

## **It's More Than Just AAI – “Continuing Obligations” And Other Ways To Limit Purchaser Liability**

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This presentation and paper discusses a variety of tools that a purchaser can use to limit its liability for pre-existing environmental conditions, with a particular emphasis on liability as a current owner under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 USC sections 9601 et seq. Other presentations will discuss the role of “all appropriate inquiry” as part of the bona fide prospective purchaser (BFPP) or innocent purchaser defenses; this paper focuses on the continuing obligations of a purchaser required to maintain the BFPP defense. In addition, we will discuss a number of other ways purchasers can be held liable for pre-existing conditions, and means by which a purchaser can limit such liability.

Although there are other statutory and common law claims under which property owners can be held liable, CERCLA presents the most well-known and obvious scenario under which a current owner can be held liability for the costs of remediating pre-existing conditions simply by virtue of owning the property; by statute, a current owner is one of the four categories of “potentially responsible parties,” or “PRPs.” See CERCLA § 107(a), 42 USC 9607(a). As a result, environmental attorneys, and their clients purchasing real property, tend to focus on CERCLA liability. Keeping with that tradition, we will first focus on defenses to liability under CERCLA and other means of limiting that liability. We will then discuss in other tools that a purchaser can use to limit liability that might arise under not just CERCLA, but other statutes or common law.

### *The Bona Fide Prospective Purchaser Defense*

As noted above, current owners are by statute “potentially responsible parties” under Section 107 of CERCLA. However, those current owners who “did not know” and, more importantly, “had no reason to know” that hazardous substances had been released on the property prior to purchasing it, were not considered “owners” for purposes of Section 107 liability. See CERCLA § 101(35)(A), 42 USC § 9601(35)(A). In contrast, purchasers who “had reason to know”, and still purchased the property, remained “owners” and therefore PRPs. The result was an obvious disincentive for buyers to buy contaminated or potentially contaminated property. To remove this disincentive, Congress amended CERCLA to include the “bona fide prospective purchaser” defense. See CERCLA § 101(40), 42 USC 9607 § 101(40).

To qualify as a BFPP, a purchaser must establish each of the following:

1. All disposal of hazardous substances occurred before its acquisition of the facility
2. It made “all appropriate inquiries” into the previous ownership and uses of the facility
3. It provides all legally required notices with respect to the discovery or release of hazardous substances at the facility
4. It exercises “appropriate care” with respect to hazardous substances at the facility, by taking reasonable steps to
  - Stop any continuing releases
  - Prevent any threatened future release
  - Prevent/limit exposure of people or the environment to previous releases
5. It has provided full cooperation, and assistance, and access to those conducting response actions
6. It has complied with all institutional controls established or relied on for the remediation of the facility
7. It has complied with all government requests and subpoenas, and

8. It has no affiliation with a PRP, through familial relationship or contractual relationships, with the exception of a contract to acquire the facility, and is not the result of a corporate reorganization of a PRP

Other presenters will be discussing what constitutes “all appropriate inquiry.” In this presentation and paper, we will discuss the continuing obligations portion of the BFPP defense, focusing on the “appropriate care” requirement. The reason for the focus on “appropriate care,” is because the two cases to address whether a party established the BFPP defense focused on this aspect of the defense.

#### Do’s and Don’ts – Contrasting Cases on Appropriate Care

Two 2010 cases from federal district courts illustrate that the application of the appropriate care standard is highly fact specific and provide examples of do’s and don’ts. In a case out of California, the property owner promptly emptied USTs as soon as it was known that they contained TCE, and successfully obtained protection as a BFPP. *3000 E. Imperial, LLC, v. Robertshaw Controls Co.*, No. CV 08-3985 PA, 2010 U.S. Dist. LEXIS 138661 (C.D. Cal. Dec. 29, 2010). By contrast, a South Carolina landowner demolished a building and left contaminated sumps exposed to the elements, torpedoing its BFPP defense. *Ashely II of Charleston, LLC v. PCS Nitrogen, Inc.*, 746 F. Supp. 2d 692 (D.S.C., 2010).

The *Imperial* case provides an example of how a diligent owner can indeed gain protection as a BFPP. Plaintiff 3000 E. Imperial, LLC (“Imperial”) owned property in Lynwood, California that had been previously owned by Defendant Whittaker Corporation (“Whittaker”) and others and used for manufacture of furniture and airplane parts. 2010 U.S. Dist. LEXIS 138661 at 4\*. Imperial brought a CERCLA Section 107 cost recovery action against Whittaker, and Whittaker brought a counterclaim against Imperial, alleging that since Imperial was the current owner of the property it was a PRP. *Id.* at \*32. Imperial claimed that as a BFPP it was not liable under CERCLA, but Defendant claimed that Imperial had not taken “appropriate care” with respect to hazardous substances because it had not excavated USTs, which had previously contained TCE, for two years after acquiring the property. *Id.* at \*32.

Under CERCLA, a party takes “appropriate care” with respect to hazardous substances if it takes “reasonable steps to (i) stop any continuing release; (ii) prevent any threatened future release; and (iii) prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance.” *Id.* at \*33. Plaintiff had the contents of the USTs sampled in May 2007, and test results reporting the presence of TCE were reported in September 2007. *Id.* at \*34. Plaintiff had the USTs emptied in October 2007, but the now empty tanks were not excavated until 2009. *Id.* at \*34-35. The court found that Plaintiff had taken reasonable steps to stop and/or prevent releases by promptly emptying the USTs once TCE was detected, and noted that “[i]t was not unreasonable for Plaintiff to leave the USTs in the ground...given that they were empty.” *Id.*

*Ashely* also began as a CERCLA Section 107 cost recovery action against a former site owner, PCS Nitrogen, Inc., who filed a counter claim against Ashley, who in turn claimed BFPP status. 746 F. Supp. 2d at 697. The property in question had been used as a container cleaning and storage facility and wastewater from the washing process collected in sumps in the wash building. *Id.* at 718. A pre-purchase Phase I identified the sumps as a recognized environmental condition. *Id.* at 719, 752. Ashley nevertheless demolished the wash building in 2008 without cleaning out or filling the sumps, leaving them “exposed to the elements” and potentially allowing further releases. *Id.* at 752. Ashley also allowed a debris pile to accumulate at the site and to remain for over a year, and allowed the crushed limestone cover at the site to deteriorate. *Id.*

The district court concluded that Ashley had not taken appropriate care with respect to hazardous substances at the site. *Id.* Courts analyzing the “due care” requirement of the innocent landowner defense have concluded that “doing nothing in the face of a known or suspected environmental hazard would likely be insufficient” to establish that a party had taken “due care”. *Id.* at 751. As BFPPs should be aware of the nature and extent of contamination through pre-purchase appropriate inquiry, and thus can plan steps that must be taken to stop or prevent releases, BFPPs may be subject to “greater reasonable steps obligations” than innocent purchasers. *Id.* at 751-52, quoting EPA guidance.

Further, the district court concluded that Ashley had not met its burden of showing that “disposals” of hazardous substances had not occurred during Ashley’s ownership period. As the sumps were deteriorated, contained hazardous substances, and were allowed to fill with rain water after the demolition of the building in 2008, “[i]t is likely that there were disposals on the [site] after Ashley tore down the structures...” *Id.* at 750.

On appeal, the Fourth Circuit upheld the lower court’s decision. Quoting the Second Circuit opinion in *New York v. Lashins Arcade Co.*, the court stated that the “‘due care’ inquiry asks whether a party ‘took all precautions with respect to the particular waste that a similarly situated reasonable and prudent person would have taken in light of all relevant facts and circumstances.’” *PCS Nitrogen Inc. v. Ashley II of Charleston LLC*, 714 F.3d 161, 181 (4<sup>th</sup> Cir. 2013). The court also stated that while it would not determine whether the “appropriate care” standard applicable to BFPPs was higher than the “due care” standard applicable to innocent landowners, the “appropriate care” standard is at least as stringent and can therefore be analyzed using existing “due care” case law. *Id.* at 180. (Ashley had claimed that “appropriate care” was less stringent than “due care.”)

These cases illustrate how important it is for a landowner to promptly and thoroughly address identified environmental conditions if it wants to seek protection as a BFPP. We also note that these cases have been cited in more treatises and articles than subsequent cases, perhaps suggesting that they will have less of an impact than one would have thought from the initial flurry of commentary.

#### Other Elements of the BFPP Defense

While the case law has focused on “appropriate care,” it should not be forgotten that to qualify as a BFPP, an owner must also provide any notices with respect to discovery or releases of hazardous substances. This includes not just any federal notices, but also under state law, such as under the Massachusetts Contingency Plan. EPA has stated in guidance that “‘Legally required notices’ may include those required under federal, state, and local laws” and that property owners “have the burden of ascertaining what notices are legally required in a given instance”. EPA, Interim Guidance Regarding Criteria Landowners Must Meet in Order to Qualify for Bona Fide Prospective Purchaser, Contiguous Property Owner or Innocent Landowner Limitations on CERCLA Liability (“Common Elements”), March 6, 2003, at p. 13. An owner must also cooperate, assist and provide access to those conducting remediation, and comply with any EPA requests for information or subpoenas.

Lastly, an owner must comply with any land use restrictions or other institutional controls used to complete remediation. To comply with the institutional controls, the owner needs to identify them as soon as possible, hopefully as part of any title search done during acquisition. What do the restrictions affect – are they simply use restrictions, such as no residential use or use of

groundwater? Do they prevent disturbance of soil or pavement that might be serving as a cap? If the new owner's intended use of the development is hindered by these institutional controls, can the controls be revised or removed? Will the owner need to perform any remediation to allow for less restricted use of the property? These are the types of questions that need to be asked and answered to ensure compliance with the "continuing obligations."

On a related note, we would be remiss if we did not mention that ASTM has adopted a standard for continuing obligations. ASTM Standard E2790-1, "Standard Guide for Identifying and Complying With Continuing Obligations," can be obtained from ASTM. [www.astm.org](http://www.astm.org).

#### *Other tools to limit CERCLA liability*

The BFPP defense is just one tool by which new owners can seek to eliminate CERCLA liability. Another tool, the use of comfort letters, are the topic of another portion of the presentation. A third way to limit CERCLA liability is to settle with EPA or the state, and cash out. Obviously such a solution only works if the property is part of a facility with which EPA or state is already involved. Examples are national priority list (NPL) sites that are comprised of regional groundwater issues, or stretches of river with a large number of PRPs. A settlement with EPA or the state provides contribution protection. CERCLA § 113(f)(2), 42 USC 9613(f)(2). I would argue that this is a better defense than the BFPP defense, as the only element that a defendant need prove is that it "resolved its liability... in an administrative or judicially approved settlement...." Id.

A last strategy to minimize or otherwise address CERCLA liability is more amorphous, and often overlooked – an assessment of the actual potential for a CERCLA claim. Obviously, this is a very fact and site-specific evaluation, but I would suggest a valuable one. How likely is it that the potential buyer will be subject to a CERCLA claim at all? Were hazardous substances released at the site? Was the only material released petroleum, and therefore not a hazardous substance? See CERCLA § 101(14), 42 USC § 9601(14). Have other PRPs already been identified? When compared to the already-identified identified PRPs, what is the buyer's likely allocation, based on the fact that it will have owned the site for a short period of time and not released any hazardous substances?

#### *Beyond CERCLA*

Discussions on how to limit the liability of a prospective purchaser (about-to-be owner) for environmental conditions tend to focus on CERCLA. I believe the reason for this is two-fold – first, liability is strict (attaches simply by virtue of owning the property), and joint and several, meaning that the new owner is at least in theory responsible for all costs in a cost-recovery action, second, the standard due diligence tool of the Phase I environmental site assessment is explicitly part of the CERCLA BFPP defense. It is important to remember, however, that there are other possible claims that can be brought against a property owner, some statutory and some based on common-law, all of which are fact specific. While a comprehensive review of state causes of action related to past or existing releases of hazardous substances is not possible in this setting, a brief summary of possible claims and possible plaintiffs is set out below.

Many states have a state "superfund" statute, analogous to CERCLA. For example, the New Jersey Spill Compensation and Control Act (Spill Act) prohibits releases of hazardous substances, but also provides for a claim by the state for costs to remediate spills and provides for a contribution claim by "dischargers and other persons" against any "other dischargers and persons

in any way responsible for a discharged hazardous substance or other persons who are liable for the cost of the cleanup and removal of that discharge of a hazardous substance.” N.J. Stat. Ann § 58:10-23.11f(a). A New Jersey appellate court case found that an owner can only be held liable for contamination that occurred prior to its acquisition if it either was “in any way responsible for” the hazardous substances or “by virtue of their lack of diligence in discovering the contamination at the time they purchased the land.” See *New Jersey Schools Development Authority v. Marcantuone*, 428 N.J. Super 546, 549, (App. Div. 2012), cert. denied, 213 N.J. 535 (2013). Both the state and private parties can sue for costs under the Spill Act.

California’s Hazardous Substances Account Act also provides for broad liability, albeit apportioned, for sites where there has been a release of “hazardous substances.” The Act defines “responsible party” or “liable person” as “those persons described in Section 107(a) of the federal act (42 U.S.C. Sec. 9607(a))” (Cal. Health & Safety Code § 25323.5(a) (1)), but also adopts the CERCLA defenses (Cal. Health & Safety Code § 25323.5(b)). Again, either the state or private parties are potential plaintiffs.

In Massachusetts, the state superfund law, found at Mass. Gen. Law 21E, Section 5, states that “persons liable” include “(a) Except as otherwise provided in this section, (1) the owner or operator of a vessel or a site from or at which there is or has been a release or threat of release of oil or hazardous material...” The Massachusetts Contingency Plan, which are regulations promulgated under 21E provide that such responsible parties are responsible for reporting and addressing releases of “oil or hazardous materials” found on their property. See 310 CMR 40.0000.

#### *State Programs That Can Limit Liability*

While state laws imposing liability differ among the various jurisdictions, many do in fact impose some sort of liability upon property owners as a result of their ownership. This scheme had the foreseeable effect of reducing the desire to purchase property that might be or was known to be contaminated. To encourage development of these “brownfields”, many states have adopted “brownfield programs” or “voluntary cleanup programs” (VCPs), many of which also include some sort of liability protection for purchasers who acquire the property after the release has occurred.

Each state’s program is different, and it is critical to understand the details of the voluntary program prior to acquisition of the property. For example, while some states allow current owners to be enter into VCPs or Brownfields programs, some states only allow a prospective purchaser to take advantage of the liability protections, such as Connecticut and Georgia. See C.G.S. § 32-769(a); GEORGIA LAW§ 12-8-200. Some states have both a VCP and a Brownfield program, one of which applies to current property owners while the other applies to prospective purchasers, such as Delaware. See 7 Del. C. § 9107 (VCP), and 7 Del. C. Ch. 91, subch. II (Brownfields).

Most states require that the prospective purchaser agree to perform some level of remediation. In contrast, Michigan’s Baseline Environmental Assessment program allows a prospective purchaser to identify the “baseline” conditions, at a “facility”, which by definition has had a release and has concentrations over contaminants over the residential cleanup criteria, and provided that the new owner complies with its “due care plan,” it is not liable for the cleanup of the existing conditions. Michigan Compiled Laws section 324.20107a. In a similar vein, Pennsylvania’s Land Recycling Program, also known as Act 2, allows a party to remediate known conditions, and receive liability protection for those known conditions. 1995 Pa. Laws 4, §501.

As can be seen from this quick overview, the terms of the voluntary cleanup or brownfield programs in each state can differ widely. To evaluate whether or not the state program is a viable liability management tool for a particular property and a particular buyer, these questions need to be asked: When does the buyer/prospective purchaser need to enter the program? What are the eligibility requirements, and does the prospective purchaser meet them? How extensive is the liability protection – is it just from the state, or does it cover third parties as well? Does it cover all pre-existing conditions, or just those that have been identified? Is remediation required? If so, is the scope limited to the property, or does migrating contamination also need to be addressed? With the answers to these questions, the buyer can assess the value of the program for this property.

### *Non-governmental Tools to Limit Liability*

The use of the purchase and sale agreement to limit liability should not be forgotten in a discussion of BFPP defenses and voluntary cleanup programs. The agreement by which the purchase acquires the property can have a wide variety of provisions that will protect the buyer – assuming that there is a viable entity behind them.

First and foremost, have the parties agreed to a division of liability that they have documented in the agreement? A typical split is pre-closing and post-closing, but depending on the purchase price, the buyer may assume all conditions, in an AS IS, WHERE IS purchase, and release the seller for all obligations.

Has the seller made any representations or warranties with respect to the condition of the property? Representations and warranties, and the accompanying disclosures and scheduled items (“Except as set forth on Schedule ENV, the property is/has ....”) are an important tool a buyer can use to assess the condition of the property. Will the seller provide an indemnity with respect to the pre-existing conditions? Since an indemnity is only as good as the entity providing it, consider whether the seller is a viable entity, or whether the buyer should look for a corporate guarantee or some other financial assurance to backstop the indemnity.

If there are known conditions, how will they be addressed? Has the seller put funds in escrow to address them? If the parties intend to remediate the known conditions, have they agreed on the cleanup standards? Will the property be remediated to industrial standards, or residential? Will there be institutional or engineered controls that are used to limit the extent of remediation? Will such controls impact the buyer’s intended use of the property? For example, did the buyer want to build condos, while the seller is only intending to remediate to commercial standards? Does the seller need access to perform remediation? Buyers will usually want to limit such access such that it does not interfere with their use of the property.

A buyer obviously has input with respect to the purchase and sale agreement it is negotiating to purchase the property, but there may be pre-existing agreements that will also provide it some protection. These might be indemnification agreements or remedial agreements that the current seller entered into when it was the buyer. Similarly, these types of provisions might be contained in the current seller’s prior purchase and sale agreement. When reviewing these documents to determine whether they provide any benefit to the current buyer, we look to see whether there agreements inure to the benefit of successors or assigns. If so, are there any obligations placed on the successors or assigns? Do they need to provide access, cooperate or perhaps limit their use of the property?

A last tool that can offer significant liability protection is environmental insurance, specifically, that insurance typically referred to as “legal liability insurance”. These policies are heavily negotiated. They begin with the form policy, with many changes being made by endorsements. The variables are the term (how long is the policy in effect?), the premium (this is a one-time payment for the term, usually), and the self-insured retention, or deductible, both per incident and in the aggregate. With insurance policies, the devil is truly in the details, and we strongly recommend reviewing the policy carefully, specifically the definitions, the exclusions and any endorsements proposed by the insurer.

Legal liability insurance will generally cover unknown conditions and any known conditions that have been disclosed to the insurer, unless the insurer excludes them by endorsement. These exclusions are sometimes by media and sometimes by contaminant. We carve back the exclusions as narrowly as possible. The insurance will also sometimes require that the insured not perform any voluntary investigations or change the use of the property. Because the risk covered by legal liability insurance is related to the condition of the property, not the insured itself, it is generally easy to include a number of parties as insureds and at no additional cost. These may include investors, lenders, or partners in a joint venture.

#### *Do the Due Diligence*

It seems so obvious that we almost hate to say it, but the best tool for providing protection from liability is to ensure that the client has done its due diligence when purchasing the property. Every client has a different risk tolerance, but few clients do not want to know what they are buying. So we end with a few thoughts on “doing” the due diligence.

Critically review the Phase I ESA. Does it actually meet the requirements AAI? Many do not, as the EPA Inspector General found a few years ago in a study of Phase I site assessments done for Brownfield funding. See <http://www.epa.gov/oig/reports/2011/20110214-11-P-0107.pdf> Does the Phase I ESA raise any other questions? For example, if the building was built in 1950, but not connected to sewer until 1975, what happened before that? It is important to read these reports critically and ask the consultant questions.

In addition to reviewing the Phase I, review all documents provided by the seller, such as prior Phase Is, Phase IIs, and any remedial reports. Are there any agency communications related to releases or non-compliance? If the property is in a state that has a robust online database for release reports or other documents, check the database. Have any institutional controls been recorded on the land records for the site? If so, what are the restrictions? Are certain uses or excavation in a certain area of the site prohibited? Do the restrictions affect the client’s goals for the property?

#### *Conclusion*

The BFPP defense is a useful tool to limit a prospective purchaser’s liability under CERCLA and some state laws. It is critical to remember that the BFPP defense is more than just conducting all appropriate inquiries, and new owners must also satisfy their continuing obligations as laid out in CERCLA. In addition, to protect against liabilities other than those laid out in CERCLA, there are a number of other tools that a prospective purchaser can use to limit its liability for pre-existing conditions.