

***"There's No Harm in Looking, Is There?:
Emerging Perspectives on Environmental Due Diligence"***

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Many business owners have become all too familiar with the need to conduct routine environmental "due diligence" prior to acquiring property to avoid environmental impairment liability in the event the site is contaminated. However, a recent court decision now suggests that the environmental site assessment process, commonly referred to as an ESA, may create liability for prospective landowners even if the deal is never consummated.²

In 1989, Hardee's Food Systems sought to expand its business operations in Kansas, City, Missouri. After identifying what it believed to be a suitable location the Company entered into a ground lease which permitted Hardee's access to the site prior to the "commencement date" to conduct an environmental assessment of the property. When the study identified the presence of significant environmental contamination, Hardee's terminated the deal and walked away from the transaction, or so it thought.

After the Missouri Department of Natural Resources ordered the owner to cleanup the property, Hardee's once prospective landlord sued the Company along with several former site owners and operators of the site for contribution to its CERCLA (i.e., Superfund) liability. It is generally well settled that any former or existing owners or operators of a facility may be jointly and severally liable under CERCLA along with anyone who generates or transports waste to a facility. In its defense, Hardee's argued that the ground lease never materialized because the

company walked away from the deal after it learned of the contamination. Specifically, the Company's right to enter the site was limited to completing pre-acquisition environmental due diligence which Hardee's argued was a condition precedent to establishing the commencement date of the lease. Hardee's seemingly rational, albeit unsuccessful, argument that the lease, while signed, had not reached its "commencement date" was unpersuasive to the court. The court held that the terms of the ground lease agreement were ambiguous as to whether Hardee's was a lessee at the time its environmental consultant performed the site investigation. Specifically, the court looked to the terms of the executed ground lease which permitted Hardee's the right of entry to conduct its environmental assessment, negotiate the scope of the environmental inquiry, and the obligation to pay the lessor liquidated damages of \$100,000 in the event it chose to terminate the deal based on the results of the study as evidence of ambiguity. Ultimately, in December 1998, the lawsuit was dismissed on technical grounds, but Hardee's one time "potential" lessor retains the right to reinstitute its claims in subsequent court actions.

A separate issue raised in this case was whether Hardee's environmental consultant in the course of completing its investigation exacerbated existing contamination and whether the placement of monitoring wells on the site by the consultant made Hardee's an "operator" of the site for purposes of CERCLA liability on a theory of the vicarious liability for Hardee's "agent." The court held that both of the foregoing issues created questions of fact and, as such, were not appropriate for summary disposition. The court's finding could potentially force Hardee's into even more protracted and expensive litigation.

While all appropriate inquiry into the past uses of a property to assess the potential for environmental conditions remains vitally important, several valuable lessons can be gleaned from Hardee's experience.

First, individuals, corporations or partnerships interested in acquiring an interest in real estate whether through purchase or lease should refrain from entering into such agreements until sufficient environmental due diligence can be completed. Generally, a properly drafted Letter of Intent will suffice to outline deal terms and conditions. Sellers and lessors may also want to consider right of access and confidentiality agreements in advance of any environmental investigation. This action will necessarily require buyers and lessees to consider environmental matters very early in the pre-transaction process. Alternatively, sellers and lessors may wish to consider conducting an environmental site assessment of their property and providing a copy of the report to the buyer or lessor. Such action will likely make the property more attractive to a buyer, provided appropriate contractual provisions can be worked out that permit the acquiring entity to rely on the results contained in the report. Further, in the later scenario, the property owner is in a position to control the scope of the investigation and dissemination of its findings, conclusions or opinions. In Hardee's case, the environmental consultant felt obligated to disclose the results of its investigation to the state regulatory agency, which eventually triggered the expensive clean up of the site and the subsequent lawsuit.

Next, where buyers or lessors do agree to undertake their own investigation, contracts with environmental consultants should be carefully reviewed by experienced legal counsel. Potential pitfalls include whether the environmental consultant will be deemed to be an agent or independent contractor; appropriate indemnification and insurance provisions from the environmental consultant in the event the investigation exacerbates the existing contamination; and careful review of any existing information relating to the environmental condition of the property known from the owner. All environmental reports should be reviewed with legal counsel to address specific concerns which may arise in the future, such as a change in site use. Only consultants with appropriate experience and training using established standards of care should be selected. In some cases it may be appropriate to limit the pre-acquisition inquiry to only a "Phase I" Environmental Site Assessment to reduce the potential for exacerbating existing

environmental conditions, as such studies generally do not involve sampling or testing of soil and groundwater.

Finally, appropriate representations, warranties and indemnification provisions in the lease, or purchase and sale agreement remain a critical component for allocating environmental liability both pre- and post-acquisition. Additionally, environmental insurance products are becoming increasingly available which limit exposure in the event an environmental condition is missed during the due diligence period. Some environmental consulting companies offer a warranty with each ESA so that, in the event a recognized environmental condition is missed during the pre-acquisition investigation, the owner or lessee is protected. A thoughtful review of such areas can result in a cogent agreement between the parties which reduces risk of environmental impairment liability and costly litigation.

So, in answer to our question: There's no harm in looking, is there? We must remember to "look smart" for potential environmental impairment liability and understand the significant legal and financial traps for the unwary. Pre-acquisition environmental site assessments and prudently drafted lease and purchase and sale agreements still offer the best protection from environmental impairment liability.

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