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Contractual Efforts to Allocate the Risk of Environmental Liability: Is There a Way to Make Indemnities Worth More Than the Paper They are Writtin On

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CONTRACTUAL EFFORTS TO ALLOCATE THE RISK OF ENVIRONMENTAL LIABILITY: IS THERE A WAY TO MAKE INDEMNITIES WORTH MORE THAN THE PAPER THEY ARE WRITTEN ON?

By

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AS the breadth of environmental liabilities have become more apparent, contracting parties have attempted to expressly apportion the risks of these liabilities between themselves. Risk allocation issues may arise in transactions between buyers and sellers, lenders and borrowers, landlords and tenants, and contractors and owners. Sometimes the resulting allocation of risk is a function of the type of transaction or the parties' relative bargaining positions. Other times parties genuinely attempt to divide responsibility for the perceived risks in a manner considered fair for both sides. These contractual provisions can take various forms, including not only indemnities, but also hold harmless clauses, exculpations, disclaimers, "as is" clauses, survival provisions and releases.[1]

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1. In practice the distinctions between these various types of contractual provisions often become blurred. For purposes of this article an "indemnity" is a contractual assumption of liability on behalf of another. *See infra* note 6 and accompanying text. A "hold harmless" clause and an "exculpation" are technically synonymous—that is, they "shield" or "release" a contracting party from financial responsibility to the other. BLACK'S LAW DICTIONARY defines an exculpatory provision as one which "clears or tends to clear a person from alleged fault or guilt; excusing." BLACK'S LAW DICTIONARY 508 (Rev. 4th Ed. 1968). The terms "hold harmless agreement" and "indemnity agreement" are sometimes used to refer to both an indemnity and an exculpation provision. *See* THE HOLD HARMLESS AGREEMENT: A MANAGEMENT GUIDE TO EVALUATION AND CONTROL 11 (4th ed. Ga. Prop. & Cas. Underwriters 1987) [hereinafter HOLD HARMLESS AGREEMENT] (a contract of indemnity is "often referred to as a hold harmless agreement"). Indeed the two concepts of indemnity and exculpation are both usually present in an indemnity agreement. For example, "Borrower agrees to indemnify and hold Lender harmless from . . . ." The pertinence of the "indemnity" or the "hold harm-

This article discusses the legal principles governing the interpretation of indemnities and contractual risk allocation provisions,[2] as well as particular environmental concerns affecting indemnities.[3] Practical considerations in negotiating and drafting environmental indemnities are also addressed.[4] While the primary focus of this article is on contractual environmental indemnities, the article also discusses other related contractual provisions and non-contractual indemnities.[5]

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less" provision to any particular dispute, however, often depends upon the fortuitous circumstance of which party is sued or suffers a loss. In a situation where a borrower indemnifies a lender, the indemnity provision will apply if the lender is sued or suffers a loss, because the lender will seek recovery from the borrower. The hold harmless or exculpation will apply if the borrower is sued or suffers the loss because the borrower will be barred from recovering from the lender by virtue of the exculpation. Notwithstanding the usual intent of the parties to treat these two concepts symmetrically (that is, the loss should be the responsibility of the borrower, regardless of whether the lender is sued first or the borrower is sued first), courts sometimes have applied different interpretive rules to indemnities and exculpations, which in turn have led to different results. *See, e.g., infra* notes 12-17 and accompanying text (discussing express negligence doctrine). *See also* Ellis & Kessler, "Exculpation and Indemnity Clauses," *23rd Annual Mortgage Lending Institute* at 3 (Univ. of Texas School of Law, September 29, 1989) (". . . the rules controlling the construction and application of exculpatory provisions have not evolved in as uniform a manner as those rules concerning the construction and application of indemnities").

"Disclaimers" refer to contractual releases or waivers of warranties which might otherwise be implied. "As is" clauses are generally considered warnings to buyers to determine for themselves whether the property to be purchased is in acceptable condition, free from defect. In the environmental field, several courts have construed "as is" clauses narrowly to provide only a disclaimer of warranties and not a general release of environmental liabilities. *See infra* notes 58-61 and accompanying text.

"Survival" provisions, though different in approach from an indemnity can be another way in which parties allocate environmental liabilities. Contractual provisions that limit the survival of representations, warranties and indemnities to a set period of time after the transaction closes may shift most of the risk of environmental liability to a buyer. Texas statutory restrictions must be observed in the drafting of this type of clause. *See infra* notes 44-45 and accompanying text. Survival clauses may not, however, cut off environmental liability if the contractual representations and warranties are not broad enough to reasonably have been intended to include statutory matters. *See* Southland Corp. v. Ashland Oil, Inc., 696 F. Supp. 994, 1004 (D.N.J. 1988) (holding two year limit in contract on survival of "all of the representations, warranties, promises and agreements" to cut off all contract claims, but not CERCLA statutory claims).

"Releases," although analogous to exculpatory provisions, are used in this article to describe general releases of claims and liabilities contemplated by settlement agreements. *E.g.*, Mardan Corp. v. C.G.C. Music, Ltd., 804 F.2d 1454, 1456, 1461 (9th Cir. 1986) (a general release and settlement payment of approximately $1 million paid in connection with various post-closing disputes in an asset purchase agreement, released seller from undisclosed and unknown environmental liabilities where the release covered "all actions, causes of action, suits . . . based upon, arising out of or in any way relating to the Purchase Agreement . . . .").

2. *See infra* notes 6-45 and accompanying text.

3. *See infra* notes 46-66 and accompanying text.

4. *See infra* notes 67-113 and accompanying text.

5. *See infra* notes 12, 33, 44-46, 58-61 and accompanying text. Environmental indemnity matters not covered in this article include: requirements of the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA), 7 U.S.C. §§ 136-136y (1988), which obligate the Environmental Protection Agency (EPA) to indemnify pesticide registrants under certain circumstances; special EPA indemnities sometimes available to hazardous waste cleanup contractors (*E.g.*, "EPA Proposed Section 119 Guidance Document on Indemnification of Superfund Response Action Contractors," 54 Fed. Reg. 46012 (October 31, 1989)); and indemnities by the Texas Water Commission for engineers or contractors who perform various services at cleanup sites (*see* TEXAS HEALTH & SAFETY CODE ANN. § 361.405 (Vernon 1991); Komiss,

I. LEGAL PRINCIPLES

Both common law and statutory principles must be considered to understand the context in which courts construe indemnities.

A. Common Law Rules For Interpreting Indemnities

An indemnity can be described generally as a contract between two parties whereby one agrees to cover any liability, loss or damage sustained by the other from some contemplated act or condition, or damage resulting from a claim or demand of a third person.[6] The indemnity may represent an actual transfer, as between the parties, of liability that otherwise would have been the responsibility of one of the parties at law. Alternatively, an indemnity may represent a confirmation of a pre-existing liability that for various reasons is expressed more precisely, or additionally addressed, as an indemnity.[7] Under certain circumstances an indemnity may actually serve to limit, not extend, the indemnitor's liability to the indemnitee. For example, an indemnity drafted as the exclusive remedy between the parties may be

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Texas Statutory Limitation on Contractor's Liability, in THE IMPACT OF ENVIRONMENTAL REGULATIONS ON BUSINESS TRANSACTIONS 513-20 (PLI 1989)).

Sample indemnity language that addresses certain of the concerns articulated in this article can be found in several sources, including Bell & Dayton, *Environmental Due Diligence in Real Estate Lending Transactions*, 25 BULLETIN OF THE SECTION ON CORPORATION, BANKING AND BUSINESS LAW 1-28 (State Bar of Texas, February 1988); Corash, *Negotiating and Drafting Provisions Allocating Environmental Liability*, in ACQUIRING PROBLEM PROPERTIES-MANAGING ENVIRONMENTAL RISK 249-80 (PLI 1990); Clare, *Indemnity Issues Relative to Loan Documents and Lease Agreements; Indemnity Provisions Relating to Environmental Matters*, in EMERGING ISSUES IN REAL ESTATE LAW (State Bar of Texas, Sept. 1990); Egan & Folladori, *Anatomy of an Asset Purchase Agreement*, in MERGERS AND ACQUISITIONS IN TEXAS 68-74 (Professional Education Systems, Inc., 1990); Gershonowitz, *What Should be in Environmental Indemnity Clauses*, 5 PRAC. REAL EST. LAWYER 55 (March 1989); J. Moskowitz, ENVIRONMENTAL LIABILITY AND REAL PROPERTY TRANSACTIONS: LAW AND PRACTICE 273-317 (1989 & Supp. 1990); Smith, *The Treatment of Selected Environmental Issues & Liabilities by Contract and Other Transaction Documents, with Selected Samples and Checklists*, in ENVIRONMENTAL LIABILITY IN TEXAS REAL ESTATE (Professional Education Systems, Inc. 1990); Davis & Morris, *Contractual Rights: Risk Limitations for Prospective Owners and Lenders*, in 2ND ANNUAL HAZARDOUS AND SOLID WASTE MANAGEMENT INSTITUTE 11-8 (University of Texas School of Law 1990).

6. BLACK'S LAW DICTIONARY defines an indemnity contract as one between "two parties whereby the one undertakes and agrees to indemnify the other against loss or damage arising from some contemplated act on the part of the indemnitor, or from some responsibility assumed by the indemnitee, or from the claim or demand of a third person, that is, to make good to him such pecuniary damage as he may suffer." BLACK'S LAW DICTIONARY 910 (Rev. 4th Ed. 1968). *See also* THE HOLD HARMLESS AGREEMENT, *supra* note 1, at 15-16 ("A hold harmless agreement is an agreement between two or more parties defining an obligation or duty resting on one party, the indemnitor, to make good the liability, loss or damage that another party, the indemnitee, has incurred or may incur."). The indemnity does not bar third party claims against the party to be indemnified. It simply provides the indemnitee with a vehicle for financial recovery, provided the indemnitor remains solvent, whenever a third party succeeds in its claim against the indemnitee. The "trigger" for the indemnity obligation will depend on the negotiation and drafting of the agreement. *See e.g., infra* notes 19-23 and accompanying text (discussing "payment" versus "liability"); 70-78 and accompanying text (practical negotiation issues concerning the indemnity "trigger").

7. For example, to confirm that a buyer is taking the property "as is" without warranty from the seller, the contract might also specify that the buyer indemnifies and holds the seller harmless from any defects or liabilities that may arise after the sale.

limited contractually to a "survival" period that is shorter than the statute of limitations for actions that could otherwise be brought under applicable tort and contract theories.

1. The Rule Of Strict Construction

In Texas and other jurisdictions, indemnities are usually construed strictly against the party seeking recovery.[8] This is particularly true in Texas if the party seeking indemnification is alleged to have been negligent.[9] The rule of strict construction does not apply if the indemnity is clear and unequivocal on its face.[10] In addition, recent cases in Texas and other states seem to indicate a trend away from the rule of strict construction, especially if the indemnity agreement is between sophisticated commercial parties.[11]

2. Express Negligence Rule

Like many other states, Texas requires express language in order to indemnify a party from its own negligence.[12] Several Texas cases hold that it is not enough to state that the indemnity covers everything "except a party's gross negligence and wilful misconduct", thereby implying indemnification for simple negligence. Instead, the indemnity must say "including such

8. Marmon Group, Inc. v. Rexnord, Inc., 822 F.2d 31, 34 (7th Cir. 1987) ("Contracts of indemnity are to be strictly construed, and the courts will not read into the contract an indemnity term where it is clear from the language of the contract that no such term was intended"); Hudson v. Hinton, 435 S.W.2d 211, 214 (Tex. Civ. App.—Dallas 1968, no writ); James Stewart & Co. v. Mobley, 282 S.W.2d 290, 294 (Tex. Civ. App.—Dallas 1955, writ ref'd); Rublee v. Stevenson, 161 S.W.2d 528, 530 (Tex. Civ. App.—Dallas 1942, no writ); Fidelity & Deposit Co. of Maryland v. Reed, 108 S.W.2d 939, 941 (Tex. Civ. App.—San Antonio 1937, writ ref'd); Smith v. Scott, 261 S.W. 1089, 1089 (Tex. Civ. App.—Amarillo 1924, no writ).

9. K & S Oil Well Serv., Inc. v. Cabot Corp., 491 S.W.2d 733, 739 (Tex. Civ. App.—Corpus Christi 1973, writ ref'd n.r.e.) ("Exculpatory or indemnity clauses which attempt to free an actor from liability for his own negligence are basically valid but must be strictly construed").

10. Ohio Oil Co. v. Smith, 365 S.W.2d 621, 627 (Tex. 1963).

11. Gulf Oil Corp. v. Burlington Northern R.R., Inc., 751 F.2d 746, 749 (5th Cir. 1985); McClane v. Sun Oil Co., 634 F.2d 855, 859 (5th Cir. 1981); Hays v. Mobil Oil Corp., 736 F. Supp. 387, 392 (D. Mass. 1990) ("[I]ndemnity clauses reflect a reasonable allocation of risks and duties to insure achieved through negotiation between the parties"); Speers v. H.P. Hood, Inc., 22 Mass. App. Ct. 598, 600, 495 N.E.2d 880, 881, *rev. denied*, 398 Mass. 1105, 498 N.E.2d 125 (1986) ("[A]n indemnity provision is no longer to be read with any bias in favor of the indemnitor and against the indemnitee; it is to be interpreted like any ordinary contract, with attention to language, background, and purpose"); Ohio Oil Co. v. Smith, 365 S.W.2d at 627 (holding that where intent of parties is clearly expressed, indemnity agreements between owners and contractors are in governed by same rules of law and construction applicable to other business contracts and not more strictly construed); Aerospatiale Helicopter Corp. v. Universal Health Serv., Inc., 778 S.W.2d 492, 502 (Tex. App.— Dallas 1989, writ denied) ("This court is mindful of the fact that indemnity agreements are to be strictly construed in favor of the indemnitor. However, the doctrine *strictissimi juris* is not a rule of construction. Rather it is a rule of substantive law only after the parties' intent has been ascertained through ordinary rules of construction.") (citing Keystone Equity Management v. Thoen, 730 S.W.2d 339, 340, (Tex. App.—Dallas 1987, no writ)).

12. Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705, 708 (Tex. 1987). At least one Texas court has held the "express negligence" rule inapplicable to exculpatory provisions. Whitson v. Goodbodys, Inc., 773 S.W.2d 381, 383 (Tex. App.—Dallas 1989, no writ).

party's negligence" or words to that effect.[13]

No Texas court has addressed whether a party may be expressly indemnified for his or her own gross negligence or willful misconduct. Other states, however, have held such an indemnity to be against public policy.[14] It seems likely that Texas courts would reach the same conclusion on similar public policy grounds.

The failure of an indemnity provision to account for the express negligence rule can invalidate coverage. A third party claim asserting environmental liability will usually include an allegation of negligence.[15] If an indemnity fails to state that it covers a party's own negligence, any degree of negligence may bar complete recovery under the indemnity.[16] As a result, even if a party is adjudged to be only ten percent negligent, recovery may not be available under an indemnity that fails expressly to include negligence. It would appear, however, that an indemnity which envisioned recovery "except to the extent of" a party's negligence or unless such party is "primarily negligent" would permit recovery where such party's negligence was not the sole or primary cause of the damages.[17]

3. *Statute Of Limitations*

A cause of action under an indemnity is normally held to accrue at the time an indemnifying event occurs, not before.[18] The precise date of accrual depends upon when the indemnified party incurred the type of loss addressed in the indemnity contract. For example, an indemnity of payment

13. B-F-W Constr. Co., v. Garza, 748 S.W.2d 611, 613 (Tex. App.—Fort Worth 1988, no writ) ("[R]egardless of cause or of any fault or negligence of contractor" held sufficient); Adams v. Spring Valley Constr. Co., 728 S.W.2d 412, 414 (Tex. App.—Dallas 1987, writ ref'd n.r.e.) (holding that language within the "four corners" of the contract must say "caused by indemnified party's own negligence"); .

14. *E.g.*, National R.R. Passenger Corp. v. Consolidated Rail Corp., 698 F. Supp. 951, 972 (D.D.C. 1988) (gross negligence and willful misconduct cannot be indemnified against). *See also* Ellis & Kessler, *supra* note 1, at 11 ("Texas courts have not, however, addressed the issue of whether a party may be indemnified for the consequences of its gross negligence").

15. For example, a third party plaintiff might assert that the property owner failed to observe due care, failed to warn others, failed to maintain the property properly and exacerbated preexisting conditions.

16. Singleton v. Crown Cent. Petroleum Corp., 729 S.W.2d 690, 691 (Tex. 1987) (indemnity provision excluding "sole negligence" not precise enough to permit recovery in situation of concurrent negligence). *But see* Atlantic Richfield Co. v. Petroleum Personnel, Inc., 768 S.W.2d 724, 726 (Tex. 1989) (degrees of negligence need not be expressed; simple reference to negligence suffices). Commentators have criticized the *Atlantic Richfield* decision for making less clear what had become a developing consistency among the cases since the issuance of Ethel Corp. v. Daniel Constr. Co., 725 S.W.2d 705 (Tex. 1987). *See* ELLIS & KESSLER, *supra* note 1, at 14-15.

17. *Cf.* Payne & Keller, Inc. v. P.P.G. Indus., 793 S.W.2d 956, 958 (Tex. 1990) (indemnity which covered owner "irrespective of whether [the owner] was concurrently negligent" enforceable as to everything except the owner's sole negligence).

18. Navarro Oil Co. v. Cross, 145 Tex. 562, 200 S.W.2d 616, 619 (1946); House of Falcon, Inc. v. Gonzalez, 583 S.W.2d 902, 906 (Tex. Civ. App.—Corpus Christi 1979, no writ) (the court stated that "a promise to indemnify does not create any liability until the promisee. . .[has] incurred a liability, loss, or expense"); Russell v. Lemons, 205 S.W.2d 629, 631 (Tex. Civ. App.—Amarillo 1947, writ ref'd n.r.e.); Duffey v. Cross, 175 S.W.2d 637, 642 (Tex. Civ. App.—Austin 1943, writ ref'd w.o.m.); Latimer v. Texas & N.O.R. Co., 56 S.W.2d 933, 935 (Tex. Civ. App.—Beaumont 1933, writ ref'd n.r.e.).

accrues once the indemnified party actually incurs a payment expense,[19] while an indemnity of liability accrues once the liability of the indemnified party becomes fixed.[20]

By contrast, the limitations period for other contract-based actions (such as breach of contract, misrepresentation, breach of warranty, deceptive trade practice or fraud), generally begin on the effective date of the contract, or, at the latest, on the date when facts underlying the cause of action are first discoverable.[21] If the indemnity is "derivative" in nature, with the indem-

19. Mullins v. Elieson, 611 S.W.2d 921, 925 (Tex. App.—Amarillo 1981, no writ) ("obligation matures when the loss is suffered"); Latimer v. Texas & N.O.R. Co., 56 S.W.2d 933, 935 (Tex. Civ. App.—Beaumont 1933, writ ref'd) ("the rule seems to be well settled that one complaining of the breach of an indemnity contract must, in order to show himself entitled to recover, show that he has paid the debt in controversy").

20. An indemnity against liability matures "as soon as liability is incurred." Mullins v. Elieson, 611 S.W.2d 921, 925 (Tex. Civ. App.—Amarillo 1981, no writ); *see also* Bernard v. L.S.S. Corp., 532 S.W.2d 419, 410 (Tex. Civ. App.—Austin 1976, writ ref'd n.r.e.) (cause of action occurs when liability becomes fixed, "as upon rendition of a judgment"). Generally, however, a court need not have entered a judgment against the indemnitee for him to obtain indemnification. In K & S Oil Well Serv., Inc. v. Cabot Corp., 491 S.W.2d at 739, the manufacturer of an allegedly defective workover rig claimed contractual indemnity from the buyer against an injured worker's products liability claim. Rejecting the buyer's argument that the manufacturer had not suffered any loss, the court held that "[t]hird party actions based on contractual indemnity against liability may be brought prior to the time judgment is rendered against the indemnitee." *Id.* at 739 (citing several decisions). *See also* Gulf Oil v. Ford, Bacon & Davis, Texas, 782 S.W.2d 28, 31 (Tex. App.—Fort Worth 1989, no writ). Similarly, where an indemnitee has settled a claim prior to adjudication, he must prove only potential rather than actual liability to the plaintiff with whom he has settled prior to obtaining recovery from the indemnitor. *E.g.*, Fireman's Fund Ins. Co. v. Commercial Standard Ins. Co., 490 S.W.2d 818, 824 (Tex. 1972) (sufficient for indemnitee to show settlement was "reasonable, prudent and in good faith"). *See also* Bridge Prod., Inc. v. Quantum Chem. Corp., 1990 U.S. Dist. LEXIS 2202 (E.D. Ill. 1990) (earliest possible date of accrual for indemnity against loss is date plaintiff entered into its consent decrees with the State of Virginia). Indemnities are often drafted to cover both liability and payment matters (for example, "all costs, liabilities, expenses, losses, etc."), rendering unclear when the statute of limitations period begins.

21. A cause of action arising out of a contractual relation normally accrues as soon as the contract or agreement is breached. Wichita Nat'l. Bank v. U.S. Fidelity & Guar. Co., 147 S.W.2d 295, 299 (Tex. Civ. App.—Fort Worth 1941, no writ). With many types of contracts, however, courts also will permit the cause of action to accrue once the breach is discovered or reasonably should have been discovered. *See* Jim Walter Homes, Inc v. Castillo, 616 S.W.2d 630, 634 (Tex. App.—Corpus Christi 1981, no writ) (limitations period under Deceptive Trade Practices Act for representations made in a mechanic's lien contract commences when damages actually begin to show on the completed house); Maddox v. Oldham Little Church Foundation, 411 S.W.2d 375, 381 (Tex. Civ. App.—Tyler 1967, writ ref'd n.r.e.) (limitations period commences on breach of contract or when claimant has notice of sufficient facts to place him on notice of breach thereof).

A fraud action based upon contract will also accrue as of the date of the contract, unless the fraud was not discoverable until a later date. Hoerster v. Wilke, 140 S.W.2d 952, 956 (Tex. Civ. App.—Austin 1940), *aff'd*, 158 S.W.2d 288 (Tex. 1942) (limitations period began on date fraud was committed or if not disclosed by transactions themselves, on date fraud should have been discovered by exercise of reasonable diligence). A breach of warranty claim in Texas may accrue either on the date of discovery or on the date the warrantor refuses to repair the defect, depending on the language of the warranty. *Compare* First Nat'l Bank v. Roller, 299 S.W. 917, 920 (Tex. Civ. App.—Waco 1927), *aff'd in part, rev'd in part on other grounds*, 14 S.W.2d 834 (Tex. Comm'n App. 1929, judgment adopted) (limitations do not begin to run against action for breach of warranty until defect is known or should have been ascertained) *with* Austin Co. v. Vaughn Bldg. Corp., 643 S.W.2d 113, 115 (Tex. 1982) (limitations period on breach of express warranty that obligated construction contractor to make necessary repairs commenced not when contractor placed defective roof on building, but when it refused to

nity obligation arising out of breaches of representations and warranties that appear elsewhere in a contract, it is not clear whether the limitations period would relate to the underlying representation and warranty or to the actual breach of indemnity. If the latter circumstance controlled, it would seem to require that the indemnity survive even though the representations and warranties on which the indemnity was based had earlier expired by their own terms. In *Bridge Products, Inc. v. Quantum Chemical Corporation*[22] the court held that a contract's representations and warranties expired and that all other contract based actions for recovery of environmental liability costs were time-barred. The court allowed the indemnity claim, however, noting that "breach of the promise of indemnification only occurs when the injury, i.e., liability or money owed to a third party, is incurred."[23]

An indemnity may also be considered a "continuing" indemnity.[24] In such a case no specific statute of limitations affects the indemnity as a whole, but a statute of limitations may arise with regard to each indemnifying event.

4. *Question Of Law vs. Question Of Fact*

The actual interpretation of the scope and meaning of the indemnity agreement is a question of law rather than a question of fact.[25] In the con-

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repair defects once it had been notified of their existence). Actions normally accrue under the Texas Deceptive Trade Practices Act, TEX. BUS. & COM. CODE ANN. 17.41-17.854. (Vernon 1987 & Supp. 1991), on the date of the transaction. *See* Wyatt v. General Motors Corp., 703 S.W.2d 708, 709 (Tex. App.—Corpus Christi 1985, writ dism'd) (cause of action against automobile seller for breach of implied warranty accrued when vehicle was purchased, not when injuries occurred); Feldman v. Manufacturers Hanover Mortgage Corp., 704 S.W.2d 422, 424 (Tex. App.—Houston [14th Dist.] 1985, writ ref'd n.r.e.) (statute of limitations period began on the date the grantor entered into the allegedly fraudulent mortgage modification). Section 17.565 of the Deceptive Trade Practices Act, however, expressly permits an action to be brought within two years of the date of the transaction or misrepresentation or "within two years after the consumer discovered or in the exercise of reasonable diligence should have discovered the occurrence of the false, misleading, or deceptive act or practice." Texas Deceptive Trade Practices Act, TEX. BUS. & COM. CODE ANN. § 17.565 (Vernon 1987).

22. 1990 U.S. Dist. LEXIS 2202 (E.D. Ill. 1990).

23. *Id. Contrast* Southland Corp. v. Ashland Oil, Inc., 1988 WL 125855 (D.N.J. 1988), *rev'g in part*, 696 F. Supp. 994, 1003-4 (D.N.J. 1988) (contractual obligation to indemnify is cut off by two year contractual limitation on "all of the representations, warranties, promises and agreements" unless indemnitee files notice of claim with indemnitor within such two year period).

24. Emhart Indus. v. Duracell Int'l, Inc., 665 F. Supp. 549, 572 (N.D. Tenn. 1987) (indemnity obligation is continuous in nature and is not cut off by three year limitations period in the contract). Generally, an indemnity remains in force during the time provided for in the contract. *See generally* 42 C.J.S. INDEMNITY 11 (and cases cited therein). *See also* Eller v. Erwin, 265 S.W. 595, 598 (Tex. Civ. App.—Dallas 1924, writ dism'd w.o.j.) (contract to indemnify indorser of note was "continuing obligation" under which it was intended that cause of action subject to statute of limitations would not accrue until indorser's ultimate loss had been determined and indemnity contract ceased to be of service). In at least one decision, however, a Texas court has ruled that where a contract specifies no time limit for performance "the rule is that . . . the law implies that it will be performed in a reasonable time." Kramer v. Linz, 73 S.W.2d 648, 650 (Tex. Civ. App.—El Paso 1934, no writ). Moreover, courts have applied the equitable doctrine of laches to bar an action on an indemnity even when it is brought within the relevant limitations period. *See* Warren Petroleum Co. v. International Serv. Ins. Co., 727 S.W.2d 801, 805 (Tex. App.—Tyler 1987, writ ref'd n.r.e.).

25. *See, e.g.*, Kemp v Gulf Oil Corp., 745 F.2d 921, 924 (5th Cir. 1984) ("Interpretation of the terms of a contract, including an indemnity clause, is a matter of law, reviewable *de novo*

text of an indemnity claim, however, many factual issues arise that must be referred to the finder of fact, whether jury or court. Such factual issues include the reasonableness of costs, the appropriateness of the behavior of the party to be indemnified and the sufficiency of any notices that were given.[26]

5. *Forfeiture And The Duty To Mitigate*

At common law certain actions taken by an indemnified party will cause forfeiture or discharge of the indemnity. In general, any act that materially increases risk under the indemnity or prejudices the rights of the indemnitor discharges the indemnity obligation.[27] The obligation to avoid such actions is variously described as a duty to mitigate,[28] a duty to act reasonably in order to minimize liability under the indemnity,[29] or simply a duty of good faith and fair dealing.[30] Some cases also address specially drafted provisions that require by their terms that the indemnified party satisfy certain conditions before being entitled to recovery.[31]

Texas courts have yet to address the mitigation issue, but equitable considerations would likely lead a court to impose some form of duty to mitigate or reasonableness standard on a party seeking relief under an indemnity.[32] A

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on appeal"); Gulf, Colo. and Santa Fe Ry. Co. v. Coca-Cola Bottling Co., 363 F.2d 465, 467 (5th Cir. 1966) (meaning of indemnity agreement presented question of law); Phillips Pipeline Co. v. Richardson, 680 S.W.2d 43, 48-49 (Tex. App.—El Paso 1984, no writ) (discussing "clear and unequivocal" rule); UMC, Inc. v. Coonrod Elec. Co., 667 S.W.2d 549, 554 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.) (holding if no ambiguity exists, construction of written instrument is question of law); Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983) (when written instrument is not ambiguous, court will construe it as a matter of law).

26. Roy L. Jones, Inc. v. Home Transp. Co., 422 F.2d 179, 181-82 (5th Cir. 1970) (ambiguity arising in an indemnity agreement from the term "automotive equipment" was a question of fact not a question of law); Phillips Pipeline Co. v. Richardson, 680 S.W.2d 43, 48-49 (Tex. App.—El Paso 1984, no writ) (discussing "clear and unequivocal" rule); UMC, Inc. v. Coonrod Elec. Co., 667 S.W.2d 549, 554 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.) ("the interpretation of a contract becomes a fact issue only when the application of pertinent rules of construction leaves a genuine uncertainty as to which of two meanings is proper"); Goodyear Tire & Rubber v. Jefferson Constr. Co., 565 S.W.2d 916, 918 (Tex. 1978) (notice of existence of indemnity is a question of fact and cannot be considered a question of law unless reasonable minds could not differ).

27. American Export Isbrandtsen Lines, Inc. v. United States, 390 F. Supp. 63, 68 (S.D.N.Y. 1975).

28. *Emhart Indus.*, 665 F. Supp. at 571.

29. *American Export Isbrandtsen Lines*, 390 F. Supp. at 69 (shipping company lost any right it might have had under indemnity because it failed in various respects to take reasonable actions in Italian courts that might have avoided the imposition of customs duties); Holiday Inns, Inc. v. Thirteen-Fifty Inv. Co., 714 S.W.2d 597, 602 (Mo. App. 1986) (breach by indemnitee of duty to act reasonably to minimize liability rose to level requiring indemnitor to be discharged under the indemnity contract).

30. *Emhart Indus.*, 665 F. Supp. at 565 n.33 ("Although the contract terms may foreordain an unreasonable result, there nonetheless remains on each party a duty to act with good faith and fair dealing within the context of their differing diseconomic incentives").

31. *E.g.*, Versatile Metals, Inc. v. Union Corp., 693 F. Supp. 1563, 1569 (E.D. Pa. 1988) (plaintiff barred from recovering on its breach of contract claim since it failed to give notice of the breach, and failed to act reasonably upon discovering the contamination; plaintiff's failure to comply with the conditions of the indemnity contract substantially prejudiced the indemnitor).

32. No duty to mitigate exists under current Texas property law. F.D.I.C. v. Coleman, 795 S.W.2d 706 (Tex. 1990); Cocke v. Meridian Sav. Ass'n, 778 S.W.2d 516, 520 (Tex. App.—

party entitled to an indemnity might otherwise have no incentive to minimize the losses that the indemnifying party has agreed to assume.

6. *Clean Hands*

The equitable doctrine requiring parties to have "clean hands" before seeking recovery under tort theories of indemnity[33] has not yet been applied to a contractual indemnity case.[34] The analogous mitigation standards discussed above, however, support the application of the doctrine in this area.

B. Statutory Limitations

Certain Texas statutory provisions may also affect the interpretation and enforceability of contractual indemnities relating to environmental matters.

1. *The Texas Anti-Indemnity Statute*

The Texas Anti-Indemnity Act[35] prohibits, with certain exceptions, indemnification for one's own negligence if the contract pertains to certain aspects of the oil, gas and mineral industries. In situations where the court applies this statute, an attempt to comply with the express negligence rule

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Corpus Christi, 1989, no writ). Thus it is difficult to predict whether Texas courts will adopt special policies of "good faith", "mitigation" or comparable standards in the interpretation of environmental indemnities where such doctrines would not apply to the remainder of the contractual agreement in which the indemnity appears. Additionally, Texas does not follow the general doctrine of "good faith and fair dealing". English v. Fisher, 660 S.W.2d 521, 522 (Tex. 1983). Texas does recognize the doctrine if a special relationship between the parties Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987). Texas also recognizes the doctrine if a contract expressly reserves to one party a right of approval in such party's "sole and absolute discretion or satisfaction." Black Lake Pipe Line Co. v. Union Constr. Co., 538 S.W.2d 80, 88-89 (Tex. 1976). By contrast, contracts for the sale of goods are governed by a duty of good faith under the Texas version of the Uniform Commercial Code. *See* TEX. BUS. & COM. CODE ANN § 1.203 (Tex. UCC) (Vernon 1968).

33. Humphreys-Mexia Co. v. Arseneaux, 116 Tex. 603, 614-15, 297 S.W. 225, 231 (1927) (he who comes into equity must come with clean hands). Texas courts have not expressly applied the clean hands doctrine to indemnity actions between joint tortfeasors, but the rationale applied to such cases is very similar. *See* Frantom v. Neal, 426 S.W.2d 268, 272 (Tex. Civ. App.—Fort Worth 1968, writ ref'd n.r.e.) (one compelled to pay damages on account of the negligent or tortious act of another has a right of action against the latter for full indemnity unless barred by the nature of his own conduct).

34. U.S. v. Union Gas Co., 1990 WL 113212 (E.D. Pa. 1990) (doctrine of unclean hands cannot be used to defeat environmental liability); General Elec. Co. v. Litton Business Sys., 715 F. Supp. 949, 955-56 (W.D. Mo. 1989) (unclean hands defense rejected); Kelley v. Thomas Solvent Co., 714 F. Supp. 1439, 1451 (W.D. Mich. 1989) (unclean hands defense rejected); Chemical Waste Management v. Armstrong World Indus., 669 F. Supp. 1285, 1291 (E.D. Pa. 1987) (an owner or operator need not have "clean hands" to be entitled to seek recovery against a prior owner of the property); *but see* Mardan Corp. v. C.G.C. Music, Ltd., 600 F. Supp. 1049, 1057-58 (D. Ariz. 1984), *aff'd on other grounds*, 804 F.2d 1454 (9th Cir. 1986) (doctrine of unclean hands bars claim for contribution under an environmental statute). In affirming the *Mardan* holding on alternate grounds, the Ninth Circuit noted that most courts had not barred contribution on the basis of unclean hands. 804 F.2d at 1457 n.3. *See also* Smith Land Improvement Corp. v. Celotex Corp., 851 F.2d 86, 90 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989) (under CERCLA the doctrine of *caveat emptor*, like the doctrine of clean hands, is not a defense to liability for CERCLA contribution, but may only be considered in mitigation of the amount due).

35. TEX. CIV. PRAC. & REM. CODE ANN. §§ 127.001 - 127.008 (Vernon 1986 & Supp. 1991).

can instead lead to a voiding of the entire indemnity. Under the statutory language, apparently actual negligence need not be present in order to render the entire indemnity invalid. Rather, the indemnity would be considered unenforceable even as to non-negligent matters if it purported to indemnify a party for that party's own negligence.[36]

The statute is designed principally to address certain perceived contracting abuses in the oil and gas industry,[37] but the breadth of the statute can create a trap for the unwary drafter. Because various oil, gas and mineral drilling operations can present environmental concerns, environmental indemnity provisions may fall within the scope of this statute. Exceptions exist under the Act for indemnities addressing pollution damage or underground damage, both of which permit an indemnity for a party's own negligence.[38] Nonexempt activities include any "purchase, gathering, storage, or transportation of oil, gas, brine water, fresh water, produced water, petroleum products, or other liquid commodities."[39]

2. *Indemnities Of Architects And Engineers*

Texas also has a statute prohibiting architects and engineers from contracting for indemnities against their own negligence.[40] Because of the increasing use of these professionals in environmental remediation projects such as asbestos abatement and underground storage tank removal, the chances of drafting a statutorily defective indemnity also arise in this area.

The statute covers any architect or engineer who prepares, approves or uses defective plans, designs or specifications, in any construction, alteration, repair or maintenance project for a "building, structure, appurtenance, road, highway, bridge, dam, levee, or other improvement to or on real property, including moving, demolition and excavation connected with the real property."[41] Any indemnity falling within this subject that purports to indemnify the architect or engineer for his or her own negligence is invalid.

The statute does not prevent an owner from seeking an indemnity from

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36. The Texas statute expressly states that "a covenant, promise, agreement, or understanding contained in, collateral to, or affecting an agreement pertaining to a well for oil, gas, or water or to a mine for a mineral . . . [that] . . . purports to indemnify a person against certain loss or liability for damage that is caused by . . . sole or concurrent negligence . . . is void and unenforceable." *Id.* § 127.003(a)(1).

37. *See* J. Tade, DRAFTING INDEMNITY PROVISIONS IN OIL AND GAS CONTRACTS: ANALYSIS AND APPLICATION OF TEXAS AND LOUISIANA CASE LAW TO OFFSHORE CONTRACTS 4, MONOGRAPH NO. 12, NATURAL RESOURCES ENERGY AND ENVIRONMENTAL LAW SECTION (American Bar Association 1989); Tade, *The Texas and Louisiana Anti-Indemnity Statutes as Applied to Oil and Gas Industry Offshore Contracts*, 24 HOUS. L. REV. 665 (1987).

38. The Texas statute excludes indemnity agreements for personal injury, death or property injury resulting from radioactivity, property injury resulting from pollution, and property injury resulting from reservoir or underground damage. TEX. CIV. PRAC. & REM. CODE ANN. § 127.004(1)-(3) (Vernon Supp. 1991).

39. *Id.* § 127.005(a). Most of the latter subjects were added by a 1989 amendment to the statute. Acts 1989, ch. 1102, 1989 Tex. Gen. Laws 4557.

40. TEX. CIV. PRAC. & REM. CODE ANN. §§ 130.001 (Vernon Supp. 1991).

41. *Id.* §§ 130.001, 130.002(1)(A).

the architect or engineer for the owner's own negligence.[42] In addition, the statute apparently does not prevent an architect or engineer from seeking an indemnity on a comparative negligence basis, that is, an indemnity of the architect or engineer to the extent of his or her non-negligence.[43]

3. *Shortening Of The Contractual Limitations Period*

Another Texas statute prohibits parties from agreeing to limit, to a period shorter than two years, the time in which they may bring suit on a contract.[44] As a consequence, a contract that purports to limit the assertion of a cause of action, or the survivability of representations, warranties, or indemnities, to a stipulated period of time must be drafted with such limitation in mind in order to protect the enforceability of the provision. By contrast, a contract provision stipulating that no representations, warranties or indemnities survive the date of the closing should be enforceable. In that situation a representation would be deemed merged into the conveyance documents, and no premature shortening of any applicable limitations period would have occurred.[45]

C. *Particular Environmental Concerns Affecting Indemnities*

There are also several important developments in the environmental field that affect the enforceability and interpretation of indemnity agreements and related contractual allocation efforts.

1. *Indemnities Under CERCLA*

Although courts have generally upheld contractual indemnification agreements,[46] several decisions have held certain agreements not to cover statu-

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42. The statute provides that "this chapter does not apply . . . to an owner of an interest in real property or persons employed solely by that owner." *Id.* § 130.004(a).

43. *Cf.* HOLD HARMLESS AGREEMENT, *supra* note 1, at 64 ("This statute allows only comparative fault indemnification of an architect, engineer, or surveyor where the liability arises out of the design or professional duties of the architect"). The Act permits comparative fault allocations by stating that it does not apply to negligent acts "other than those described by this chapter." *Id.* § 130.005(1).

44. TEX. CIV. PRAC. & REM. CODE ANN. § 16.070 (Vernon 1986) ("A person may not enter a stipulation, contract or agreement that purports to limit the time in which to bring suit on the stipulation, contract, or agreement to a period shorter than two years. A stipulation, contract or agreement that establishes a limitations period that is shorter than two years is void in this state").

45. *See* Carter v. Barclay, 476 S.W.2d 909, 914-15 (Tex. Civ. App.—Amarillo 1972, no writ) (in absence of fraud, accident or mistake, conveyance absolute on its face must be considered final expression and sole repository of the parties' agreed upon terms); Wells v. Burroughs, 65 S.W.2d 396, 397 (Tex. Civ. App.—Texarkana 1933, no writ) (contract of sale is regarded as merged into deed where deed is delivered and accepted as performance of the contract).

46. *See, e.g.*, Marmon Group, Inc. v. Rexnord, Inc., 822 F.2d 31 (7th Cir. 1987) (complaint stated cause of action under indemnity provision of sales contract); American National Can Co. v. Kerr Glass Mfg. Corp., 1990 WL 125368 (N.D. Ill. 1990) (sophisticated business entities may allocate risk, including the risk of unforeseen liability under environmental statutes not yet enacted at the time of contracting); Hays v. Mobil Oil Corp., 736 F. Supp. 387, 393 (D. Mass. 1990) (indemnity clauses are permitted under CERCLA); Southland Corp. v. Ashland Oil, Inc., 696 F. Supp. at 1000 (parties are free to enter into contractual agreements

tory liability under the Comprehensive Environmental Response and Compensation Liability Act (CERCLA),[47] unless the agreement "clearly and unequivocally" expresses an intent to address such liability.[48]

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where they are indemnified or held harmless by another party); *see also* Jones-Hamilton Co. v. Kop-Coat, Inc., 750 F. Supp. 1022 (N.D. Cal 1990) (there is no public policy against private parties bargaining over indemnity; the freedom of private parties to contract amongst themselves is not impinged by CERCLA). Several courts, however, have rejected attempts to assert claims of noncontractual indemnities. United States v. Cannons Eng'g Corp., 899 F.2d 79, 92-93 (1st Cir. 1990) (holding that in effect, noncontractual indemnity claim is only a more extreme form of a claim for contribution; where contribution would be barred, so would a noncontractual indemnity claim); Central Ill. Pub. Serv. Co. v. Industrial Oil Tank & Line Cleaning Serv., 730 F. Supp. 1498, 1507 (W.D. Mo. 1990) (rejecting arguments that CERCLA creates a noncontractual right to indemnity, and that Missouri law provides for noncontractual indemnity in equity, with respect to contribution obligations under CERCLA).

47. 42 U.S.C. §§ 9601-9675 (1988) (CERCLA), as amended by the Superfund Amendments and Reauthorization Act of 1986 Pub. L. No. 99-499, 100 Stat. 1613 (SARA). Certain "responsible parties" designated under CERCLA § 107(a), such as owners and operators of a facility and generators and transporters of hazardous waste, may have liability under CERCLA not only in actions brought by the federal government, but also in private actions. 42 U.S.C. § 9607(a). Pursuant to CERCLA § 107(a), a private party may recover response costs from one of the responsible parties identified in CERCLA § 107(a) where there has been a "release" or "threatened release" of a "hazardous substance" from a "facility", the release or threatened release has caused the plaintiff to incur costs in responding to the release, and the plaintiff's response costs are "necessary" and "consistent with the national contingency plan." *See* 42 U.S.C § 9607(a); *see also* Wiegmann & Rose Int'l Corp. v. NL Indus., 735 F. Supp. 957, 959 (N.D. Cal. 1990). Additionally CERCLA § 113(f) provides an express right to seek contribution from "any other person who is liable or potentially liable under [CERCLA] § 107(a)." *See* 42 U.S.C. § 9613(f). *See also* Southland Corp. v. Ashland Oil, Inc., 696 F. Supp. at 999. While courts have recognized that contribution under CERCLA § 113 shares certain similarities with indemnification (*see* United States v. Cannons Eng'g Corp., 899 F.2d 79, 92 (1st Cir. 1990)), that statutory provision does not contemplate the recovery of various costs or losses that may be recoverable under a contractual indemnity (*see* note 73 *infra*) such as costs for remediation of oil contamination, consequential damages and attorney's fees. *See* Mesiti v. Microdot, Inc., 739 F. Supp. 57, 62-63 (D.N.H. 1990).

48. Southland Corp. v. Ashland Oil, Inc., 696 F. Supp. at 1002 (contract provisions did not specify in clear enough terms that the parties intended to include CERCLA statutory recovery actions in the two year cut-off of liability under the "survival" clause); Chemical Waste Management, Inc. v. Armstrong World Indus., Inc., 669 F. Supp. at 1295 ("If owner/operators and generators wish to redistribute the risks distributed by Congress [under CERCLA], they must do so clearly and unequivocally."); FMC Corp. v. Northern Pump Co., 668 F. Supp. 1285, 1289 (D. Minn. 1987), *appeal dism'd*, 871 F.2d 1091 (8th Cir 1988) (CERCLA § 107(e)(1) permits private indemnity actions, but no indemnity obligation will be implied by virtue of a parent/subsidiary relationship unless expressly included in the agreement). *But cf.* Mardan Corp. v. C.G.C. Music, Ltd., 804 F.2d at 1462 (contractual release need not expressly mention CERCLA liabilities to cover the same if the general release language was broad enough "to clearly indicate that the parties intended to settle more than certain [expressly mentioned] issues"); Rodenbeck v. Marathon Petroleum Co., 742 F. Supp. 1448 (N.D. Ind. 1990) (release of "all claims and obligations" bars all claims whether sounding in tort or contract, as well as CERCLA and other statutory claims).

If a release is not clear and unequivocal and is thus not effective, a seller, for example, seeking to enforce the release could be subject to claims brought by the buyer in a private action under CERCLA, including an action to recover response costs and a contribution action. *See supra* note 47. Even if a release is effective, unless the buyer's release of the seller is accompanied by an exculpation or similar indemnification provision (*see supra* note 1), the buyer will not be responsible for any losses incurred by the seller from similar CERCLA claims brought by third parties other than the buyer.

Where the buyer and seller have not attempted contractually to allocate potential environmental liabilities between themselves, courts have split on whether the doctrine of *caveat emptor* may provide a defense for the seller under a common law tort action brought by the buyer (*compare* Philadelphia Elec. Co. v. Hercules, Inc., 762 F.2d 303 (3d Cir. 1985), *cert.*

Indemnification agreements are contemplated in CERCLA section 107(e)(1) which provides as follows:

> No indemnification, hold harmless, or similar agreement or conveyance shall be effective to transfer from the owner or operator of any vessel or facility or from any person who may be liable for a release or threat of release under this Section, to any other person the liability imposed under this Section. Nothing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this Section.

Courts have recognized the apparent inconsistency between the two sentences of section 107(e)(1) and have attempted to interpret the provision in a manner that would render each sentence consistent with the other. Some courts have reconciled these two sentences to provide that parties can indemnify or release each other with respect to CERCLA liability, but that any such agreement will not bind the federal government or other third parties, both of whom remain free to pursue their CERCLA claims against the indemnified party.[49]

One court, however, has recently interpreted section 107(e)(1) of CERCLA to prohibit any contractual transfer of CERCLA liability between two potentially responsible parties. In *AM International, Inc. v. International Forging Equipment*[50] the court reviewed the legislative history of CERCLA[51] and concluded that Congress did not intend to permit "joint

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denied, 474 U.S. 980 (1985) (*caveat emptor* applies) *with* T&E Indus., Inc. v. Safety Light Corp., 227 N.J. Super. 228, 546 A.2d 570 (N.J. Super. Ct. App. Div. 1988) (*caveat emptor* does not apply)). The *caveat emptor* defense has been held not to be applicable in a CERCLA § 113 contribution action (Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86 (3d Cir. 1988), *cert. denied* 488 U.S. 1029 (1989)) or a CERCLA § 107 cost recovery action (Sunnen Prod. Co. v. Chemtech Indus., Inc., 658 F. Supp. 276 (E.D. Mo. 1987)).

49. Mardan Corp. v. C.G.C. Music, Ltd., 804 F. Supp. at 1456 (general release in settlement agreement held to cover CERCLA liability where release covered "all actions, causes of action, suits, . . . based upon, arising out of or in any way relating to the Purchase Agreement. . ."); Hays v. Mobil Oil Corp., *supra* note 46, at 393 (CERCLA prohibits a party from shielding itself from the government through an indemnity, but "indemnification clauses are still permitted to allocate the burdens of risks and costs among otherwise liable parties"); *see also* Central Ill. Pub. Serv. Co. v. Industrial Oil Tank & Mine Cleaning Serv., 730 F. Supp. at 1507; Southland Corp. v. Ashland Oil, Inc., 696 F. Supp. at 1000; Chemical Waste Management, v. Armstrong World Industries, 669 F. Supp. at 1293 ("CERCLA'S liability provisions do not abrogate the parties' contractual rights"); FMC Corp. v. Northern Paper Co., 668 F. Supp. at 1289.

50. 743 F. Supp. 525 (N.D. Ohio 1990).

51. The court specifically noted the Senate debate over the final CERCLA bill where Senator Cannon said:

> the net effect [of § 107(e)(1)] is to make the parties to such an agreement, which would not have been liable under this section, also liable to the degree specified in the agreement. It is my understanding that this Section is designed to eliminate situations where the owner or operator of a facility uses its economic power to force the transfer of its liability to other persons, as a cost of doing business, thus escaping its liability under the act all together.

S. REP. 1480, 96th Cong., 2d. Sess., 126 Cong. Rec. 30, 984 (1980). Senator Randolph, one of the bill's co-sponsors, then responded to Senator Cannon's characterization, indicating that his interpretation of § 107(e)(1) was correct. *Id.* The court concluded from these remarks that:

> . . . Congress intended subsection 107(e)(1) to prevent the parties from contractually relieving themselves of liability under the act, whether that liability is

tortfeasors" to seek indemnity against one another under CERCLA, although they could seek pro-rata contribution from one another.[52] In so deciding, the court concluded that the second sentence of section 107(e)(1) would be rendered "nugatory" if interpreted in the manner suggested by other courts.[53] The court reasoned instead that Congress intended to permit private persons to contract with others to relieve themselves of liability under CERCLA only if such other persons were not otherwise liable under the Act.[54]

The *AM International* court's decision is particularly significant in its marshaling of CERCLA's legislative history in support of its conclusion.[55] If the rule in *AM International* is generally followed by other courts,[56] indemnification for CERCLA liabilities between potentially responsible parties will not be permitted. Indemnity agreements should nonetheless remain useful to allocate the risk of liabilities arising under environmental laws other than CERCLA.[57]

> enforced by action of the government or in a suit by a person who performed the clean-up and sues others for contribution under the act. In addition, by the second sentence, Congress intended to permit any person to contract with others not already liable under the act to provide additional liability by way of insurance or indemnity.

743 F. Supp. at 529.

52. The court held that § 107(e)(1) permits indemnities between parties otherwise not liable under CERCLA; indemnities among liable parties are not permitted according to the court. 743 F. Supp. at 531. In a typical acquisition transaction, the seller, as the former owner or operator of a facility, and the buyer, as the current owner or operator, will each be a "responsible party" for liability purposes under CERCLA § 107(a). Therefore, under the principle enunciated by the *AM International* court, neither party will be able to obtain an indemnity from the other.

53. This is not an entirely fair criticism of the other courts' holdings. Other courts faced with resolving the apparent conflict between the first and second sentences of § 107(e)(1) have arrived at an interpretation which gives each sentence independent meaning and does not appear to render the second sentence "nugatory." *See supra* note 49 and accompanying text.

54. 743 F. Supp. at 529.

55. By contrast, the other courts that have interpreted § 107(e)(1) have not cited support for their position from the legislative history of the Act. *See Mardan*, 804 F. Supp. at 1458 (citing to the government's position regarding the interpretation of § 107(e)(1), but not legislative history); *Hays*, 736 F. Supp. at 393 (construing language in the Massachusetts version of CERCLA, but without reference to either the federal or state legislative history of the relevant CERCLA provision); *Southland Corp.*, 696 F. Supp. at 1000 (citing *Mardan*, *FMC*, and *Chemical Waste* decisions, but not legislative history, for proposition that § 107(e)(1) "does not abrogate the parties' contractual rights"); *FMC Corp.*, 668 F. Supp. at 1289 (citing no legislative history). At least one court construing CERCLA § 107(e)(1), however, has said that the general legislative history of CERCLA is far from clear and that "CERCLA's legislative history is sparse and generally uninformative. CERCLA was enacted hastily and is the product of political compromise. Moreover, last minute additions and deletions to the statute render its legislative history are of little practical use." *Chemical Waste Management, Inc.*, 669 F. Supp. at 1290 n.6.

56. *See* Jones-Hamilton Co. v. Kop-Coat, Inc., 750 F. Supp. 1022 (N.D. Cal. 1990) (Although *AM International's* citation to the legislative history has persuasive appeal, *AM International* stands alone and is not the law of Ninth Circuit).

57. *See AM International*, 743 F. Supp. at 530 (state claims for indemnity held valid, notwithstanding the invalidity of federal CERCLA releases). *Cf.* Marmon Group, Inc v. Rexnord, Inc., 822 F.2d 31, 33 (7th Cir. 1987) ("cutting oil" not a substance regulated by CERCLA; court held that seller's indemnity claim nevertheless stated a cause of action under Massachusetts environmental laws).

2. *"As Is" Clauses*

Courts have held, for a variety of reasons, that "as is" clauses do not release a seller from liability to the buyer for environmental conditions affecting property. Some courts have held that an "as is" clause is not effective in releasing the seller from liability for hazardous conditions unless the "as is" clause expressly mentions the relevant environmental condition.[58] Other courts have held that an "as is" clause is a disclaimer of warranties and may only serve to bar actions based upon a breach of warranty.[59] In the latter cases other causes of action (such as actions under CERCLA, as well as tort, contract misrepresentation and deceptive trade practice actions) may still be pursued, notwithstanding the "as is" clause.

In *Brockton Wholesale Beverage Co. v. Chevron U.S.A.*[60] a buyer agreed to acquire certain assets on an "as is" basis. The acquisition agreement expressly referenced the possibility of leaking underground storage tanks, but did not disclose that several drums and a waste oil catch basin were also buried under the property, all of which were leaking contaminants into the soil and water. The court held that the buyer was responsible for contamination attributable to underground storage tanks (including contamination from several tanks whose existence was unknown at the time of the sale). The court denied summary judgment as to the leaking drums and catch basin, however, since the seller's "as is" clause had not disclosed that leaking drums and a catch basin might be present on the property.[61]

3. *Will State Or Federal Law Govern The Interpretation Of Environmental Indemnities?*

Normally state law governs the interpretation of contract terms,[62] but federal law governs issues affecting federal causes of action.[63] Even when federal law governs, however, state law may be incorporated to provide the

58. Amland Properties Corp. v. Aluminum Co. of Am., 711 F. Supp. 784, 802 (D.N.J. 1989) ("as is" clause does not excuse liability for an abnormally dangerous product such as asbestos); Garb-Ko, Inc. v. Lansing-Lewis Servs., Inc., 167 Mich. App. 779, 423 N.W.2d 355, 358 (Mich. Ct. App. 1988) ("as is" clause does not shift risk of loss to a buyer for an unknown, undisclosed leaking storage tank; buyer is instead entitled to rescission).

59. Mardan Corp. v. C.G.C. Music, Ltd., 600 F. Supp. 1049, 1055 (D. Ariz. 1984), *aff'd on other grounds*, 804 F.2d 1454 (9th Cir. 1986) ("as is" clause is a warranty disclaimer, effective only to preclude breach of warranty claims); Wiegmann & Rose Int'l Corp. v. NL Indus., 735 F. Supp. 957 (N.D. Cal. 1990) ("as is" clause is merely a disclaimer of warranties); International Clinical Laboratories, Inc. v. Stevens, 710 F. Supp. 466, 469 (E.D.N.Y. 1989) ("as is" clause is warranty disclaimer); Channel Master Satellite Systems, v. JFD Elec. Corp., 702 F. Supp. 1229, 1231 (E.D.N.C. 1988) ("an 'as is' provision is merely a warranty disclaimer and as such precludes only claims based on breach of warranty . . ."); *Southland Corporation*, 696 F. Supp. at 1001 ("as is/where is" clause is warranty disclaimer; such clause does not supersede an indemnification agreement, based upon the contractual principle that a more specific provision will control over a general provision in the event of an inconsistency).

60. 1990 U.S. Dist. LEXIS 9998 (D. Mass. July 26, 1990).

61. *Id.*

62. *See* Mardan Corp. v. C.G.C. Music, Ltd., 804 F.2d 1454, 1458 (9th Cir. 1986) ("Absent CERCLA, these contracts would be interpreted under state law.").

63. Dice v. Akron, Canton & Youngstown R.R. Co., 342 U.S. 359, 361 (1952); Mardan Corp. v. C.G.C. Music, Ltd., 804 F.2d at 1457.

content of the federal law.[64] Some courts that have faced the question of whether to develop a uniform federal law or to apply state law principles to these contractual environmental agreements have resolved the matter in favor of state law, even when CERCLA liability is at issue.[65] Others have concluded that a uniform federal law must be developed.[66]

II. NEGOTIATING AND DRAFTING ENVIRONMENTAL INDEMNITY PROVISIONS

Various issues arise in the negotiation and drafting of an environmental indemnification provision. This section will focus primarily on a seller's indemnification obligations in the context of an acquisition transaction, such as a stock or asset purchase or a merger, that includes real property.[67] The

64. United States v. Kimbell Foods, Inc., 440 U.S. 715, 727-29 (1979) (State law will be applied unless either: (i) there is a clear congressional intent to develop a uniform federal standard; (ii) the issue requires a uniform national law; (iii) state law would frustrate the federal law's objective; or (iv) a uniform federal law would not frustrate commercial relationships predicated on state law).

65. *See* Mardan Corp. v. C.G.C. Music, Ltd., 804 F.2d at 1458 ("a uniform federal rule should not be developed to govern the issue of whether and when agreements between private "responsible parties" can settle disputes over contribution rights under section 107 [of CERCLA]"); International Clinical Laboratories, Inc. v. Stevens, 710 F. Supp. 466, 469 (E.D.N.Y. 1989); Lyncott Corp. v. Chemical Waste Management, Inc., 696 F. Supp. 1409, 1417 (E.D. Pa. 1988).

66. Wiegmann & Rose Int'l Corp. v. NL Indus., 735 F. Supp. 957, 962 (N.D. Cal. 1990); *see also* Mardan Corp. v. C.G.C. Music Ltd., 804 F.2d at 1466 (Reinhardt, J., dissenting) ("Given the need for uniformity, the potential harm to federal interests and the absence of any disruption of commercial relations, I would hold that the adoption of a uniform federal rule regarding CERCLA releases is called for"). The application of state law would appear to be the better approach, however, since many environmental indemnities and agreements address more than just environmental matters. If different rules govern the interpretation of the environmental and non-environmental matters, the parties may be faced with inconsistent rules of construction and interpretation. For example in Mardan Corp. v. C.G.C. Music, Ltd., 804 F.2d at 1458, the Ninth Circuit Court of Appeals noted that "commercial enterprises selling their assets or insuring themselves will normally look to state law to interpret their indemnification provisions, which will generally indemnify the enterprises against a whole host of possible liabilities."

67. In a stock transaction or merger, the parties would expect the environmental liabilities of the acquired entity to continue to exist, either as liabilities of the acquired entity in the case of a stock transaction, or as liabilities of the surviving company in the case of a merger. The parties would negotiate indemnities for environmental matters accordingly.

In asset transactions, the traditional common law rule has been that a corporation that purchases the assets of another corporation does not succeed to the liabilities of the transferor unless there is an express or implied assumption of liability, a de facto merger, a mere continuation of the transferee by the transferor, or a fraudulent conveyance. *See* 15 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS 7122 (rev. perm. ed. 1990). A number of judicial decisions have found successor liability for CERCLA liabilities notwithstanding this common law rule. *See* Note, *CERCLA, Successor Liability, and the Federal Common Law: Responding to an Uncertain Legal Standard*, 68 TEX. L. REV. 1237, 1238 n.9 (1990). In particular, two recent environmental cases have expanded the "mere continuation" exception to the common law principle. These cases have deemed an asset purchaser to be responsible, under newly developed federal common law, for its predecessor's generator liability arising under CERCLA § 107(a)(3). In United States v. Carolina Transformer Co., Inc., 739 F. Supp. 1030, 1039 (E.D.N.C. 1989) and United States v. Distler, 741 F. Supp. 637, 643 (W.D. Ky. 1990), CERCLA liability was imposed on an asset purchaser by reason of the "substantial continuity" between a successor corporation and its predecessor. In Louisiana-Pacific Corp. v. Asarco, Inc., 909 F.2d 1260, 1266 (9th Cir. 1990), however, the court deter-

negotiation of those obligations will involve the parties' agreement regarding the trigger for indemnification, the scope of the indemnification obligation, and the mechanics of the obligation.

Indemnification obligations, while customary in such transactions, are generally the subject of considerable negotiation between the parties.[68] Environmental issues have added a new complexity to this process, requiring the parties to focus carefully on the identification of environmental risk and to determine how and under what circumstances risks shall be allocated between them.[69]

A. The Trigger

The trigger for an indemnification agreement will depend in large part on the nature of the transaction. In an acquisition agreement, the indemnity may be an integral part of the overall remedies provisions,[70] triggered by a breach of any representation, warranty or covenant.[71] As such, the indemni-

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mined that it did not have to consider whether to apply a continuity test where the business segment creating the liabilities was discontinued prior to the asset sale and was not continued by the asset purchaser. *Id.* As a result of the uncertainty created by these and other cases, buyers will want to assure themselves that the indemnities they receive are broad enough to include such potential liabilities.

The indemnification issues that arise in the context of the acquisition of commercial real estate properties, or in connection with real estate financing transactions, will be substantially similar to the issues generally arising in an asset acquisition transaction, and thus are not separately addressed. In all such circumstances, buyers and sellers will attempt to allocate responsibility for as many of the potential environmental liabilities as possible to the other party in the transaction.

68. Typically, the seller will take the position that the buyer is purchasing an operating business and that contingent liabilities and operational risks are considered in negotiating the purchase price. The buyer, on the other hand, will take the position that it is acquiring a business operation that can continue to be operated as it has been by the seller, with no environmental property conditions that may adversely impact either the existing operations or the buyer's expansion of operations. The negotiation process will require an accommodation of the parties' positions somewhere on the spectrum between the two poles.

Additionally the seller may seek protection from environmental risk arising out of the buyer's post-acquisition activities (including the buyer's exacerbation of conditions arising out of pre-acquisition activities). Depending upon its bargaining position, the seller may also seek release from all or selected environmental liabilities arising from preacquisition acts or conditions. *See infra* notes 84-86 and accompanying text.

69. *See* Dore, *A Practical Guide to Environmental Indemnification Agreements*, 55 DEF. COUNS. J. 297 (1988). Given courts' inclination to interpret indemnification provisions strictly against the party seeking recovery (*see supra* notes 8-11, and accompanying text), the indemnitee should insist on a detailed indemnification provision. Although the parties to a transaction may attempt to anticipate and address all potential environmental risks, they often criticize environmental indemnities as providing, at best, an opportunity for future renegotiation of liabilities that arise post-acquisition and, at worst, a contractual invitation to litigate the responsibility for those liabilities.

70. Many times an indemnitor will insist that the indemnification provision be the sole remedy for an indemnitee. The indemnitee, in agreeing to such a provision, would waive any rights to sue for breach of contract based upon representations and warranties that may have survived the closing. Depending upon the wording of the waiver, the indemnitee also may waive, to the extent permitted under law, its statutory rights to bring a CERCLA action. *See supra* note 47. Presumably the indemnitee would not be waiving its ability to bring an action for fraud that may have induced the indemnitee to agree to such a limitation on remedies.

71. Typical environmental representations and warranties will cover the following matters: (1) compliance with environmental laws; (2) no order, notice or other communication of

fication may cover a much wider range of matters than those relating solely to environmental matters, which themselves will ordinarily be the subject of specific representations, warranties and covenants.

An indemnification provision may also be designed to deal specifically with environmental matters. These provisions may be crafted narrowly to address particular environmental matters, such as conditions identified in a pre-acquisition environmental assessment, or broadly to provide indemnification from all environmental matters. Lenders commonly require the broader provision from borrowers in loan transactions. Specific environmental indemnification provisions may be in addition to the other contractual remedies available to an indemnified party.[72]

Drafting the triggering provisions is often complicated by the process of developing the defined terms that will underlie such provisions. These terms will typically include definitions of the obligations covered by the indemnity (generally referred to as "losses" or "damages")[73] and the substances that

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alleged or potential violation, or failure to comply with, applicable law; (3) all necessary permits and compliance with, and transferability of, such permits; (4) no liabilities or remedial obligations with respect to assets or operations; (5) no generation, manufacture, transportation, treatment, storage, handling, disposal, production, importation, use or processing of any hazardous materials except in compliance with applicable laws; (6) no release or threat of release; (7) no underground storage tanks; and (8) no claims, liens, encumbrances or other restrictions resulting from liabilities or arising under environmental laws. *Cf.* Channel Master Satellite Sys., Inc. v. JFD Elec. Corp., 702 F. Supp. 1229, 1232 (E.D.N.C. 1988) (indemnity against violations of law, by its own language, did not cover violations of federal laws and did not bar CERCLA action).

Covenants are more typical in loan agreements and leases, where there are ongoing operations and properties in which the other party has a continuing economic interest. Covenants may also appear in acquisition agreements where part of the purchase price is payable after the date the transaction closes or where there is a period of time between the execution of the acquisition agreement and closing. These provisions will generally require, at a minimum, that the party covenant: (i) to comply with applicable environmental laws (including procuring, maintaining and complying with required permits, licenses and approvals); (ii) to notify the other party of the covenanting party's spills, notices of violations or other matters relating to compliance with law; and (iii) to not create, or permit others to create, a remedial obligation.

An indemnification provision will generally provide that losses must "arise out of or in connection with" representations or warranties, or specified acts or conditions, in order to trigger the indemnification obligation. One case has suggested (in the context of personal injury indemnity agreements) that such triggering provisions will be afforded an expansive reading under Fifth Circuit jurisprudence construing Texas law. *See* Fontenot v. Mesa Petroleum Co., 791 F.2d 1207, 1215 n.7 (5th Cir. 1986) (dicta).

72. *See* Nunn v. Chemical Waste Management, Inc., 856 F.2d 1464, 1469 (10th Cir. 1988) (breach of environmental warranty in acquisition agreement). Environmental representations and warranties may be subsumed in general representations and warranties relating to litigation, permits and compliance with laws. The preferable method is to address environmental issues in a separate section that focuses on those matters, even though some of the specific matters will duplicate the general matters covered elsewhere.

73. A typical broadly drafted definition of the covered obligations would refer to any and all losses, liabilities, damages, demands, claims (including, without limitation, claims for injuries to person, real or personal property or natural resources and claims for injunctive relief), obligations, actions, judgments, causes of action, assessments, penalties, costs and expenses (including, without limitation, the fees and disbursements of outside legal counsel, consultants, investigators, accountants, laboratory fees and the charges of in-house legal counsel and accountants), and all foreseeable and unforeseeable consequential damages.

Indemnities, like most contracts, are not normally held to include coverage for attorneys' fees unless expressly stated. *See* Buck v. Johnson, 495 S.W.2d 291, 297 (Tex. Civ. App.—Waco 1973, writ ref'd n.r.e.) (unless provided for by statute or by contract between the parties,

create contaminated conditions (generally referred to as "hazardous materials," "materials of environmental concern" or similar terms). Defining the term "hazardous materials" in a manner that will adequately cover all likely environmental concerns presents a drafting challenge. Environmental statutes do not consistently define which materials are covered by this term. Many statutes purposely exclude particular types of hazardous materials because they are adequately dealt with in other statutes. For example, CERCLA does not cover petroleum products.[74] Some definitions in relevant environmental statutes are admittedly so broad as to include items such as "dirt" and "water" as pollutants.[75] Additionally, the presence of certain materials may not violate environmental statutes, but may present the possibility of liability through third party toxic tort suits.[76] Threshold quantities

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attorneys' fees incurred by a party to litigation are not recoverable against his adversary either in an action in tort or a suit upon a contract). Limited exceptions to this rule exist. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 38.001 (Vernon 1986). The prudent drafter will, nevertheless, insist that the indemnity cover attorneys' fees. At least one commentator has also concluded that an indemnity must specifically address a duty to defend in order for a defense obligation to be included in the indemnification obligation. *See* Scheer, *The Contractual Indemnity Provision Effective to Protect an Indemnitee Against His Own Negligence or Other Fault*, 17 TEX. TECH L. REV. 845, 878 (1986) ("There is no reason to assume that a duty to defend exists solely by virtue of the existence of an obligation to indemnify. If the duty to defend is intended to be included as part of the indemnity agreement, therefore, it should be specifically stated").

74. The definition of "hazardous substance" set forth in CERCLA § 101(14) provides that:

> [t]he term [hazardous substance] does not include petroleum, including crude oil or any fraction thereof which is not otherwise specifically listed or designated as a hazardous substance under subparagraphs (A) through (F) of this paragraph, and the term does not include natural gas, natural gas liquids, liquefied natural gas, or synthetic gas usable for fuel (or mixtures of natural gas and such synthetic gas).

75. The definition of "waste" in § 26.001 of the TEXAS WATER CODE includes "other waste" which in turn includes "sawdust" and "sand." TEX. WATER CODE ANN. § 26.001(6), (12) (Vernon 1988 & Supp. 1991). The term "pollutant" in the same statute includes "dredged soil," "rock," "sand" and "cellar dirt." *Id.* § 26.001(13). Until permit authority is delegated to the Texas Water Commission under the federal National Pollutant Discharge Elimination System (NPDES system), the term "other waste" is also defined to include "tail water or runoff water from irrigation or rainwater runoff from cultivated or uncultivated range land, pasture land, and farmland that may cause impairment of the quality of the water in the state." *Id.* § 26.001(12). Even after NPDES authority is delegated to the state, the definition of "other waste" would impliedly include non-agricultural forms of runoff waters. *Id.*

76. Asbestos is a hazardous substance within the meaning of CERCLA § 101(14). *See* 40 C.F.R § 302.4 (1990); 40 C.F.R § 401.15 (1990); 40 C.F.R § 61.01(a) (1990). The presence of asbestos does not, however, necessarily result in liability under CERCLA, since courts have concluded that CERCLA does not provide for cost recovery actions for removal of asbestos from the structure of a building. *See* 3550 Stevens Creek Assoc. v. Barclays Bank of California, 915 F.2d 1355, 1363 (9th Cir. 1990); Dayton Indep. School Dist. v. U.S. Mineral Prod. Co., 906 F.2d 1059, 1064 (5th Cir. 1990); First United Methodist Church v. United States Gypsum Co., 882 F.2d 862, 868 (4th Cir. 1989), *cert. denied*, 110 S. Ct. 1113 (1990); Retirement Community Developers, Inc. v. Merine, 713 F. Supp. 153, 158 (D. Md. 1989). While apparently no reported cases have imposed liability on building owners or managers for asbestos-related health claims of tenants, employees or visitors, commentators have warned of the future potential of toxic tort suits brought against building owners and managers arising out of asbestos in buildings. *See* Billauer, *Asbestos in your Bedroom: Protection for the Latest Wave of Asbestos Litigation*, 60 N.Y. ST. B.J. 12 (Feb. 1988). *See also* Layne v. GAF Corp., 42 Ohio Misc. 2d 19, 26, 537 N.E.2d 252, 259 (Ohio Comm. Pl. 1988) (jury awarding verdict for worker who claimed she had contracted mesothelioma during her employment in a federal

are not generally a part of the definition sections in these statutes.[77] Therefore, a simple definition referring, for example, to any substance regulated as hazardous under applicable environmental laws may create an unworkable standard since most properties have de minimis quantities (in some cases naturally occurring) of these so-called hazardous substances.[78]

B. The Scope

The scope of the indemnity will reflect the negotiated allocation of risks

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office building that contained asbestos). It may even become possible for building occupants to claim liability against property owners in circumstances where no asbestos-related disease has been detected *Cf.* Dartez v. Fiberboard Corp., 765 F.2d 456, 468 (5th Cir. 1985) (asbestos manufacturer held liable for plaintiff's mental anguish proximately resulting from his fear of developing disease from asbestos exposure).

Indoor pollution lawsuits are another area where very little governmental regulation has appeared, making it difficult for building owners and operators to determine the level of "cleanness" that must be maintained in order to avoid third party liability. The EPA has identified indoor pollution as one of the most significant environmental human health risks currently not regulated. *See* REPORT TO CONGRESS ON INDOOR AIR QUALITY (U.S. EPA August 1989); COMPARING RISKS AND SETTING ENVIRONMENTAL PRIORITIES (U.S. EPA December 1989). "Sick Building Syndrome" and "Legionnaire's Disease" cases are two examples of the types of third party liabilities that may arise in indoor pollution lawsuits. *See, e.g.*, 4 INDOOR POLLUTION L. REP. 7 (August 1990) (reporting $1 million jury verdict in a "sick building" case where plaintiffs suffered from physical and mental health problems resulting from multiple exposures to pesticides in an office building containing an improperly functioning ventilation system); Rogers v. Benjamin Moore & Co., No. 90-009348 (Dist. Ct. of Harris Cty, 157th Jud. Dist. of Texas, February 26, 1990)) (complaint filed against public school contractors for allegedly using materials that exposed children to high levels of hydrocarbons, carbon dioxide, carbon monoxide and formaldehyde) (reported both in 3 INDOOR POLLUTION L. REP. 7 (April 1990) and Zimmerman, *Pollution Liability Increasing*, 12 NAT'L L.J., July 23, 1990, at 15); *Legionnaire's Disease Claims Five Patients*, 4 INDOOR POLLUTION L. REP. 1 (July 1990) (state hospital found to have "Legionella" bacteria in building's hot water system).

Buildings built or renovated since 1973 are now regarded as presenting a greater risk of indoor pollution liability than buildings built before and after such dates, because accepted ventilation standards during that period are now regarded as inadequate. *See* Zimmerman, *supra* note 76, at 17, n.11 (reporting that the American Society of Heating, Refrigerating and Air Conditioning Engineers (ASHRAE) has now revised its Standard 62-1989, because the prior ventilation standard is considered inadequate).

77. For example, *compare* CERCLA § 103(a) (notification of National Response Center is required by a person in charge of a vessel or a facility as soon as he has knowledge of any release (other than a federally permitted release) of a hazardous substance equal to or in excess of the reportable quantities established under CERCLA § 102), *with* CERCLA § 104(a)(1) (removal costs may be incurred, in accordance with the National Contingency Plan, whenever any hazardous substance is released or there is a substantial threat of such a release into the environment, or there is a release or substantial threat of release into the environment of any pollutant or contaminant which may present an imminent and substantial danger to the public health or welfare). *Cf.* Amoco Oil Co. v. Borden, Inc., 889 F.2d 664, 670-71 (5th Cir. 1989) (liability element necessary for recovery of response costs is satisfied as a matter of law "if it is shown that *any* release violates, or any threatened release is likely to violate, *any* applicable state or federal standard, including the most stringent." Court rejected EPA's contention that CERCLA liability attaches upon the release of any quantity of hazardous substance because such an interpretation would exceed CERCLA's statutory purposes by imposing liability where there has been no threat to the public or the environment).

78. Trace elemental metals are commonly found in soils, plants and water. *See* U.S. ENVIRONMENTAL PROTECTION AGENCY, HAZARDOUS WASTE LAND TREATMENT (SW-874) (April, 1983) at 272-78. *See also* Amoco Oil Co. v. Borden, Inc., 889 F.2d at 670 n.10 ("The EPA has listed several other substances, such as zinc, sodium, and selenium, that are present in most soil. *See* 40 C.F.R. § 302.4 (1988). Harmless and, indeed, essential to humans at low levels, they are also toxic in higher concentrations.").

between the parties to a transaction. These risks primarily relate to previously-created conditions or past actions that raise the specter of present or future environmental liabilities. An additional risk may involve the "fitness of purpose" of certain acquired property. This concern arises where the landowner plans to utilize the property for certain purposes, such as residential housing, but is prevented from doing so by environmental conditions existing on the property.[79]

Allocation of environmental risks presents special problems. Foremost is the issue of identifying those conditions that carry with them current liability or the potential for future liability. Purchasers in acquisitions involving real property will routinely commission an environmental risk investigation to assist in the risk assessment process. A consultant's discovery of a problem may serve to negate the innocent landowner defense under CERCLA,[80] but will not necessarily identify all the conditions that may potentially result in liabilities (particularly the latent conditions). Additionally, while an experienced environmental engineer may be able to provide a range of costs associated with potential liabilities, the process remains much more an art than a science. Finally, given the broad guidelines established for cleanup, and the resulting agency discretion, applicable cleanup standards are not readily determinable.[81] Therefore, it may be difficult to quantify the transac-

79. *Cf.* Tanglewood East Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568 (5th Cir. 1988) (residential development on site of former wood-treatment facility). The seller may attempt to guard against such indemnification liability by disclosure to the buyer (such as through the Texas solid waste disposal site deed recordation requirement set forth in 31 TEX. ADMIN. CODE § 335.5 (West 1989)) and imposition of a covenant restricting the use of the property for certain purposes by buyer and its successors, accompanied by indemnification of the seller.

80. Under the so-called "innocent landowner" defense, a prospective site owner may insulate itself from potential CERCLA liability for releases by a party with which it is in direct or indirect contractual relationship by establishing that at the time of its acquisition it did not know and had no reason to know that any hazardous substance was disposed of on, in, or at the property. 42 U.S.C § 9601(35)(A) (Supp. 1990). In order to establish that a party had no reason to know of the existence of any hazardous substance at the property, the party must undertake, at the time it acquires title to the property, "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability." 42 U.S.C. § 9601(35)(B) (1988). Under certain limited circumstances the innocent landowner defense may be available to provide protection from CERCLA claims; *see* United States v. Pacific Hide & Fur Depot, Inc., 716 F. Supp. 1341 (D. Idaho 1989). The defense does not, however, provide protection from liabilities or remedial obligations arising under other environmental laws.

81. Neither CERCLA nor the Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901-6992k (1988) (RCRA), establish specific numeric cleanup standards. Section 121 of CERCLA, added by SARA, provides that CERCLA remedial actions at a site must be protective of human health and the environment, be cost effective, and be, to the extent practicable, in accordance with the EPA's National Oil and Hazardous Substances Pollution Contingency Plan (55 Fed. Reg. 9666 (March 8, 1990), amending 40 C.F.R. Part 300 (NCP)). Additionally, any cleanup standard utilized in connection with the remedial actions selected must attain legally applicable or relevant and appropriate federal and state standards, requirements, criteria or limitations (ARARs) for the hazardous substances, pollutants or contaminants at the site. 42 U.S.C. § 9621(d) (1988). The NCP sets forth certain criteria, derived in part from CERCLA § 121, to be considered in selecting a remedy at a Superfund site. 55 Fed. Reg. at 8849-50 (to be codified at 40 C.F.R. § 300.430(e)(9)(iii)(A)-(H)). The EPA is to use these

tional risks, even with respect to known problems.[82]

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criteria in a process that allows consideration and balancing of site-specific factors to select the most appropriate remedial action for the site.

Section 3004(u) of RCRA, 42 U.S.C.A. 6924(u) (1988), added by the Hazardous and Solid Waste Amendments of 1984, Pub. L. No. 98-616, 98 Stat. 3221 (HWSA), requires corrective action for releases of hazardous waste or constituents from solid waste management units at a treatment, storage or disposal facility seeking a RCRA permit. The EPA's proposed rule entitled Corrective Action for Solid Waste Management Facilities (55 Fed. Reg. 30798 (July 27, 1990)) (Corrective Action Rule) would define requirements for conducting remedial investigations, evaluating potential remedies, and selecting and implementing remedies at RCRA facilities based on site-specific analysis and considerations. EPA also intends that the proposed Corrective Action Rule be applicable to response actions under CERCLA. 55 Fed. Reg. 30802.

These CERCLA and RCRA statutory and regulatory provisions grant to the federal government considerable flexibility in selecting remedies, thus preserving wide agency discretion relating to the nature of treatment technology, timing of cleanup expenditures, the use of permanent rather than temporary remedial solutions and, in particular, applicable cleanup levels. The EPA recognizes that

> [o]ne of the more controversial issues related to corrective action is the cleanup goals for contaminated media, or "how clean is clean." EPA has not attempted in [its proposed Corrective Action Rule] or elsewhere to establish specific cleanup levels for different hazardous constituents in each medium. Instead, EPA believes that different cleanup levels will be appropriate in different situations, and that the levels are best established as part of the remedy selection process.

55 Fed. Reg. 30,804. As a result, before the cleanup levels are negotiated as part of the remedy selection process, quantification of site remediation costs will be speculative. *Accord* Corash, *supra* note 5, at 257 ("Statutory requirements and regulatory standards, such as the National Contingency Plan established by EPA under CERCLA and the Clean Water Act, should not generally be used as a basis for a 'cleanness' determination. These documents contain broad guidelines, leaving plenty of room for agency discretion"). *See* also J. Moskowitz, *supra* note 5 at 278 ("agencies often require remediation of soils which are contaminated at levels far lower than would qualify the soils as a 'hazardous waste.' Many agencies have no predefined cleanup levels at all, or only levels which attach to a few substances").

The cleanup standards for hazardous materials required by the Texas Water Commission (TWC) under the State of Texas' enforcement and spill response programs and under RCRA (implementation of which in Texas has been delegated to the TWC) for regulation of solid waste management units contemplate that contaminated sites be cleaned up to "background" levels (i.e. the concentrations of the materials found in the soil and groundwater of nearby non-contaminated property). The TWC is currently considering the adoption of a risk assessment methodology similar to that contemplated under CERCLA and the proposed Corrective Action Rule. *See* McFaddin, *Negotiating Contaminated Site Cleanups with the Texas Water Commission: How Clean is Clean?*, 2ND ANNUAL HAZARDOUS AND SOLID WASTE MANAGEMENT INSTITUTE (University of Texas School of Law 1990). Although the TWC generally does not establish numerical guidelines for cleanup standards, it has published detailed cleanup criteria for groundwater and soil contamination resulting from releases from petroleum storage tanks. *See* Texas Water Commission, *TWC Petroleum Storage Tank Guidance Manual for LPST Cleanup in Texas*, 7-1 to 7-13 (1990). *See also* White, Shelton and Knebel, *Cleaning Up Our Mess: A Comparison of Clean Up Standards under Four Regulatory Programs*, in *Hazardous Waste in Texas* 193 (National Business Institute, 1990).

82. In response to numerous requests received by the EPA from prospective owners of contaminated property for covenants not to sue, the EPA has adopted a policy under which it may consider entering into a pre-acquisition agreement with prospective property owners. EPA MEMORANDUM dated June 6, 1989 from Edward E. Reich and Jonathan Z. Cannon to Regional Administrators, Regional Counsel, and Waste Management Division Directors "Re: Guidance on Landowner Liability Under Section 107(a)(1) of CERCLA, De Minimis Settlements under Section 122(g)(1)(B) of CERCLA, and Settlements with Prospective Landowners of Contaminated Property," *reprinted in* HAZARDOUS WASTE AND SUPERFUND 1990, at 33 (American Bar Association, 1990). A pre-acquisition agreement would include a covenant not to sue, which would provide protection from civil liability under §§ 106 and 107(a) of CER-

There is also the issue of "real" versus "perceived" risk. The use of "hazardous materials" in the operations of the acquired entity, and the presence of these hazardous materials at the acquired facilities, will many times lead a buyer to insist on indemnification even though there may not be a presently existing condition that could lead to liability under current law.[83]

The parties may also focus on "fault" with respect to past conditions for which indemnification is requested. In particular, a seller will often take the position that it will be responsible for environmental conditions it may have caused, but not those caused by its predecessors. Although some environmental statutes assign liability to the party that engages in an advertent action,[84] other statutes provide for liability solely on the basis of a person's status. For example, a party may be liable due to its status as an owner or operator of, or responsible party with respect to, a facility or vessel.[85] Each party to the indemnity may be equally blameless with respect to an environmental liability, but under the law the liability may attach irrespective of fault,[86] and thus, the parties need to decide how that risk is to be allocated.

In most negotiations, three issues typically arise with respect to the scope of indemnity. The remainder of this subsection is devoted to a discussion of these issues.

CLA and § 7003 of RCRA arising from contamination of a facility that exists as of the date of acquisition of the facility.

Conceptually, a pre-acquisition agreement is a useful tool to limit environmental liability in the acquisition of property where contamination is known to exist, because in such cases the "innocent landowner defense" under CERCLA (*see supra* note 80) is not available. The conditions that have to exist before the EPA's policy can be utilized and the limited protection provided by such a covenant not to sue, however, raise questions as to how much practical protection the policy provides.

In particular, a covenant not to sue would not provide protection against actions brought by state governments under comparable state provisions, unless the states were also parties to a covenant not to sue. Perhaps even more importantly, a covenant not to sue would not provide protection against third-party plaintiffs bringing toxic tort or other actions. Even if the cost of cleanup can be quantified, the costs associated with potential third party actions, by their very nature, are not determinable.

83. The presence of a hazardous material, no matter how broadly defined, will not necessarily result in liability. *See infra* notes 88-94 and accompanying text.

84. *See, e.g.*, RCRA of 1976, § 3008(e), 42 U.S.C. § 6928(e) (1983 & Supp. 1990) (providing liability for "[a]ny person who knowingly transports, treats, stores, disposes of, or exports any hazardous waste . . . who knows at that time that he thereby places another person in imminent danger of death or serious bodily injury").

85. CERCLA § 107(a), 42 U.S.C. § 9607 (1983 & Supp. 1990) provides for the liability of "the owner and operator of a vessel or a facility," and "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 . . . ." Section 1002(a) of the Oil Pollution Act of 1990, Pub. L. No. 101-380, 104 Stat. 484, imposes liability for removal costs and damages on each "responsible party" for a vessel or a facility from which oil is discharged, or which poses the substantial threat of a discharge of oil, into or upon the navigable waters or adjoining shorelines or the exclusive economic zone. The term "responsible party" is defined to include: (i) any person owning, operating or demise chartering a vessel; (ii) any person owning or operating an onshore facility (other than a pipeline); (iii) the lessee or permittee of the area in which an offshore facility (other than a pipeline or a deepwater port) is located or the holder of a right of use and easement granted under applicable law for that area; (iv) the licensee of a deepwater port; and (v) any person owning or operating a pipeline.

86. *See* New York v. Shore Realty Corp., 759 F.2d 1032, 1044 (2d Cir. 1985) (CERCLA liability imposed on current owner of facility without regard to causation).

1. Current Versus Future Law

The parties will need to consider, as between themselves, who will be responsible for liability arising out of a condition existing prior to closing as a result of a post-acquisition change in the law. The buyer will contend that the preexisting condition is attributable to the seller, who would be liable for remediation but for the acquisition by the buyer. Additionally, the buyer will be concerned about retroactive liability imposed by future environmental laws.[87] The seller will point to the increasing stringency of environmental laws and argue that it should not be required to provide indemnity for a situation that cannot be currently ascertained. Language drafted to implement this aspect of allocation of liability should deal with instances where a successor law replaces the current law with no essential change in coverage, or where the actual statutory or regulatory provision does not change, but its judicial or administrative interpretation does.

2. Presence Of Hazardous Materials Versus Hazardous Materials Liabilities

The presence, in and of itself, of hazardous materials at a property site will not necessarily impose liabilities on the property owner under applicable environmental laws.[88] Hazardous materials are commonly used as an integral part of many manufacturing processes or used in machinery and equipment.[89] Environmental liabilities arise out of contamination caused by improper management or disposal of such hazardous materials. Generally liability is triggered by a release, threatened release spill, emission or discharge or that is not covered by government permits, that exceeds a reportable quantity or that poses the potential for offsite contamination. The primary liability of concern for property owners is the remedial obligation that can be imposed under CERCLA and similar state laws, requiring the property owners and other responsible parties to clean up, or reimburse governmental agencies or private parties for expenses they incur to clean up, contamination attributable to the property.[90]

An indemnitor does not want to be in the position of agreeing to provide indemnity with respect to the presence of hazardous materials unless that

87. *See*, United States v. Northeastern Pharmaceutical and Chem. Co., 810 F.2d 726, 732-37 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).

88. *See* In re Chateaugay Corp., 112 B.R. 513, 521-22 (S.D.N.Y. 1990) (mere presence of hazardous wastes, without a related CERCLA release or threatened release, did not give rise to contingent claim). *See also supra* note 76 and accompanying text.

89. Certain materials that constitute "hazardous substances," "extremely hazardous substances," "hazardous chemicals" and "toxic chemicals" are the subject of public reporting and notification requirements under the Emergency Planning and Community Right-to-Know Act of 1986 (EPCRA), which was enacted as Title III of the Superfund Amendments and Reauthorization Act (SARA Title III), Pub. L. No. 99-499, 100 Stat. 1613 (1986), 42 U.S.C. §§ 11001-50. Texas and other states have similar reporting requirements. *See e.g.*, the Texas Hazard Communication Act, TEX. HEALTH & SAFETY CODE ANN. §§ 502.001-.016. (Vernon 1991).

90. *See* CERCLA §§ 106, 107, 42 U.S.C. §§ 9606, 9607; TEX. HEALTH & SAFETY CODE ANN. §§ 361.272-73 (Vernon 1991).

presence could actually result in the indemnitee's liability.[91] The indemnitee on the other hand wishes to avoid problems that contamination may cause in the future, whether under current law or, as discussed above, under future law.[92] The presence of contamination could adversely impact the development of the property or even the normal conduct of business operations. Additionally, the buyer does not want to be subject to the enforcement discretion of government agencies under cleanup standards that tend to be determined on a case-by-case basis.[93] A possible compromise position is for the seller to accept the risk of liability arising out of the preacquisition presence of hazardous materials, but only to the extent that such presence constituted a violation of, or created a remedial obligation under, applicable law.

In drafting the indemnification language, the buyer will desire to avoid using language that limits coverage to the liabilities arising out of "violations of environmental laws." Under the strict liability provisions of CERCLA, remedial obligations can arise without a violation of law. If an environmental indemnity provides coverage only for "violations of environmental laws," recovery could remain unavailable if a governmental authority never issued a notice of violation.[94]

3. *Voluntary Versus Mandatory Cleanup*

For various reasons, the buyer typically will seek the right to institute cleanup voluntarily at a site, even where the cleanup has not been mandated by government authorities. Although quantities of on-site hazardous materials may be below required response levels, it may be advantageous to per-

91. In Emhart Indus., Inc. v. Duracell Int'l, Inc. 665 F. Supp. 549, 570, 572 (N.D. Tenn. 1987), a seller indemnified the buyer for all environmental cleanup costs "imposed by law." PCB contamination had been discovered at one of three manufacturing facilities purchased from the seller. The buyer took various actions in anticipation of regulatory requirements, negotiated various standards of cleanup with regulatory officials, and conducted preliminary investigations of the other two sites (even though the only basis for investigating the other sites was the fact that contamination had been discovered at the first location). Some of these costs were not technically "imposed by law" since governmental authorities had not required the buyer to conduct tests at these facilities. The court determined, nonetheless, that the buyer should recover all of its response costs in the "imposed by law" indemnity. The court argued that "reasonable actions taken in good faith to fulfill legal obligations or to avoid the risk of liability are 'imposed by law' within the meaning of an indemnity." *Id.* at 570.

92. Governmental authorities may be willing to settle at the present time for a lesser standard of site remediation (or will not be willing to get involved approval of the sufficiency of the cleanup at a site), causing indemnitees to be concerned that future third party claims may nonetheless arise against the site. *See*, Corash, *supra* note 5, at 257-58. In addition, government authorities may elect to re-open their review of a cleanup site, notwithstanding prior approvals obtained for such site. Under CERCLA § 121(c) (42 U.S.C. § 9621(c)), if a remedial action is selected that results in any hazardous substances, pollutants, or contaminants remaining at the site, the EPA is required to review such remedial action within the succeeding five year period. This requirement "assure[s] that human health and the environment are being protected by the remedial action being implemented." If that standard is not met, further remediation at the site may be required.

93. *See supra* note 81 and accompanying text.

94. *See*, J. MOSKOWITZ, *supra* note 5, at 283 ("A common error in environmental agreements is to assume that so long as no 'violation' of an environmental law exists on the property, no environmental liability exists. . . .[B]eing the possessor of a large environmental problem often only coincidentally evidences a violation of the law").

form the cleanup sooner rather than later. Delay in cleanup may adversely affect the operations at the site or future cleanup standards may become more stringent and remediation more expensive.

Additionally, certain materials, such as asbestos and other indoor pollutant materials, may present health hazards and exposure to liability under toxic tort actions even though there is presently no statutory response action required with respect to such materials.[95] The seller providing indemnification will, of course, resist any voluntary cleanup prior to clear indication from the government that remedial work is required.[96] If remediation is required, the seller will want to minimize the cost of that cleanup.

The applicable cleanup standard may also be the subject of heavy negotiation. The indemnitor will resist any indemnification obligation that could impose stricter standards than those required by the government. On the other hand, a number of cleanup options may exist, some of which may be more beneficial to the indemnified party than others. Absent language to the contrary, the indemnity will not be construed to cover the "best" cleanup plan for the indemnified party, but only the plan which renders the site "clean enough."[97]

C. *The Obligation*

Once the scope of the indemnity has been determined, there are a number of issues that involve the "mechanics" relating to the obligation created.

1. *What Are The Contingencies Indemnified Against?*

Generally the covered obligations of the indemnitor created by the indemnity will be stated broadly to include indemnity for not only liabilities and damages, but also for losses, costs and expenses, claims, causes of action, proceedings, judgements, damages, fines and penalties. This allows a court to interpret the indemnification provision without distinguishing between indemnities against liabilities from those against losses, and how each of those

95. *See supra* note 76 and accompanying text.

96. *See* Channel Master Satellite Sys., Inc. v. JFD Elec. Corp., 702 F. Supp. 1229, 1232 (E.D.N.C. 1988) (indemnitors resisted cleanup cost reimbursement where costs were incurred "voluntarily" and had not been ordered by either state or federal authorities); *Cf.* P.H. Glatfelder Co. v. Lewis, 746 F. Supp. 511, 516 (E.D. Pa. 1990) (claim under indemnification provision of acquisition agreement arising out of indemnitees' payment of alleged tax deficiency without assessment by government authority).

97. In Emhart Indus., Inc. v. Duracell Int'l, Inc., 665 F. Supp. 549, 565 n.33 (N.D. Tenn. 1987), the plaintiff determined that extensive PCB contamination and cleanup would leave a less productive manufacturing facility than if the plaintiff simply closed the facility permanently (after stabilizing the contamination problem to the satisfaction of state authorities) and moved to another location. The cost of shutting down the facility permanently was apparently higher than the cost of moving to another site, but not appreciably so. The long-term production value of a new facility was markedly better than the old facility. *Id.* Nonetheless, the court held that the indemnity could not be construed to cover the cost of permanently shutting down the old facility and moving to a new facility, arguing that "the indemnity does not require that [defendant] underwrite the most economically productive solution to the . . . PCB problem." *Id.* at 571.

differ from a hold harmless agreement or an agreement to defend.[98] The buyer may also seek to include "diminution in value" within the definition of covered obligations. Such a concept attempts to address, on behalf of the buyer, the economic impact of environmental hazards that do not cause the buyer to incur out-of-pocket expenses, but have an adverse effect on the value or marketability of the property.

2. *Who Is The Indemnitor?*

An indemnity is only as good as the financial wherewithal of the indemnitor. The indemnitee will seek a "deep pocket" as the indemnitor. Usually the indemnitor is the person or persons who receive the direct benefit from the transaction. The acceptability of such an indemnitor will depend in part on whether the seller will continue to own substantial assets following the transaction. Additionally, an indemnity may be provided by a party that receives an indirect benefit, such as a parent corporation where its subsidiary is selling assets.[99] Even if financial wherewithal is sufficient for the present, financial stability, or even corporate existence, can change over time. To guard against these future credit risks, the indemnitee may seek to require an escrow arrangement, a letter of credit or a surety bond to back up the indemnity obligation.

3. *What Parties Are Indemnification Beneficiaries?*

In an acquisition transaction, the buyer naturally will be an indemnified party. Additionally, the indemnification should recognize that successors of a purchasing entity, or the heirs and legal representatives of a purchasing individual, should succeed to the coverage provided to the original indemnitee. A buyer should also insist on having the indemnification continue to extend to its assigns. In view of the owner and operator liability that can arise under CERCLA and other environmental laws, the buyer should insist that coverage extend to officers, directors and shareholders, and should additionally request coverage for its employees, attorneys and agents.[100]

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98. *See supra* note 1 and accompanying text. *See also supra* note 73 and accompanying text.

99. The enforceability of such an obligation under Texas law may depend on whether there is sufficient consideration flowing to the parent to support the obligation. *See*, TEX. REV. CIV. STAT. ANN. art. 1302-2.06 (Vernon 1980 & Supp. 1991).

100. *See, e.g.*, Quadion Corp. v. Mache, 738 F. Supp. 270, 273-75 (N.D. Ill. 1990) (liability of individual shareholders as "owners" of a closely-held corporation under CERCLA based on the substantial ownership of the corporation by the shareholders); Kelley v. Thomas Solvent Co., 727 F. Supp. 1532, 1544 (W.D. Mich. 1989) (liability of corporate officer or director under CERCLA based on whether that individual could have, based upon general authority and specific responsibility for health and safety practices, prevented or significantly abated the release of hazardous substances); United States v. Kayser-Roth Corp., 724 F. Supp. 15, 22-23 (D.R.I. 1989), *aff'd*, 910 F.2d 24 (1st Cir. 1990) (liability of parent corporation as an "operator" under CERCLA based on parent's exercise of control over its subsidiary's management and operations). *See also* Florida Power & Light Co. v. Mid-Valley, Inc., 763 F.2d 1316, 1322 (11th Cir. 1985) (indemnity contracted for by corporation "presumptively includes the acts of employees and agents of the corporation within the line and scope of the agency relationship"). *See generally*, Phillips, *Personal Liability under Environmental Laws*, in TEXAS ENVIRONMENTAL SUPERCONFERENCE (August 19, 1990).

4. What Are The Limits Of The Indemnity Obligation?

An indemnification provision may be drafted so as to impose an unlimited indemnification obligation on the indemnitor. In most negotiations of risk sharing and the scope of the indemnification, however, the indemnitor is successful in setting limits on its obligation. The limits may encompass the following concepts:

a. The Floor For Coverage

The indemnitor may insist that the indemnitee incur a minimum covered obligation, and thereby exceed a set threshold "floor," before the indemnification obligation arises. The aggregate claims that comprise such a minimum loss are usually referred to as a "basket." The concept behind the basket is that the indemnitor should not be asked to address small amounts of losses. The basket applies to individual claims as well as claims in the aggregate. The floor can act as a "deductible," meaning that the indemnitee recovers only the amounts in excess of the threshold, or a "cliff," meaning that the indemnitee recovers all amounts of covered obligations once the threshold has been crossed, rather than only the amounts in excess of the threshold.

Many times the trigger provisions in indemnities, and in related representations and warranties, are qualified by a materiality standard. Under this type of trigger provision, liability arises only if the breach is "material." Materiality can be defined either quantitatively (e.g., claims that individually or in the aggregate exceed a certain value, which may be expressed as a percentage of the acquired entity's balance sheet or income statement) or qualitatively (e.g., claims that individually or in the aggregate adversely impact the ability of the acquired entity to conduct its operation in the same manner as it did before the acquisition).[101] To the extent that certain environmental matters are specifically addressed in the indemnity, these matters may be excluded from the basket provisions and treated separately without the necessity of reaching the floor applicable to non-environmental matters.

b. The Cap On Coverage

The indemnitor may also seek to limit the maximum amount of monetary liability under the indemnity. As the indemnitor, the seller will generally argue that the maximum indemnification should not exceed the amount of the purchase price paid by buyer. The underlying rationale is that where the seller is in corporate or limited partnership form, the seller has limited liability and should not be responsible for covering losses that it would not be liable for had it not sold. This argument will not necessarily be persuasive in light of liabilities arising under CERCLA and other statutes that, as a practi-

101. Applying both the materiality exception and the basket concept may result in a "double dip" in favor of the indemnitor. This would result where immaterial items are not counted toward the basket. Immaterial breaches would be excluded from the basket even though they could be material in the aggregate. Egan & Folladori, *supra* note 5, at 71.

cal matter, may not be limited by corporate or similar limited liability ownership.[102]

The indemnitor will also attempt to limit the term of its indemnification obligation and establish a final end to its continuing obligation.[103] The indemnitee will be concerned that third party environmental claims may arise at any time in the future and will not necessarily be cut off by a statute of limitations. Therefore, the indemnitee will attempt to assure that the indemnity period runs for a term sufficient to allow the indemnified matters to be identified or all claims to be raised.[104]

c. Sharing

The indemnification provision may also call for the parties to share covered obligations between the floor and the cap. For example, the indemnitor may be responsible for all covered obligations up to a set monetary threshold, after which the parties share responsibility for the obligations, in a dollar for dollar ratio (*e.g.*, for every three dollars of losses paid by the indemnitor, the indemnitee will be responsible for one dollar of losses). The parties could also provide for a shift in the sharing ratio over time, with the indemnitee assuming a greater portion of the obligations over the life of the indemnity.

5. Notice And Defense Of Third Party Claims

Typically, an indemnification provision will require the indemnitee to timely notify the indemnitor of the assertion of any claim or the discovery of any fact upon which the indemnitee intends to base a claim for indemnification.[105] Many indemnification agreements provide for release of the indem-

102. *See* United States v. Mottolo, 695 F. Supp. 615, 624 (D.N.H. 1988) ("CERCLA places no importance on the corporate form"); Price, "Liability of Corporate Shareholders and Successor Corporations for Abandoned Sites Under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)," EPA MEMORANDUM (June 13, 1984) (EPA may disregard the corporate entity when the shareholder controlled or directed the activities of a hazardous waste generator, transporter, or facility). *But see* Joslyn Mfg. Co. v. T. L. James & Co., 893 F.2d 80, 83-84 (5th Cir. 1990) (rejecting appellant's contention that CERCLA imposes direct liability on parent corporations for violations by wholly-owned subsidiaries; holding that corporate veil should not be pierced to impose liability on facts presented).

103. *See supra* note 24 and accompanying text (discussing "continuing obligations" of indemnities).

104. Environmental matters may be contrasted with other matters that are more susceptible of identification through buyer's due diligence. Even if an environmental condition is identified, the determination that the condition has to be remediated, or a claim that the indemnitee has responsibility for such remediation, is generally within the discretion of governmental authorities. As a result, although the indemnification for many corporate matters will be capped at the one to five year range, the time frame may be significantly greater with respect to environmental matters.

105. Section 16.071 of the TEXAS CIVIL PRACTICE AND REMEDIES CODE may limit the enforceability of notice requirements contained in a contractual indemnification. Section 16.071(a) provides: "A contract stipulation that requires a claimant to give notice of a claim for damages as a condition precedent to the right to sue on the contract is not valid unless the stipulation is reasonable. A stipulation that requires notification within less than 90 days is void." TEX. CIV. PRAC. & REM. CODE ANN. § 16.071(a) (Vernon 1986). Where an indem-

nitor's obligations with respect to any claim of which timely notice is not given. A more sensible approach is to carve back the indemnitor's obligations only to the extent that the indemnitor is adversely affected by its failure to receive notice.

The indemnitor typically will want to control any litigation or responses to third party claims, and may stipulate in the indemnification provision that its defense obligation is premised upon the use of counsel selected by the indemnitor. With respect to claims relating to environmental matters, the indemnitor will want to reserve the right to participate in settlement negotiations and negotiations with governmental authorities relating to the scope of required corrective action. Because any one environmental matter may trigger multiple claims by various governmental authorities and private claimants based on numerous statutory and common law theories of liability, indemnitors will want to retain the ability to devise and implement a strategy to address the various sources of exposure. The indemnitee will want to retain the ability to participate in any settlement negotiations that relate to matters other than monetary damage, such as settlement of matters that could impose criminal penalties on it or its officers, directors or employees. Indemnity agreements commonly include provisions that prohibit either party from settling a claim without the consent of the other.

6. *Right To Remedy*

The indemnitor has an interest in reserving the right to remedy the environmental condition triggering the indemnification obligation. The right to remedy allows the indemnitor to control the remediation process, along with its attendant costs. To preserve its ability to do such work, the indemnitor should reserve a right of access, under license or otherwise, that will allow it and its agents to enter the contaminated property and conduct the necessary remediation activities.[106] The indemnitee will want to provide for reasonable limits on the indemnitor's activities to minimize the disruption of the operations at the site. Additionally, the indemnitee will want assurance from the indemnitor that all such work will be done in compliance with applicable laws (so generator liability for the materials disposed of from the site does not later return to the indemnitees) and cleanup standards.

7. *Impact Of Third Party Protections On Indemnification Obligation*

The indemnitor will want to determine whether any other parallel protection from environmental liabilities is already available to the indemnitee from other sources. If so, the indemnitor should insist that the indemnification agreement requires that such protection will be primary and pursued by the indemnitee before the indemnitor's obligations arise. The parallel pro-

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nity agreement does not require notice, the courts will not infer a notice requirement as a condition precedent to a right to recover on the indemnity agreement. Fontenot v. Mesa Petroleum Co., 791 F.2d 1207, 1221 (5th Cir. 1986) (applying Texas law).

106. *See* Gebhardt, *The Environmental Inspection Easement: An Essential Commercial Loan Document*, 107 BANKING L. J. 317 (1990).

tection could include governmental reimbursement programs and insurance coverage,[107] or other sources of contractual indemnification (including any such indemnification rights relating to the assets being acquired that the seller previously received and are being assigned to the buyer in the present transaction). Both the indemnitor and the indemnitee will need to ensure that these sources of potential recovery do not, by their terms, limit such an arrangement in such a manner that neither party may recover available funds.

In Texas, the Petroleum Storage Tank Remediation Fund establishes a reimbursement program for corrective action involving product release from petroleum storage tanks.[108] Under certain circumstances, eligible owners may, upon satisfaction of a $10,000 deductible, recover up to $1 million per occurrence in cleanup costs associated with a leaking petroleum storage tank. Eligibility under the Remediation Fund may be forfeited if application for reimbursement is not timely or properly made, or if the tanks otherwise fail to comply with applicable registration and financial responsibility requirements.[109] Where a seller agrees to indemnify a buyer for liability arising out of underground storage tank leakage prior to the date of sale, the seller should insist that the indemnity agreement obligate the buyer to take all necessary steps to first seek recovery under the Remediation Fund before claiming recovery under the indemnity. The seller may also take the position that if eligibility under the Remediation Fund is denied due to the buyer's own fault, buyer should not be able to claim under the indemnity as an alternate source of recovery.

Among the assets of a company a buyer acquires in a stock acquisition transaction will be any historic commercial general liability insurance policies relating to the acquired company's business or assets. Additionally, in an asset acquisition transaction the buyer may seek to include within the definition of the assets being transferred certain of seller's rights relating to the property or operations being sold. Those rights may include rights to insurance coverage provided by historic commercial general liability insurance policies.[110] Although such insurance policies have become increasingly

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107. See *infra* notes 108-112 and accompanying text.

108. TEX. WATER CODE ANN. § 26.3573 (Vernon Supp. 1991).

109. *See*, 15 Tex. Reg. 3,558-59 (June 19, 1990) (proposed amendment to be codified at 31 TEX. ADMIN. CODE § 334.302 and replacing emergency § 334.502 adopted on January 26, 1990). *See also* Texas Water Commission, *TWC Petroleum Storage Tank Guidance Manual for LPST Cleanup in Texas*, at 9-1 through 9-7 (1990); Edwards, *LUST - Deep in the Heart of Texas: Federal EPA Regulations Affecting Underground Storage Tanks - The Texas Statutory and Regulatory Counterparts*, 21 ST. MARY'S L.J. 401, 446-47 (1990).

110. Commentators have questioned whether an assignment of a policy will be binding upon an insurance company whose consent has not been obtained. *See* J. APPLEMAN, 5a & 7 INSURANCE LAW AND PRACTICE §§ 3425, 4269 (1942, 1970 & Supp. 1990) (stating that anti-assignment provisions in insurance policies are generally enforced). There appear, however, to be several circumstances under which such assignments may be upheld. *See e.g.*, Ocean Accident & Guarantee Corp. v. Southwestern Bell Tel. Co., 100 F.2d 441, 447 (8th Cir. 1939), *cert. den.* 306 U.S. 658 (1939) (a general assignment of a liability policy in a bill of sale was upheld as to losses occurring before the transfer of assets); University of Judaism v. Transamerica Ins. Co., 132 Cal. Rptr. 907, 910, 61 Cal. App. 937, 942 (1976) (an arbitrary refusal by an insurer to consent to an assignment of a fire policy merely because it was not informed of the assign-

more restrictive in pollution and contamination coverage,[111] such policies may be available to cover third party claims and, under older policies, perhaps an insured's own property damage claims.[112]

8. *Avoiding Inadvertent Admissions Of Liability To Third Parties*

Finally, parties negotiating an indemnity agreement must be sensitive to third party liabilities that inadvertently may be created by language included in the indemnity agreement itself. For example, where a seller agrees to retain any liabilities arising out of conditions identified in a pre-transaction assessment, the seller may insist that the contract contain a provision that such an undertaking does not constitute any type of admission that those conditions arise from acts of or conditions created by seller or constitute violations of applicable laws.[113]

III. CONCLUSION

The courts have upheld, in large part, the attempts of parties to allocate between themselves contractually specified risks of environmental liabilities. Common law principles governing the interpretation of indemnities and statutory limitations on indemnification need to be identified and addressed in the negotiation and drafting process to avoid frustration of the parties' in-

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ment until after a loss had occurred was not consistent with the duty of good faith); National Am. Ins. Co. v. Jamison Agency, Inc., 501 F.2d 1125, 1128 (8th Cir. 1974) (an unconsented assignment of a fire policy to the sole shareholder of a dissolved corporation did not work a forfeiture of coverage where the assignment did not increase the risk or hazard of loss).

111. In 1986, the so-called "absolute pollution exclusion" clause was added to the standard form liability policy. Hendrick & Wiezel, *The New Commerical General Liability Forms—An Introduction and Critique*, 36 FED'N INS. & CORP. COUNS. Q. 319, 346-47 (1986).

112. *See* Parker, *Past Policy Coverage Issues—Including Third Party Rights to Insurance Contracts*, ENVIRONMENTAL LAW SYMPOSIUM (South Texas College of Law Seminar, 1991); Gordon & Westendorf, *Liability Coverage for Toxic Tort, Hazardous Waste Disposal and Other Pollution Exposures*, 25 IDAHO L. REV. 567 (1989). In addition, the duty to defend under an insurance policy is considered to be broader than the duty to indemnify. *See* National Grange Mut. Ins. Co. v. Continental Casualty Ins. Co., 650 F. Supp. 1404, 1407-08 (S.D.N.Y. 1986) ("the obligation to defend has been deemed 'litigation insurance' as well as 'liability insurance.' Thus, the insurer is required to provide a defense to any action, however groundless, in which there exists any possibility that the insured may be held liable for damages where facts are alleged within the coverage of the policy" (footnote omitted)). As a consequence, a seller attempting to minimize its indemnity exposure to a buyer might require that the buyer first seek coverage and defense costs from the buyer's own insurance policies. In addition, the seller may wish to require a waiver of subrogation rights so that, in the event the buyer's insurance policies cover the relevant cleanup costs, the buyer's insurer cannot thereafter pursue the seller under a subrogation claim.

113. In Pennzoil's $11 billion dollar jury verdict against Texaco in 1985, significant weight was attributed to the admissions seemingly drafted into the indemnity agreement between Texaco and the Getty interests. *See, e.g.*, T. PETZINGER, JR., OIL & HONOR: THE TEXACO-PENNZOIL WARS 300-01 (1987) (use of the indemnity provisions in voir dire of the jury panel by plaintiff's counsel); Hayes, *Texaco Tells Court It's Fighting for Life*, N.Y. Times, December 6, 1985, at D-1, col. 4 ("the biggest evidence against Texaco in the case was the company's willingness to indemnify all Getty officers and directors against any charges of wrongdoing that they might face in reneging on the Pennzoil agreement in favor of Texaco's offer"); Moffett, Petzinger & Stewart, *Courting Disaster: How Texaco Turned Big Takeover Victory Into Bigger Legal Loss*, Wall St. J., December 20, 1985, at 12, col. 2 ("the jury interpreted the indemnities as evidence that Texaco knew Getty and Pennzoil had a deal.").

tent. Additionally, particular environmental concerns, such as arrangements for one party to indemnify the other against liabilities under CERCLA, will affect the negotiations of the parties. Subject to these considerations, the only limit in indemnification arrangements is the creativity of the negotiators and their scriveners. Solutions to environmental issues arising in a transaction should be addressed in the context of the particular environmental risks identified. Using a boilerplate approach for contractual allocation of environmental risk may create unintended consequences, with neither party receiving the bargain it attempted to negotiate.