

Recent Supreme Court Decision Limits Contribution Claims Under Superfund and Confirms Importance of Environmental Due Diligence in Real Estate Transactions

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A recent U.S. Supreme Court decision confirms the critical role of pre-acquisition environmental due diligence in real estate acquisitions. The Court's decision underscores the need to identify environmental concerns early in the acquisition, development or divestiture process, and will be a critical factor in avoiding potentially substantial environmental impairment liability.

On December 13, 2004, the U. S. Supreme Court held in *Cooper Industries, Inc. v Aviall Services, Inc.* that a private party who has not been sued under Comprehensive Environmental Response, Compensation and Liability Act's (CERCLA or Superfund) injunctive relief or cost recovery provisions may not obtain contribution under the statute from other liable parties. The Court ruled that, unless they themselves are subject to an enforcement action under §106 (cost recovery provision) or §107(a) (injunctive relief provisions), private parties who undertake private cleanups may not obtain contribution under §113 from other potentially responsible parties (PRPs). In other words, the Court's ruling means that one PRP cannot voluntarily cleanup a site and then seek to recover costs from other PRPs under §113. Accordingly, prospective purchasers of environmentally impaired properties should carefully consider availing themselves of the defenses to CERCLA's broad liability scheme. When environmental issues are identified, every effort should be made to thoroughly assess and negotiate legal liability between the parties. The Supreme Court's decision in *Aviall* left open the related issue of whether a PRP would have standing under §107. Lower courts have previously held that similarly situated PRPs may not recover costs under this provision of CERCLA.

Historic Superfund Liability

CERCLA's liability provisions can be onerous, as liability for existing environmental contamination is strict, joint, several and retroactive. This means that current and former owners and operators of real estate, along with those who have transported and/or generated hazardous substances that came to be located on the site, can be held liable in the event that contamination is discovered on the subject property. This liability scheme applies even where the PRP did not cause, contribute, or otherwise have knowledge of the release due to their failure to conduct appropriate environmental due diligence. For this reason, most prudent real estate professionals have routinely conducted some form of environmental due diligence into the past ownership and use of a property prior to acquisition using Phase I Environmental Site Assessments (ESAs).

Since the 1980s, the scope and quality of ESAs varied significantly, with many users often seeking the lowest cost option. This created a wide disparity in the quality of environmental

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assessments prepared by consultants. Recent federal legislation now regulates the manner in which these studies should be conducted.

In 2001, Congress passed federal Brownfield law, which amended CERCLA and established an interim standard to conduct All Appropriate Inquiry (“AAI” and EPA’s term for the Environmental Site Assessment process) in order for a party to avoid Superfund liability. The interim AAI standard requires that a party must complete a Phase I Environmental Site Assessment in accordance with the requirements established by the ASTM Standard Practice for Completing Phase I Environmental Site Assessments (reference ASTM Standard E 1527-00). In doing so, a party can demonstrate that they did not know and had no reason to know of the existence of environmental impairment, and, thus qualify as an “Innocent Purchaser” under CERCLA. Congress declared that the ASTM interim standard shall remain in place until EPA published its own regulation, which is currently two years past due. Since 2003, the Agency has been working closely with ASTM, interested parties and the public to develop its own AAI standard. In August 2004, EPA published its proposed regulation in the *Federal Register* that closely tracks the existing ASTM Standard, while imposing additional obligations on the various parties involved. A final Rule is expected in late 2005.

Background of *Aviall* Decision

Cooper Industries, Inc. owned four industrial properties in Texas until 1981, when it sold them to Aviall Services, Inc. After operating those sites for several years, Aviall discovered that both it and Cooper had contaminated the soil and groundwater with hazardous substances. This discovery occurred in connection with the sale of the properties to a third party. In that transaction, Aviall assumed responsibility for the cleanup and notified the State of the contamination. Neither Texas nor the Federal government took judicial or administrative measures to compel clean up, although the State threatened to take enforcement action if Aviall refused to act. Aviall then commenced clean up on its own under oversight of the Texas Natural Resource Conservation Commission. Aviall expended over \$5 million in its efforts. Aviall then filed an action against Cooper to recover a portion of its costs.

The issue presented to the U.S. Supreme Court was whether a private party who has not been sued under §106 or §107(a) may nevertheless obtain contribution under §113(f)(1) from other liable parties. In reversing and remanding the Fifth Circuit’s reversal of the District Court’s ruling, the Supreme Court held that it may not. Justice Ginsberg, joined by Justice Stevens dissented.

CERCLA provides that any private person “may” seek contribution (i.e. cost recovery) from any other liable or potentially liable person through a cost recovery action under §107(a) “during or following any civil action” under CERCLA §106, which authorizes the Federal Government to compel responsible parties to clean up contaminated sites. This was the most common legal provision used by private parties who were not also PRPs. Section 107 of CERCLA empowers the Government to recover its response costs from PRPs who are actually liable. Where an otherwise liable responsible party incurred response costs, such parties historically sought contribution (i.e. cost sharing) from the other PRPs under §113 CERCLA. Section 113(f)(1) provides a savings clause that states “(n)othing in this subsection shall diminish the right of any

person to bring an action for contribution on the absence of a civil action under” §106 or §107. Amendments to Superfund in 1986 also created a separate right of contribution for a “person who has resolved its liability to the United States or a State for some or all of a response action or form some or all of the costs of such action in an administrative or judicially approved settlement.” Many of these provisions have been heavily litigated.

As written, the Court’s decision in *Aviall* would most likely apply to parties that failed to conduct proper environmental due diligence and, thus, avail (no pun intended) themselves of the CERCLA’s defenses contained in the new AAI regulation.

What is clear from the *Aviall* decision is that, unless they themselves are subject to an enforcement action under §106 (injunctive relief) or §107 (cost recovery), private parties who undertake private cleanups may not obtain contribution under §113 from other PRPs. Simply put, this means that one PRP cannot voluntarily cleanup a site and then recover costs from other PRPs under §113. Further, although the Supreme Court chose not to address the related issue, it is not clear that *Aviall* would have standing under §107, as other courts have previously held that similarly situated PRPs may not recover costs under §107. Thus, it is uncertain under the latest Supreme Court ruling whether PRPs who voluntarily clean up a site will be able to recover any of their costs from other PRPs under this provision of CERCLA.

Implications for Real Estate Developers and Brownfields Sites

On its face, the *Aviall* decision does not appear to affect the rights of a private party who is not a PRP to recover response costs under CERCLA §107. Such a holding underscores the importance of environmental due diligence. Without properly conducted AAI, the prospective owner or operator (i.e. leasee) of a contaminated party may be considered a PRP whose ability to recover any necessary cleanup costs would be limited by the *Aviall* decision. Further, this decision may reduce the value of potential future cost recovery actions under CERCLA.

The effect of the *Aviall* decision should also be considered in assuming the value of the transaction, and reporting environmental liabilities (e.g. Sarbanes-Oxley, etc.) in connection with future mergers or acquisitions by publicly held companies.

Creative Solutions & Lessons Learned

Proper environmental due diligence prior to acquisition is cheaper (much, much cheaper) than legal fees and costs incurred to bring a civil action under CERCLA. Real estate professionals have little to gain – and much to lose - from not identifying potential environmental impairment liability issues early on in the deal process. When it comes to managing environmental issues “don’t ask, don’t tell” can lead to disastrous consequences.

EPA, in conjunction with ASTM and others, is in the process of developing federal regulations that will clarify the meaning of “all appropriate inquiry” into the past use and ownership of property prior to acquisition in order to qualify for CERCLA’s defenses to liability. In the interim, the current ASTM E 1527-00 Standard applies. Note, the federal Brownfield law did not reference the Transaction Screen process (ASTM Standard E 1528), which typically involves

significantly less inquiry and cost. Accordingly, the ASTM Phase I Standard should be the *minimum* level of inquiry completed. If necessary, additional study, to include sampling and analysis, should be undertaken. Where the future use of the property will involve many of the same potential hazardous materials as the existing use, a comprehensive assessment should be made to distinguish between prospective releases and those that occurred wholly in the past.

EPA's proposed regulation under the federal Brownfields law for completing AAI will also define the term "Environmental Professional" to establish the minimum qualifications for environmental consultants completing proper Phase I studies. It is broadly assumed that EPA's new regulations will add about 20% to the cost of completing Phase I ESAs, in addition to imposing delays necessary to obtain certain information. Accordingly, it is critical to undertake environmental due diligence early in the acquisition process.

In instances where environmental contamination is identified on a property during the due diligence process, parties would be well advised to consider appropriate means to address these issues. One alternative to purely voluntary cleanups taken outside of any regulatory program would be to pursue the cleanup under a state voluntary remediation program. Many of these programs contain provisions for recovering costs from liable parties. Experienced environmental legal counsel can help you evaluate these programs as alternatives to CERCLA for recovering costs of remediation, and limiting liability exposure from environmental claims.

Properly drafted Purchase and Sale Agreements should include provisions to identify known and suspected environmental concerns, and allocate legal and financial responsibility for environmental liabilities. In the past, parties often approached the allocation of environmental liability on the basis of "My watch, your watch". In theory, such an approach seems simple. However, as the *Aviall* decision shows, putting such an allocation strategy in place can prove to be very costly.

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