 1988).
260. 42 U.S.C. § 9607(b)(3) (1988): "[A]n act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly with the defendant . . . ."
261. New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985).
262. 716 F. Supp. 1341 (D. Idaho 1989).
263. *Id.* at 1346-47.
264. 42 U.S.C. § 9601(35)(A) (1988).

treated as a PRP and the third-party defense is not available.[265]

Several courts have considered the innocent-purchaser defense. In *Wickland Oil Terminals v. Asarco Inc.*[266] Wickland asserted that Asarco, from whom it acquired property on which there was slag, was responsible for remediation and sought summary judgment. Because Wickland knew of the presence of the slag and failed to conduct an appropriate inquiry, the court denied Wickland's motion and granted Asarco's counterclaim, holding Wickland to be a PRP.[267] In *United States v. Serafini*,[268] on the other hand, the court denied the government's motion for summary judgment, finding that a failure to inspect in 1969 did not necessarily vitiate the innocent-purchaser defense.[269]

CERCLA amendments currently are pending in Congress to clarify the requirements of appropriate inquiry under the innocent purchaser defense.[270] The bill would create a rebuttable presumption of all appropriate inquiry for purposes of certain commercial transactions. The rebuttable presumption would be available if a preacquisition investigation were conducted by an environmental professional, which included: (1) historical research of prior ownership and uses; (2) governmental records review; and (3) an on-site investigation.[271]

Even if a purchaser were able to assert successfully the innocent-purchaser defense under CERCLA, as a practical matter, the purchaser nonetheless could be required to remediate on-site conditions to preclude or reduce liability to third parties with potential toxic tort claims. In Texas, for example, the owner of property containing a nuisance becomes liable for the consequences of that nuisance if the owner knows of its existence.[272]

5. *De Minimis Settlement*

An innocent purchaser who fails to satisfy the requirements of having made a reasonable investigation pursuant to section 107(b)(3)[273] nonetheless may obtain some relief under section 122(g)(1)[274] of CERCLA. This section authorizes the EPA to enter into a de minimis settlement with an innocent purchaser if the purchaser did not conduct or permit the generation, transportation, storage, treatment, or disposal of any hazardous substance at the facility and did not contribute to the release or threat of release of a hazardous substance through any act or omission, unless the purchaser had actual or constructive knowledge that the property was used for the generation,

265. *Id.* § 9601(35)(C).
266. No. C-83-5906-SC (N.D. Cal. Feb. 23, 1988), *reprinted in* Hazardous Waste Litig. Rep. (Andrews Publication) 12,533 (1988).
267. *Id.* at 12,536.
268. 711 F. Supp. 197 (M.D. Pa. 1988).
269. *Id.* at 197-98; *see also* United States v. Pacific Hide & Fur Depot, Inc., 716 F. Supp. 1341, 1341 (D. Idaho 1989).
270. H.R. 2787, 101st Cong., 1st Sess., 135 CONG. REC. 3317 (1989).
271. *See id.*
272. 54 TEX. JUR. 3D *Nuisances* § 24 (1987).
273. 42 U.S.C. § 9607(b)(3) (1988).
274. *Id.* § 9622(g)(1).

transportation, storage, treatment, or disposal of any hazardous substance.[275] Thus, an innocent purchaser who failed to make a reasonable inquiry may cut its losses through a de minimis settlement.

On August 18, 1989, the EPA published its guidance for de minimis settlements for landowners.[276] That guidance suggests that the EPA will conduct a case-by-case review of items such as the condition of the property at the time of purchase, representations made at the time of sale regarding prior uses of the property, the purchase price, fair market value of comparable property, and information regarding any specialized knowledge on the part of the purchaser that may be relevant.[277] Using this guidance, the EPA is unlikely to release a PRP completely from liability because of the innocent-purchaser defense. Based upon the strength of a PRP's defense, the EPA may instead allow the PRP to enter a de minimis settlement. In a de minimis settlement, the settling PRP pays a proportionately higher amount of the estimated cleanup costs in settlement of the EPA claims against the PRP to avoid protracted and expensive litigation and its uncertain results.

The policy statement focuses on the state of knowledge of the purchaser at the time of acquisition and appears to mistakenly apply the test for establishing an innocent-purchaser defense, that is, not whether the defendant had actual or constructive knowledge, as provided for de minimis settlement under the statute, but rather whether the landowner conducted all appropriate inquiry. If the all appropriate inquiry test were satisfied, the landowner should incur no liability, not de minimis liability. The EPA also mistakenly asserts that this test must be satisfied if the contamination were caused by someone not in the chain of title, such as a midnight dumper. In that case, the contractual relationship that otherwise would vitiate the third-party defenses would be absent. Thus, the landowner would not need to demonstrate that it was an innocent purchaser, but instead, only that the contamination was solely caused by a third party.

In the same statement, the EPA announced a policy for settling with prospective purchasers if the purchasers participate in a cleanup. Recently, the agency entered into such a settlement.[278] In exchange for limited response actions, the EPA covenanted not to sue the prospective purchaser and others.

F. Real Property Transactions and CERCLA

Typically, litigation involving real property transactions is brought by a purchaser who discovers the existence of on-site contamination. The cause of action may be based on the contract, tortious theories such as fraud or negligent misrepresentation, or state deceptive trade practices statutes. Frequently causes of action relating to the contract are coupled with private

275. *Id.*
276. 54 Fed. Reg. 34,235 (1989).
277. *Id.*
278. *See Contaminated Property Sales—First EPA Covenant Not to Sue Purchaser*, 4 INSIDE EPA'S SUPERFUND REP., Sept. 13, 1989, at 3.

CERCLA claims.[279] As the developing case law clearly suggests, an understanding of the interrelationship between CERCLA and contractual claims is important to those negotiating real estate transactions. Pertinent issues discussed below include: the applicability of caveat emptor; the effect of various contractual provisions including releases, "as is" clauses, indemnification provisions, and representations; and sellers' use of CERCLA.

1. Caveat Emptor

In a number of cases involving CERCLA claims, the seller has interposed a defense of caveat emptor or buyer beware. The seller's assertion is that the rule, in effect, releases the seller from CERCLA liability to the buyer, because the buyer had responsibility for determining if any defects existed. The developing case law appears to be moving in the direction of considering caveat emptor in equitably allocating costs, but generally not as a bar to a CERCLA action.[280]

In *Philadelphia Electric Co. v. Hercules, Inc.*[281] a property owner brought suit claiming negligence, private nuisance, and public nuisance against the seller and its predecessor-in-interest because of contamination of groundwater during that company's operation of an on-site chemical plant. The court rejected a private-nuisance theory because private-nuisance law applies to conflicts between neighboring, contemporaneous land uses, rather than successive landowners.[282] The court also rejected a public-nuisance claim, finding a lack of standing.[283] Applying the rule of caveat emptor, the court next rejected the plaintiff's request for indemnification.[284] The court explained it was not stating the general proposition that a party that contaminates land, or its successor, can escape liability by selling the property, but only that the purchaser had no cause of action.[285] The court suggested that causes of action might lie with neighboring landowners and the public.[286]

In contrast, in *Smith Land & Improvement Corp. v. Celotex Corp.*[287] the court ruled the doctrine of caveat emptor unavailable as a defense in actions under CERCLA, even though the purchaser's predecessor had inspected the property and knew of the possibility that environmental cleanup costs might be incurred in the future.[288] The court held that factors pertinent to the doctrine of caveat emptor could only be considered in mitigating the amount

279. *See supra* note 98.

280. *See* Philadelphia Elec. Co. v. Hercules, Inc., 762 F.2d 303 (3d Cir.), *cert. denied*, 474 U.S. 980 (1985); PVO Int'l, Inc. v. Drew Chem. Corp., Hazardous Waste Litig. Rep. (Andrews Publication) 13,136 (D.N.J. 1988).

281. 762 F.2d at 303.

282. *Id.* at 315-16.

283. *Id.* Similarly, in Amland Properties Corp. v. ALCOA, 711 F. Supp. 784 (D.N.J. 1989), the court rejected claims by a subsequent property owner against a prior owner based on private and public nuisance, finding those claims inapplicable. *Id.* at 807-09.

284. 762 F.2d at 316-19.

285. *Id.* at 318.

286. *Id.*

287. 851 F.2d 86 (3d Cir. 1988), *cert. denied*, 109 S. Ct. 837 (1989).

288. *Id.* at 89-90.

due.[289] In *PVO International, Inc. v. Drew Chemical Corp.*,[290] PVO, the present owner of a site, brought suit against Drew, the former owner and operator, and argued in its motion for summary judgment that even if liable as a PRP, PVO should be entitled to 100 percent recovery against Drew, who caused the contamination. The court denied the motion referencing, among other things, the increase in property value that would be attributable to removal of hazardous waste—a pertinent equitable consideration in the allocation of costs.[291] In *Sunnen Products Co. v. Chemtech Industries, Inc.*[292] the court rejected the seller's defense of caveat emptor and held the seller strictly liable to the buyer for its cleanup costs.[293]

2. Releases

Parties to a contract can allocate or transfer CERCLA liabilities between themselves. The intent to allocate liabilities, however, must be clear. In *Mardan Corp. v. C.G.C. Music Ltd.*[294] the purchaser of a manufacturing facility and related property brought an action against a seller seeking recovery for costs incurred in cleaning up a waste disposal site. The court construed provisions of the contract between the parties and concluded that the release barred the buyer's private right of action under CERCLA, despite the asserted mutual mistake of fact concerning the necessity for cleanup.[295]

In *Southland Corp. v. Ashland Oil, Inc.*[296] the purchaser of a chemical plant sued the seller, seeking contribution under CERCLA or indemnity under the contract. The court noted that the parties could, between themselves, allocate or transfer CERCLA liability, but, unlike the parties in *Mardan*, they did not.[297] The court explained that to preclude recovery of response costs, an express provision in the contract must allocate these risks to one party.[298] Citing *FMC Corp. v. Northern Pump Co.*,[299] the court said the release need not specifically reference CERCLA as long as it is worded sufficiently broadly to encompass CERCLA claims.[300] The *Southland* court also noted that equitable factors affect apportionment, not the issue of liability.[301]

3. "As Is" Clauses

A number of cases involve contracts containing "as is" clauses. In *Inter-*

289. *Id.* at 90.
290. Hazardous Waste Litig. Rep. (Andrews Publication) 13,136 (D.N.J. 1988).
291. *Id.* at 13,140.
292. 658 F. Supp. 276 (E.D. Mo. 1987).
293. *Id.* at 278.
294. 804 F.2d 1454 (9th Cir. 1986).
295. *Id.* at 1461-63.
296. 696 F. Supp. 994 (D.N.J. 1988).
297. *Id.* at 1000.
298. *Id.* at 1002.
299. 668 F. Supp. 1285, 1292 (D. Minn. 1987).
300. 696 F. Supp. at 1002.
301. *Id.* at 1003.

national Clinical Laboratories, Inc. v. Stevens[302] the court held that although "as is" clauses might defeat claims based on breach of warranty, "as is" clauses do not affect CERCLA claims.[303] The court further found that the failure to inspect the property prior to the sale did not defeat CERCLA claims.[304] The court distinguished *Mardan*,[305] noting that in that case the "as is" clause also was not held to be a bar to a CERCLA action, and that the release, not the disclaimer, barred the CERCLA claim.[306] The *Stevens* court conceded that the steps taken or not taken by the buyer to protect itself likely would be relevant in apportioning liability for costs.[307] The *Southland*[308] case also involved an "as is" clause, which that court found precluded a breach of warranty claim, but did not bar the CERCLA claim.[309]

4. Indemnification

The *Southland* court also considered an indemnification provision. In granting Southland's motion for reconsideration, the court held that the indemnification provision in the contract was effective and provided a viable, alternative basis for recovery.[310] The court held that the provision did not limit recovery to situations involving formal lawsuits.[311] The court contrasted that provision to the provision in issue in *Jones v. Sun Carriers Inc.*,[312] in which a formal demand was a prerequisite to recovery under an indemnification provision. In *Channel Master Satellite Systems, Inc. v. JFD Electronics Corp.*,[313] also involving CERCLA cleanup claims, the contract contained an indemnification running from the buyer to the seller, but it related only to *violations* of law, meaning violations of state or local law. Because the cleanup under CERCLA was voluntary and involved no violation and because CERCLA is a federal law, the court held the indemnification provision inapplicable.[314]

5. Seller's Reliance on CERCLA

Most cases relying on CERCLA involve disgruntled purchasers. In some instances, however, sellers have sought to take advantage of CERCLA. In *Garb-Ko, Inc. v. Lansing-Lewis Services, Inc.*[315] the seller sought to rescind a contract for the sale of land based on a defect in the property discovered

302. 710 F. Supp. 466 (E.D.N.Y. 1989).
303. *Id.* at 470.
304. *Id.*
305. 804 F.2d 1454 (9th Cir. 1986).
306. 710 F. Supp. at 470.
307. *Id.* at 471.
308. 696 F. Supp. 994 (D.N.J. 1988).
309. *Id.* at 1001.
310. *Id.* at 1003-04.
311. *Id.* at 1000.
312. 856 F.2d 1091, 1093 (8th Cir. 1988).
313. 702 F. Supp. 1229, 1230-32 (E.D.N.C. 1988).
314. *Id.* at 1232.
315. 167 Mich. App. 779, 423 N.W.2d 355 (1988).

after the parties entered into the sales agreement. At the time they executed the agreement, neither party was aware that underground gasoline storage tanks were leaking. The stated concern of the seller was its continuing obligations and responsibilities for the environmental contamination over which it no longer would have control. The court upheld rescission of the contract, reasoning that the seller needed to have control and use of the property to contain further cleanup costs and third-party claims.[316]

In *Greer Properties, Inc. v. LaSalle National Bank*,[317] a contract provided the seller with an out if the cost of cleanup rendered the sale economically impractical, based on its best business judgment. The seller used this clause to terminate the contract, but then subsequently entered into a more profitable contract with another purchaser. The court reversed a summary judgment in favor of the seller and determined that a fact issue existed.[318]

6. *Representations*

In *Nunn v. Chemical Waste Management, Inc.*[319] the former owners of a corporation operating an industrial waste disposal facility brought suit against the buyers of the corporation for breach of their contractual duty to pay for the corporation's stock. The buyer counterclaimed for, among other things, breach of warranty. The court held that the seller's warranty that the facility complied with all laws was breached when leakage in violation of state law was discovered.[320] The court awarded the cost of remediation, but noted that the CERCLA claims had not been fully developed.[321]

If the leakage in *Nunn* were not a violation of state law, however, a warranty and representation of compliance with environmental laws would not support recovery by the purchaser because no violation would have occurred. The existence of liability under CERCLA or section 7003(a) of RCRA is not based on any violation, but rather on the presence of, or an involvement with, hazardous substances or solid waste.[322]

V. PRACTICAL CONSIDERATIONS IN EVALUATING AND STRUCTURING A DEAL

As this Article makes clear, any contract involving commercial real estate should address environmental concerns. Knowledgeable parties have a variety of options for handling the risks and uncertainties associated with on-site contamination and other environmental concerns and for enabling them to proceed with their transaction. Some of these approaches for addressing environmental concerns are suggested below.

316. *Id.* at 357-58.
317. 689 F. Supp. 831 (N.D. Ill. 1988), *rev'd*, 874 F.2d 457 (7th Cir. 1989).
318. 874 F.2d at 461.
319. 856 F.2d 1464 (10th Cir. 1988).
320. *Id.* at 1470.
321. *Id.* at 1470-71.
322. 42 U.S.C. § 9607(a)(4)(A)-(D) (1988).

A. Structure of the Deal

1. Business Form of Purchaser

Because the costs associated with on-site contamination may far exceed the value of the property and because liability may attach solely by virtue of ownership, a prospective purchaser of property with potential environmental concerns should consider structuring the transaction to limit liability to the value of the investment by creating a corporation or limited partnership. The liability of a corporation, a general partner, and an individual under Superfund statutes is unlimited.[323]

2. Assets or Stock

In an acquisition of assets that includes real estate, the concerns of the purchaser relate to the on-site presence of contamination and to existing violations that may continue after the deal is closed. The condition of adjacent property also may be of concern. For example, if on-site contamination exists on adjacent property, the purchaser may not be able to develop the acquired property until the contamination has been addressed. If the adjacent property owner is insolvent, the cleanup costs may fall upon the purchaser, although recovery against the Superfund is possible.[324] In an assets acquisition, the possibility of de facto merger or some other form of successor liability also should be considered. The concerns of the seller generally relate to the possibility of being held jointly and severally responsible for new or exacerbated conditions created by the purchaser.[325]

In a stock acquisition or merger, the concerns of the purchaser include, in addition to those associated with an assets acquisition, potential liabilities relating to off-site disposal and prior violations. Because the purchaser in a merger steps into the shoes of the seller, the purchaser may be responsible for the actions of its predecessor.[326] The shareholder, officer, or employee, however, should not be liable for the preacquisition actions of the predecessor company: potential liability as an operator should be prospective only, though liability may be joint and several.[327] The concerns of the seller relate to the possibility of being held jointly and severally responsible as an operator for new or exacerbating conditions created by the purchaser, based on the prior involvement of the seller in the management of the site.[328]

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323. *Id.* Compare *id.* with 33 U.S.C. § 1321(f) (1988).

324. *See* text accompanying notes 219-238.

325. These concerns were the basis for the action by the seller in Garb-Ko, Inc. v. Lansing-Lewis Servs., Inc., 167 Mich. App. 779, 423 N.W.2d 355, 355 (1988) to rescind its contract of sale.

326. 19 C.J.S. *Corporations* § 1630 (1940). A number of cases, however, suggest that the corporate veil will not be pierced absent a showing of corporate control at the time of occurrence of the activity giving rise to liability. *See, e.g.*, Berger v. Columbia Broadcasting Sys., Inc., 453 F.2d 991, 995 (5th Cir. 1972).

327. *See* United States v. Northeastern Pharm. & Chem. Co.(NEPACCO), 579 F. Supp. 823, 847 (W.D. Mo. 1984) (vice president and major stockholder held jointly and severally liable), *aff'd in part, rev'd in part and remanded*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).

328. 42 U.S.C. § 9607(c) (1988).

3. *Properties with Existing Problems*

For the seller, the retention of problem property insures adequate control and the ability to remediate. A sale of the problem property creates the potential for joint and several liability with the purchaser.[329] For the purchaser, the retention of the problem property by the seller avoids associated liabilities unless the acquisition is of stock or by a merger and the acquired company is liable for that property even though it no longer owns the property. From the purchaser's perspective, even if the problem property is carved out, contamination on the retained property might affect the value and use of the property that is acquired. Consequently, in addition to carving out the property, it may be worthwhile for the purchaser to insist on provisions addressing the potential for the retained property to contaminate the newly acquired property, for instance, an indemnification.

Another option for both parties is a lease purchase. From the purchaser's perspective, it allows time to evaluate the property prior to assuming ownership and associated liabilities. In addition, it allows access to property for other uses that may not create liability. From the perspective of the owner as a potential lessor, a key concern is possible liability resulting from on-site conditions created by the lessee.[330] The lease likely would vitiate any third-party defense. On the other hand, the lease purchase option may enable a deal to go forward that otherwise might be stalled until complete resolution of the environmental problem could be completed. As noted, the law is unsettled as to whether a lessee, not an operator or a sublessor, can be an owner under section 107.[331] Another more conservative approach is simply to acquire an option, with a right to inspect or test.

4. *Involvement of Lender in the Affairs of the Borrower*

For the lender, substantial involvement in the affairs of the borrower may create liability for on-site and off-site conditions, as well as for violations of environmental statutes, as an operator.[332] At the same time, however, the lender does want assurance that the value of the collateral will not be adversely affected. Additionally, if the lender were to foreclose and acquire the property, the lender would have responsibility as a current owner for any on-site conditions.[333] In drafting the loan document, therefore, the lender needs to walk a fine line between adequate protection and undue involvement.

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329. *Id.*

330. New York v. Shore Realty Corp., 759 F.2d 1032, 1045 (2d Cir. 1985) (owner responsible for unauthorized tenants); Versatile Metals, Inc. v. Union Corp., 693 F. Supp. 1563, 1563 (E.D. Pa. 1988) (owner and tenant jointly and severally liable); United States v. Argent, 21 Env't Rep. Cas. (BNA) 1354, 1355 (D.N.M. 1984) (owner responsible regardless of connection to tenant's business).

331. *Id.*

332. *See supra* notes 192-198 and accompanying text.

333. United States v. Maryland Bank & Trust Co., 632 F. Supp. 573 (D. Md. 1986).

5. *Involvement of Acquiring Shareholders in the Management of an Acquired Company*

In general, the company, but not the acquiring shareholder, continues to be liable for preacquisition conditions and violations.[334] On the other hand, the acquiring shareholder, if actively involved in the management or, possibly, if possessing the potential to control the acquired company, may acquire on-going liability for actions of the company after the acquisition.[335] Presumably, however, the acquiring shareholder would not acquire liability for pre-existing conditions or actions.

B. Pertinent Provisions

1. Representations and Warranties

A number of representations and warranties are useful in addressing environmental concerns. Any exceptions to a representation or warranty should be included in schedules. These scheduled items may indicate areas on which the environmental audit should focus. In each case, the seller or borrower likely will attempt to limit the representation and warranty by adding the qualifier: "to the best of [seller's or borrower's] knowledge" or by requiring that the matter referred to result in a "material adverse effect." From the perspective of either the purchaser or the lender, of course, a representation or warranty without such limitations is preferable. The seller also may attempt to add a disclaimer of warranty that real property is being sold "as is."[336] Any representation and warranty should be supported by a corresponding provision for indemnification. The value of that indemnification, of course, depends on the solvency of the seller. The representation and warranty should survive closing.

a. Disposal On-Site.

From the purchaser's perspective, it is important to receive representations and warranties that there has been no on-site disposal of hazardous substances as defined in CERCLA,[337] of petroleum, because petroleum is not a hazardous substance under CERCLA, or of other pollutants. The problem with this representation is that leakage of oil from automobiles literally would fall within the scope of the representation. A qualification could be added that the representation extends only to those substances the presence of which poses a threat to human health or welfare or the environment. Also useful would be representations concerning the absence of storage tanks, both above ground and, especially, below ground, because contamination often is associated with tanks, as well as representations concerning spe-

334. *See supra* notes 110-112.

335. *See* New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985); United States v. Northeastern Pharm. & Chem. Co.(NEPACCO), 579 F. Supp. 823 (W.D. Mo. 1984), *aff'd in part, rev'd in part and remanded*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).

336. *See supra* text accompanying notes 303-309.

337. *See supra* text accompanying note 107.

cific materials like asbestos and PCBs. These representations and warranties should be coupled with the right to perform or have performed an environmental audit.

A representation and warranty concerning on-site contaminants also is useful for a prospective lender. On-site contamination adversely affects the value of the collateral and makes foreclosure undesirable. Such a representation and warranty also might provide some protection to appraisers, brokers, and counsel.

b. Disposal Off-Site.

If the potential exists for acquiring the liabilities of the seller, the purchaser should obtain a representation concerning off-site disposal. As noted, generators of hazardous substances who have disposed of their wastes off-site have liability under CERCLA if the site itself poses a threat to human health through the environment.[338]

c. Environmental Compliance.

From the perspective of both the purchaser and the lender, a representation and warranty that a facility complies with environmental laws is useful. It is important to note, however, that liability under Superfund arises independent of any violation.[339] As a consequence, a representation and warranty of compliance with environmental laws will not be breached by the presence of on-site contamination triggering CERCLA liabilities.

In general, a representation and warranty concerning compliance will be more useful for ongoing operations, which must comply with environmental regulations, than for the purchase of undeveloped land. Many states, however, do proscribe leaks.[340] In some states, a failure to record notice of existing contamination in the county real property records also may be a violation.[341] Such a failure also may be a violation of the notification requirements under state or federal law depending on when the contamination occurred.[342]

d. Existing or Threatened Judicial Administrative Litigation.

From the perspective of the purchaser and the lender, it would be useful to have a representation and warranty stating that there is no existing or threatened judicial or administrative litigation. The representation might go further and assert that the seller or borrower is aware of no facts that would give rise to litigation.

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338. 42 U.S.C. § 9607(a)(1)-(4) (1988).

339. *Id.* § 9607.

340. Nunn v. Chemical Waste Management, Inc., 856 F.2d 1464, 1468 (10th Cir. 1988).

341. The Texas Water Commission has asserted that there is an ongoing obligation to deed record contamination resulting not only from intentional disposal, but from spills as well, even though that occurred prior to the effective date of that provision.

342. 33 U.S.C. § 132(b)(5) (1988); 42 U.S.C. § 9603(a) (1988); New Jersey Hazardous Substance Discharge Reports and Notices Rule, N.J.A.C. 7:1-7.1 (West Supp. 1988).

e. Existence of Laws or Regulations Adversely Affecting Use of Property or Transactions; Fitness for Intended Purpose; and Necessity of Government Consent to Transfer Property.

Because a seller or borrower may have peculiar information not readily available, a purchaser or lender should obtain a representation and warranty concerning the existence of laws with potential adverse effects, the fitness of property for a particular purpose, and the necessity for governmental consents to transfer property. In New Jersey, for example, the Environmental Cleanup and Responsibility Act, or ECRA,[343] may significantly affect a proposed transaction. As a practical matter, however, the purchaser or lender itself should be knowledgeable as to whether any such laws with potential adverse effects exist.

2. Covenants

a. Environmental Audit.

Provision for the performance of an environmental audit should be considered in all contracts concerning commercial property. Through such an audit the seller or lender can determine if significant problems exist that would affect the real property value. The innocent-purchaser provisions of CERCLA virtually require that an audit be performed to demonstrate due diligence.[344] For appraisers, brokers, and counsel, an environmental audit helps minimize exposure to liability for breach of a duty either to discover or to disclose an unknown or concealed problem. From the perspective of both a seller, on the one hand, and a lessor and lessee, on the other, an audit also is beneficial: for sellers, to prevent subsequent claims asserting pre-existing contamination or to address problems of which the seller may be unaware; for lessors and lessees, to establish a baseline to preclude later arguments by the other party that it caused or contributed to on-site contamination.

For lenders and lessors, the opportunity to conduct periodic environmental audits is important: for a lessor, to insure that on-site problems are not being created; for a lender, to insure that the value of its collateral is not being impaired and also, as protection, prior to foreclosure.

It is important that the contract also contain provisions for responding to the results of the audit. The ability to perform an audit is of little value if the contract has no provisions that enable the parties to take advantage of the results of that investigation. For example, both parties to a sale may use the results to quantify liabilities, to adjust the purchase price, or to create an escrow.

b. Authorization to Review Government Files.

Although government files generally are available under various state

343. *See supra* note 35.

344. For a discussion of the innocent-purchaser defense, see *supra* text accompanying notes 250-272.

open records acts and the federal Freedom of Information Act,[345] it often is helpful to have express authorization from a company to review files relating to the company. As a consequence, provisions should be included in the contract to authorize the review of those documents. This type of provision is especially useful for ongoing businesses that routinely are regulated by environmental agencies.

c. Provision of Corporate Documents and Access to Files.

Obviously, an adequate investigation requires access to pertinent corporate documents. Confidentiality, however, may pose some concerns for the seller. This concern may be addressed by a confidentiality agreement. Files may be found not only at corporate headquarters, but at individual facilities as well. Both locations should be investigated.

d. Cooperation in Investigation, Ongoing Cooperation with Environmental Agencies, and Post-deal Access to the Site.

This type of provision is useful in assuring that necessary work can be done, from the perspective of both the purchaser and the seller. If an ongoing problem is discovered, the seller, who may have responsibility, may need access to the site to do necessary work. The purchaser also may find it useful to be able to refer to information and resources of the seller in discussions with environmental agencies.

e. Remediation of Existing Problems.

Provisions should be included in the contract concerning problems that are uncovered by the environmental audit or that otherwise are known. A determination should be made as to how these problems will be addressed. Included within that provision should be consideration of who will do the work and how the parties will determine that the work has been accomplished. A key issue in these types of situations is: how clean is clean? Recourse to state environmental agencies sometimes is a useful method for addressing this issue. Another option is to have independent consultants for both parties to the transaction, with recourse to a third consultant selected by the other two in case of a conflict.

An advantage to a purchaser who performs the work and is reimbursed by the seller is some additional degree of certainty that the job is being done correctly. On the other hand, the remediation itself could give rise to liability. The site to which the contaminated materials are taken could become a problem, or adjacent landowners or residents might assert damage to health or property as a result of the cleanup. For that reason, the purchaser may prefer the seller to have responsibility for remediation and that remediation occur prior to closing.

345. 5 U.S.C. § 552 (1988).

f. Transfer of Permits.

If existing permits need to be transferred, it is important that the parties cooperate in the transfer. Timing may pose another issue. Because the transfer of permits typically cannot be effected at the time of closing of the transaction, either the seller or the buyer may well incur liabilities associated with an untransferred permit. The parties should address this concern.

g. Covenant Not to Handle On-Site Hazardous Substances and to Allow On-Site Inspection to Verify.

From the perspective of the lender or lessor, it is important that the covenant contain a provision to prevent the borrower or lessee from handling hazardous substances or other pollutants of concern on-site, unless the activity is a necessary part of the business. In that case, other provisions should be included. Such a provision, for example, might impose restrictions on the presence and use of chemicals on-site. To provide teeth to that covenant, the lessor should insert a provision allowing on-site inspections to verify.

3. Releases

From the perspective of the seller, if part of the consideration for the deal is that monies will be expended to clean up the site, then it would be useful to have a release and possibly an indemnification, to be in place after cleanup has been effected. The release, if it is to cover CERCLA liabilities, should expressly reference them. The release would protect against litigation by the purchaser; the indemnification would provide reimbursement for litigation by third parties.

4. Indemnification

With regard to each of the representations and warranties, the purchaser or lessor should insert a provision providing for indemnification. The indemnification provision should indicate the period for which it is in effect and the trigger for the applicability of that provision. If the party providing the indemnification is not financially sound and, possibly regardless, consideration should be given to establishing an escrow or requiring environmental impairment liability insurance, if available.

5. Escrow

To the extent environmental liabilities are unknown, the use of an escrow is a useful method for assuring that funds will be available, particularly if the seller may not have the financial wherewithal, to cover the costs. The escrow also is useful for known, but unquantified liabilities. The escrow agreement should explicitly state what kinds of expenses are covered and what triggers the ability to draw on the fund, for example, the discovery of a problem or the assertion of a claim.

6. Allocation of Liabilities

In particular where ongoing businesses are involved, but in other situations as well, it is useful to provide for an allocation of liabilities. Often these liabilities are divided, with the seller having responsibility for conditions existing prior to closing and the purchaser having responsibility for conditions arising after closing. A key issue relates to the placement of the burden of proof should a problem arise. The placement of the burden may determine who ends up responsible. In addition, a seller may want to have a cut-off period so that if no liabilities are discovered within a certain time period, then regardless of the factual situation giving rise to those liabilities, the purchaser is liable if the time period has expired. Among the costs to be considered in allocating liabilities are costs of environmental compliance, remedial costs, and toxic tort liability.

7. Insurance

Much litigation has concerned the ability of an insured to recover on a comprehensive general liability policy that contains a pollution exclusion. In many instances, such recovery has been allowed, though case law is divided.[346] Consequently, the existence of an insurance policy may be a valuable asset if contamination is later discovered, provided the policy is an occurrence policy rather than a claims-made policy. The parties should include a provision to determine who is entitled to recover under a policy. Additionally, environmental impairment liability policies may be available to protect against liability for off-site contamination. If available, these policies can be useful to quantify unknown liabilities.

8. Counsel's Opinions

From the perspective of the lender, the lessor, and the purchaser, it may be useful to have counsel for the other party opine that pertinent requirements have been satisfied. This opinion generally may track the representations and warranties made by counsel's client and should provide some additional degree of comfort.

9. No Assignment Without Consent

To insure that a carefully worded contract is not rendered ineffectual, the contract should prohibit the borrower or lessee from transferring or subleasing the property to another without approval by the lender or owner. Liabilities may be based on on-site conditions, regardless of who creates them.[347]

10. Alternative Dispute Resolution

The parties to a real estate transaction should consider the inclusion of a provision dealing with alternative dispute resolution. Environmental issues

346. *Compare* Mraz v. Canadian Universal Ins. Co., 804 F.2d 1325 (4th Cir. 1986) *with* Port of Portland v. Water Quality Ins. Syndicate, 549 F. Supp. 233 (D. Or. 1982).

347. 42 U.S.C. § 9607(a)(1)-(4) (1988).

are highly complex and expensive to resolve through litigation. Mediation and binding arbitration are two less expensive alternatives.

VI. CONCLUSION

Environmental laws are complex, far-reaching, and of potentially tremendous significance in transactions involving real estate. To address the concerns associated with this complex body of law, real estate professionals should be familiar with the ways in which various environmental laws can affect both real estate and the parties to a real estate transaction. Provisions should be included in any commercial real estate transaction to identify pertinent environmental liabilities and restrictions on land use and to address those concerns in the structuring of the transaction and in the preparation of transaction documents. The risks, though significant, generally can be addressed.