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# ENVIRONMENTAL LIABILITY IN REAL PROPERTY TRANSACTIONS

*Timothy G. Hayes\**

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## I. INTRODUCTION

In recent years, the scope of environmental liability has broadened considerably. Cleanup costs are no longer solely the concern of those directly engaged in the generation and disposal of hazardous wastes. Federal and state environmental statutes now create potential liability for parties to a variety of seemingly innocent transactions. Purchasers of contaminated property may be required to pay for hazardous waste cleanup. Corporate entities may also face environmental liability through mergers, consolidations and asset acquisitions. In addition, lenders may risk liability or impairment of collateral when contaminated property is used to secure a loan.

In another context, laws that restrict or regulate property use may frustrate the goals of purchasers and developers of land. Development in protected areas such as wetlands, subaqueous beds and floodplains may be prohibited or limited by permit restrictions. When permits are issued for development in these and other areas, development costs will often increase considerably because of mitigation requirements. An awareness of land use limitations created by environmental statutes and regulations is therefore important in evaluating specific transactions.

Initially, this article briefly outlines several environmental statutes that create liability for parties to real property transactions as well as those that limit real property use. This article will then discuss these laws in the context of commonly encountered real property transactions. Finally, this article will discuss environmental investigations and site assessments as a method of avoiding or limiting liability associated with real property transfers and other

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transactions.

## II. OVERVIEW OF ENVIRONMENTAL STATUTES

### A. *The Comprehensive Environmental Response, Compensation and Liability Act of 1980*

The Comprehensive Environmental Response, Compensation and Liability Act of 1980<sup>1</sup> ("CERCLA") and its 1986 amendments, the Superfund Amendments and Reauthorization Act<sup>2</sup> ("SARA"), create a broad statutory framework within which the Environmental Protection Agency ("EPA") can effectuate the identification<sup>3</sup> and cleanup<sup>4</sup> of property contaminated by hazardous substances.<sup>5</sup>

CERCLA's provisions create four categories of persons who may be potentially liable: (1) current owners and operators of the contaminated site; (2) those who owned or operated the site when disposal occurred; (3) generators of hazardous substances; (4) transporters of hazardous substances.<sup>6</sup>

The consequences for a party found to be responsible for cleanup costs can be extreme. Liability under CERCLA is generally held to be strict,<sup>7</sup> and may be joint and several.<sup>8</sup> CERCLA

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1. 42 U.S.C. §§ 9601-57 (1982).

2. Pub. L. No. 96-510, 94 Stat. 2767, Pub. L. No. 99-499, 100 Stat. 1613 (codified as amended in scattered sections of 42 U.S.C.).

3. The 1986 amendment to CERCLA were incorporated throughout the statute. The current version of the United States Code and the 1986 supplement includes CERCLA and SARA. 42 U.S.C. §§ 9601-75 (1982 & Supp. IV, 1986). Title III of SARA was codified at 42 U.S.C. §§ 1001-11050 (Supp. IV 1986). Under CERCLA, the EPA has authority to investigate sites for potential contamination and create a list of those sites which are eligible for cleanup using Superfund monies. 42 U.S.C. § 9605(a)(8)(B) (1982 & Supp. IV 1986). The term "Superfund" is derived from the tax supported trust fund created under CERCLA. *Id.* § 9611 (1982).

4. A responsible party may owe costs for cleanup of a site to the EPA, any state, or any person who has incurred necessary response costs. *Id.* § 9607(a) (1982).

5. A "hazardous substance" is defined under CERCLA as including any substance listed under other specified federal statutes, (which are listed in 42 U.S.C. § 9601(14)) or those substances listed pursuant to the CERCLA at 40 C.F.R. § 302.4 (1987). Petroleum products are not included as hazardous substances under CERCLA. 42 U.S.C. § 9601(14).

6. *Id.* § 9607(a).

7. *See, e.g.,* *United States v. Monsanto Co.*, 858 F.2d 160, 168 (4th Cir. 1988) ("Traditional elements of tort culpability on which the site-owners rely simply are absent from the statute."); *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985) (imposing CERCLA liability upon purchaser of contaminated property even though purchaser did not contribute to the generation, transportation or disposal of the hazardous waste).

8. *See, e.g.,* *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 811 (S.D. Ohio 1983) (holding that the burden rests with the defendant to show that the harm is divisible, and that costs should thus be assessed against individual defendants in proportion to their share

contains four affirmative defenses that provide only a narrow avenue of escape for a potentially liable party.<sup>9</sup> Under CERCLA's "third party defense," a defendant must show that the contamination was caused solely by a third party with whom the defendant was not contractually related,<sup>10</sup> that the defendant took due care after discovering the contamination, and that the defendant took precautions against foreseeable acts and omissions by the third party.

The "innocent purchaser" defense allows a purchaser to escape liability if he acquired the site after the hazardous substance was placed on the property, exercised due care once the contamination was discovered, and at the time of the transaction did not know or had no reason to know that hazardous substances were disposed at the site.<sup>11</sup> Because of CERCLA's mandate that due care be exercised as a prerequisite for availing oneself of the innocent purchaser defense, environmental investigations are rapidly becoming an integral part of many real property transactions.<sup>12</sup>

#### B. *The Resource Conservation and Recovery Act*

The Resource Conservation and Recovery Act<sup>13</sup> ("RCRA"), establishes a program whereby the EPA can regulate active hazardous waste generation, handling, and disposal from "cradle to grave." The goal of the statute is to require that "hazardous waste be properly managed in the first instance, thereby reducing the

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of the liability).

9. 42 U.S.C. § 9607(b) (1982). A defendant can escape liability if he can show that the contamination was caused by an act of God, an act of war, an act or omission of a third party, or any combination of the above.

10. A contractual relationship includes "land contracts, deeds, or other instruments transferring title or possession." *Id.* § 9601(35)(A) (Supp. IV 1986).

11. *Id.* § 9601(35)(B). This statutory provision requires the defendant to have "undertaken, at the time of acquisition, 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." *Id.* The statute further directs the courts to

take into account any specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property if uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the ability to detect such contamination by appropriate inspection.

*Id.*

12. See *infra* notes 106-120 and accompanying text.

13. Pub. L. No. 94-580, 90 Stat. 2795 (1976) (codified as amended at 42 U.S.C. §§ 6901-91 (1982 & Supp. II 1984)).

need for corrective action at a future date."<sup>14</sup>

Hazardous waste handlers, all of whom are subject to RCRA regulations, fall into four different categories: generators, or those whose activity creates the waste;<sup>15</sup> transporters of hazardous waste;<sup>16</sup> owners or operators of treatment, storage or disposal facilities;<sup>17</sup> and those who resell or use the hazardous waste.<sup>18</sup>

Transactional liability under RCRA arises primarily in the context of section 6973, which allows the EPA to bring suit whenever "any past or present handling, storage, treatment, transportation or disposal of any solid waste or hazardous waste may present an imminent and substantial endangerment to health or the environment."<sup>19</sup> In contrast to the rest of RCRA, which regulates active hazardous waste management, section 6973 can apply to inactive waste sites in a manner analogous to CERCLA liability. The inclusion of "past" activities in the 1984 amendment to RCRA appears to codify prior case law which applied the imminent and substantial endangerment standard to inactive sites.<sup>20</sup>

RCRA also implements a program regulating underground storage tanks containing either petroleum products or hazardous substances.<sup>21</sup> The statute provides that notification be given to the EPA for tanks which have been taken out of service after November 8, 1984, but remain in the ground.<sup>22</sup> The statute also imposes comprehensive regulatory requirements that must be met by owners and operators of storage tanks. These requirements include leak detection, tank testing, record keeping, and financial responsibility.<sup>23</sup>

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14. 42 U.S.C. § 6902(a)(5) (Supp. II 1984).

15. *Id.* § 6922 (1982 & Supp. IV 1986).

16. *Id.* § 6923.

17. *Id.* §§ 6924 (Supp. IV 1986), 6925 (1982 & Supp. IV 1986).

18. *Id.* See generally J. MACHLIN & T. YOUNG, *MANAGING ENVIRONMENTAL RISK*, § 4.02[2][a] (1988).

19. 42 U.S.C. § 6973(a) (1982 & Supp. IV 1986).

20. See, e.g., *United States v. Waste Indus., Inc.*, 734 F.2d 159, 164 (4th Cir. 1984) (finding that RCRA applied to past disposal activity when present leaking of hazardous waste created an imminent and substantial hazard); *United States v. Price*, 523 F. Supp 1055, 1073 (D.N.J. 1981) (holding that successor property owner is "contributing" to improper disposal merely by virtue of awareness and indifference to existing hazardous conditions and failure to act to contain leaking of contaminants,) *aff'd*, 688 F.2d 204 (3d Cir. 1982).

21. 42 U.S.C. § 6991(2) (Supp. IV 1986). Underground tanks are defined as those having 10% or more of their volume beneath the surface of the ground. *Id.* § 6991(1).

22. *Id.* § 6991(a)(2)(A).

23. *Id.* § 6991(b).

Pursuant to authority established under RCRA section 6991(c), Virginia implemented the Underground Storage Tank Act.<sup>24</sup> This statute requires owners who have actual knowledge of underground tanks taken out of service before January 1, 1974 to notify the State Water Control Board.<sup>25</sup> The Virginia statute requires the owner or operator of the storage tank to correct any release of petroleum or hazardous substance. In addition, the State Water Control Board is authorized to take corrective action and recover its expenses for the cleanup from the responsible party.<sup>26</sup>

Liability for underground tank leakage can become significant when it causes groundwater contamination. Apart from the potential liability created by leaking underground tanks, compliance with regulatory requirements can be a significant cost to a small business.

### III. REAL PROPERTY TRANSACTIONS: ENVIRONMENTAL LIABILITY AND RESTRICTIONS

#### A. *Real Property Transactions*

##### 1. Liability in the Purchase of Real Property

A purchaser of real property should attempt to meet the statutory requirements of the innocent purchaser defense in order to successfully defend against a CERCLA action.<sup>27</sup> Congress has explicitly delineated the expectations placed upon the purchaser. The purchaser is expected to conduct an inquiry into the previous ownership and uses of the property and to discover commonly known or reasonably ascertainable information about the property including appropriate inspection for obvious contamination.<sup>28</sup>

If a title search indicates that the property was at one time held by a manufacturing concern or other entity likely to have produced or handled wastes, a further investigation into the site's prior uses is required. In order to discover "commonly known or reasonably ascertainable" information about prior uses of the property, inter-

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24. VA. CODE ANN. §§ 62.1-44.34:8 to :12 (Repl. Vol. 1987).

25. *Id.* § 62.1-44.34:9(7).

26. *Id.* § 62.1-44.34:9(9).

27. 42 U.S.C. § 9607(b)(3) (1982). The defense was elaborated in the superfund Amendments and Reauthorization Act. *Id.* §§ 9601(35)(A)-(B) (Supp. IV 1986); *see also* J. MACHLIN & T. YOUNG, *supra* note 18, § 9.04[1][a][ii] (discussing requirements for innocent purchaser defense).

28. 42 U.S.C. § 9601(35)(B) (Supp. IV 1986); *see supra* note 11.

views should be conducted with neighboring landowners or former employees of a facility. The degree to which contamination is apparent is an important factor. Therefore, a visual inspection should be conducted as part of a diligent investigation of the property. If the purchaser's inquiry creates a reasonable suspicion that the property may contain hazardous substances, the purchaser should plan to undertake a more thorough environmental investigation.<sup>29</sup>

The purchaser should inspect for underground storage tanks, which can be significant sources of liability under federal and state law.<sup>30</sup> Many industrial facilities and many commercial sites such as gasoline stations, grocery stores, and office buildings have underground tanks. Although certain types of tanks, such as those used for storage of heating oil consumed on the premises, may be exempt from regulation, the tanks can still expose the owner to liability if groundwater contamination occurs.<sup>31</sup>

In order to protect against liability if underground tanks are present, the purchaser should conclusively establish that the tanks are sound and that no leakage has occurred or insist that the seller remove the tanks and remedy any contamination caused by leakage. If these precautions are not taken, and contamination is later discovered at the site, the purchaser may have difficulty proving that the prior owner caused the contamination.<sup>32</sup>

## 2. Liability in the Sale of Real Property

Under current environmental statutes, an owner of a contaminated facility or property cannot escape liability simply by selling it.<sup>33</sup> Under CERCLA, the person who owned or operated a facility at the time the hazardous waste was deposited, or at a time when a release of hazardous substance occurred, continues to be liable for the expense of correcting the hazardous condition as long as it exists.<sup>34</sup> Furthermore, if a person purchases the property and subse-

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29. See *infra* Parts IV-V for an overview of the requirements of an environmental investigation.

30. See *supra* notes 21-26 and accompanying text.

31. See VA. CODE ANN. § 62.1-44.34:2 (Repl. Vol. 1987).

32. See generally Minor, *Permitting*, in *ESSENTIALS OF ENVIRONMENTAL LAW FOR THE VIRGINIA LAWYER* V-7 (1988) (giving a hypothetical situation regarding underground storage tanks to provide guidance in advising client on environmental laws and regulations).

33. This differs from the common law, where a seller's liability for hazardous conditions on the property ends after the buyer has had a reasonable time or opportunity to discover and abate the hazardous condition. *RESTATEMENT (SECOND) OF TORTS* § 373 (1977).

34. 42 U.S.C. § 9607(a)(2) (1982); see *Smith Land & Improvement Corp. v. Celotex*

quently discovers contamination, an affirmative duty arises that requires the seller to disclose this condition to the purchaser.<sup>35</sup> If a seller fails to disclose this knowledge, the seller will be held "liable under section 107(a)(1) and no defense under section 107(b)(3) shall be available."<sup>36</sup>

Even when a seller is not liable for contamination on his property by virtue of the third party or innocent purchaser defense, practical considerations may still require that the seller incur expenses for cleaning up the property. The market for known contaminated property is not large,<sup>37</sup> and the presence of hazardous substances on the property may subject the seller to common law liability.<sup>38</sup>

Under RCRA, a seller may also remain liable for the release of hazardous waste that occurred after the sale of the property.<sup>39</sup> While RCRA generally applies to active hazardous waste disposal practices, several courts have determined that if past disposal practices caused leaking that creates an imminent and substantial hazard to health and the environment, the responsible party will remain liable even after sale of the property.<sup>40</sup>

Because of continued liability after the sale of contaminated property, the prudent seller should conduct a pre-sale environmental audit. Such an investigation will allow the seller to record chemical and waste handling practices at the site, identify any present contamination and document any cleanup of the site. By thoroughly memorializing the condition of the facility or property before the sale, the seller can establish a "baseline" of the prior

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Corp., 851 F.2d 86 (3d Cir. 1988) (holding that the defense of *caveat emptor* does not apply within the context of a CERCLA action, even when the purchaser is a sophisticated entity that thoroughly inspected the property); *United States v. Reilly Tar & Chem. Corp.*, 546 F. Supp 1100 (D. Minn. 1982) (prior owner of waste disposal site held liable ten years after sale of property); *see also United States v. Carolawn Co.*, 21 Env't Rep. Cas. (BNA) 2124, 2128 (D.S.C. 1984) (defendant who only held title to contaminated land for one hour was found by the court to be potentially liable under CERCLA).

35. 42 U.S.C. § 9601(35)(C) (Supp. IV 1986).

36. *Id.*

37. Although the market for contaminated property is not large, it is by no means non-existent. The cost of cleaning up contaminated property may not be so prohibitive as to make the property worthless. Therefore, cleanup costs should be a factor considered in the transaction.

38. *See, e.g., SCA Servs. of Indiana v. Thomas*, 634 F. Supp. 1355, 1364 (N.D. Ind. 1986) (discussing the lack of marketability of contaminated property).

39. 42 U.S.C. § 6973 (1982 & Supp. IV 1986).

40. *See supra* note 20 and accompanying text.



existing state of the property to defend against future claims for cleanup costs arising out of the seller's use of the property.<sup>41</sup>

Sellers should fully disclose whether a release of hazardous substance has occurred. A failure to disclose will prevent the seller from asserting any defenses under CERCLA should an action be brought against him as a past owner.<sup>42</sup> Furthermore, disclosure may allow the parties to the transaction to allocate the cleanup expenses among themselves or reflect the costs in the purchase price.

### 3. Liability in the Leasing of Real Property

A tenant's action that leads to contamination of the property can create both CERCLA and RCRA liability for the unwary or absent landlord. CERCLA imposes liability upon any person who owned the property when the hazardous substance was deposited there.<sup>43</sup> In *United States v. Monsanto Co.*,<sup>44</sup> the land owners argued that they should not be held liable for the improper hazardous waste disposal of their tenants. The court held, however, that the landlords were liable "regardless of their degree of participation in the subsequent disposal of hazardous waste."<sup>45</sup> Furthermore, the court stressed that the landlords could not avail themselves of CERCLA's third party defense<sup>46</sup> because they were in a contractual relationship with the lessees<sup>47</sup> and failed to take precautionary action against the foreseeable acts of the lessees.<sup>48</sup>

Landlords can take several precautions against becoming liable for a tenant's activity. First, the landlord should determine if there

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41. Smith, *Management Considerations: Environmental Advice for Business Decisions*, in *THE IMPACT OF ENVIRONMENTAL REGULATIONS ON BUSINESS TRANSACTIONS* 351, 357 (1986).

42. 42 U.S.C. § 9601(35)(C) (Supp. IV 1986).

43. 42 U.S.C. § 9607(a)(2) (1982).

44. 858 F.2d 160 (4th Cir. 1988).

45. *Id.* at 168.

46. CERCLA's innocent purchaser or third party defense is codified at 42 U.S.C. § 9607(b)(3) (1982). The third party defense was subsequently elaborated in the Superfund Amendments and Reauthorization Act. 42 U.S.C. § 9601(35) (Supp. IV 1986).

47. Under CERCLA, a contractual relationship includes "land contracts, deeds, or other instruments transferring title or possession." 42 U.S.C. § 9601(35)(A) (Supp. IV 1986).

48. *Monsanto*, 858 F.2d at 169; see also *United States v. Northernair Plating Co.*, 670 F. Supp. 742, 747-48 (W.D. Mich. 1987) (owner who leased facility to disposing party could not assert affirmative third party defense by virtue of the contractual relationship); *United States v. Argent Corp.*, 21 Env't Rep. Cas. (BNA) 1354 (D.N.M. 1984) (holding owner of property liable for tenant's activity even though owner neither created nor disposed of hazardous waste at the site).

is any contamination on the property before entering into a lease. The extent of contamination and any cleanup should be documented. While cleanup and documentation will not relieve the landlord from liability for hazardous substance releases caused by the tenant, it will provide a baseline to use in a contribution action against the tenant. If the activity involves the use of hazardous substances, the landlord should take precautions against any foreseeable improper handling or disposal. These precautions may include a provision in the lease agreement that requires tenants to comply with all RCRA regulations and provides for termination of the lease for any RCRA violation.<sup>49</sup>

#### 4. Liability in the Financing of Real Property

Although lenders are not liable for environmental contamination simply because they hold a security interest in the property, they must exercise caution for several reasons. Imposition of cleanup costs on the borrower may force him into default. In the event of default, lenders may find themselves unable to exercise remedies such as foreclosure or workout arrangements because of the threat of liability. Even if they manage to avoid liability, lenders may find themselves holding loans secured by impaired or unmarketable collateral. Accordingly, major lenders are becoming increasingly insistent on environmental investigations prior to making loan commitments. Typically, lenders will require an investigation followed by a statement from the borrower's consultant and an opinion from the borrower's counsel as to the condition of the property, its compliance with environmental standards, and factors bearing upon potential liability.

Under CERCLA, a secured lender can be held liable as an "owner or operator".<sup>50</sup> First, if the lender forecloses upon contaminated property and takes title, it may become liable as a current

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49. See generally Levitas & Hughes, *Hazardous Waste Issues in Real Estate Transactions*, 38 MERCER L. REV. 581, 637 (1987) (discussing liability limiting lease agreements in the context of the small quantity generator under RCRA).

50. Under CERCLA, an "owner or operator" is defined as any person owning or operating a facility, or:

[I]n the case of any abandoned facility, any person who owned, operated, or otherwise controlled activities at such facility immediately prior to such abandonment. Such term does not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility. 42 U.S.C. § 9601 (20)(A) (1982).

owner.<sup>51</sup> Second, a lender that chooses not to foreclose on contaminated property can still be liable if it exercised sufficient control over the borrower's operations (e.g., as part of a workout or participation loan) to be treated as an owner or operator.<sup>52</sup> Under either theory, a lender may escape liability if its actions are construed or intended primarily to protect its security interest in the property.<sup>53</sup> Because there is limited case law in this area, lending institutions have little guidance as to when foreclosure is considered merely a measure to protect a security interest or to what extent involvement in the borrower's affairs creates liability.

In *United States v. Mirabile*,<sup>54</sup> the court found that a secured creditor must, at a minimum, "participate in the day-to-day operational aspects of the site" before it can be held liable as an owner or operator.<sup>55</sup> In *Mirabile*, the United States sued the property owners for cleanup costs associated with the removal of over 500 drums of hazardous waste.<sup>56</sup> The owners joined the secured creditors, American Bank and Trust Company and Mellon Bank (East) National Association as third party defendants.<sup>57</sup> The banks counterclaimed against the United States relying on the alleged involvement of the Small Business Administration in making loans to the former operators of the site.<sup>58</sup>

The court dismissed the plaintiff's motions for partial summary judgment holding that their respective participation in the site only amounted to financial involvement and was thus insufficient to impose liability upon the secured creditors.<sup>59</sup> The court, how-

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51. *Id.* § 9607(a)(1); *see also* *United States v. Maryland Bank & Trust Co.*, 632 F. Supp 573 (D. Md. 1986).

52. 42 U.S.C. § 9601(20)(A); *United States v. Mirabile*, 15 *Envtl. L. Rep. (Envtl. L. Inst.)* 20994 (E.D. Pa. 1985).

53. 42 U.S.C. § 9601(20)(A).

54. 15 *Envtl. L. Rep. (Envtl. L. Inst.)* 20994 (E.D. Pa. 1985).

55. *Id.* at 20996. The court noted earlier that the difficulty arises "in determining how far a secured creditor may go in protecting its financial interests before it can be said to have acted as an owner or operator within the meaning of the statute." *Id.* at 20995.

56. *Id.* at 20992-93.

57. *Id.* at 20994-95.

58. *Id.*

59. *Id.* American Bank & Trust Co. foreclosed upon the property, and as the highest bidder at the sheriff's sale, it took equitable title to the property. About four months later, the bank assigned its bid to the Mirabiles. In the time between the purchase of the property at the sheriff's sale and the assignment, the bank boarded up windows, changed the locks, made inquiries into disposal costs for the drums located on the property, and visited the property on several occasions to show it to prospective purchasers. The court found that these activities were undertaken merely to protect its security interests in the property, and

ever, denied Mellon's motion for summary judgment, finding that the bank participated in the daily operations of the site through the actions of its loan officer, who "came to the site frequently and insisted on certain manufacturing changes and reassignment of personnel."<sup>60</sup>

The issue of lender liability was again addressed in *United States v. Maryland Bank & Trust Co.*<sup>61</sup> In that case, Maryland Bank & Trust lent money to the owner and operator of a garbage dump site. The bank subsequently loaned money to the purchaser of the site, securing the loan with the property.<sup>62</sup> When the purchaser defaulted on the loan, the bank foreclosed on the property and purchased it at the sheriff's sale. More than a year after the bank had purchased the property, the EPA cleaned the site and sued to recover its costs from Maryland Bank & Trust.<sup>63</sup>

The bank attempted to avoid liability by asserting that its ownership of the property was merely to protect its security interest.<sup>64</sup> The court rejected this argument, stating that Maryland Bank & Trust purchased the property at the foreclosure sale to protect its investment rather than its security interest.<sup>65</sup> The court also distinguished the present case from *Mirabile*, holding that the mortgagee turned owner in *Mirabile* had promptly assigned its interest in the property, whereas Maryland Bank & Trust "held title for

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therefore, the bank never participated in the management of the site. *Id.* at 20996.

The Small Business Administration did not take legal or equitable title to the property or any action regarding the property's day-to-day management. *Id.* at 20997.

60. *Id.*

61. 632 F. Supp. 573 (D. Md. 1986).

62. *Id.* at 575. The original owner allowed the disposal of hazardous wastes on the site. *Id.*

63. *Id.* at 575-76.

64. *Id.* at 577. Maryland Bank & Trust asserted that CERCLA excludes from liability a person who, "without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel. 42 U.S.C. § 9601(20)(A) (1982).

65. *Maryland Bank & Trust*, 632 F. Supp. at 579. The court interpreted the term "indicia of ownership" to protect mortgagees in those states where the common law technically places title in the hands of the mortgagee during the time of the mortgage. Because Maryland Bank & Trust purchased the property at the foreclosure sale, the court concluded that it held full title at the time of the EPA cleanup. *Id.*

The court believed that exempting the mortgagee from liability would convert CERCLA into "an insurance scheme for financial institutions" where the federal government would shoulder the cost of cleanup while the mortgagee-turned-owner would benefit from the cleanup by the increased value in the now unpolluted land. The court suggested that mortgagees could protect themselves adequately by making prudent loans, by investigating and discovering potential problems before making loans, and by avoiding foreclosure. *Id.* at 580.

nearly four years, and a full year before the EPA clean-up."<sup>66</sup>

The issue of lender liability in a foreclosure situation was recently addressed in *United States v. Fleet Factors Corp.*<sup>67</sup> In 1976, Fleet entered into a factoring agreement with Swainsboro Print Works, Inc. Fleet agreed to advance funds against Swainsboro's accounts receivable, with additional collateral provided by Swainsboro's plant and equipment.<sup>68</sup> In 1981, the court declared Swainsboro bankrupt. In 1982, with court permission, Fleet foreclosed on its security interest in inventory and equipment and contracted with Baldwin Industrial Liquidators, Inc. to conduct an auction. Baldwin allegedly removed between 400 and 500 leaking drums of hazardous substances from the sales area before the auction.<sup>69</sup> Fleet subsequently contracted with Nix Riggers to remove the equipment remaining after the auction. During the removal, Nix allegedly disturbed asbestos that was present on the machinery pipes.<sup>70</sup> The government alleged that the actions of Baldwin and Nix created an immediate risk to public health and the environment for which it incurred response costs.<sup>71</sup>

The court held that Fleet was not liable for the period between the beginning of its relationship with Swainsboro in 1976 and the time Baldwin entered the facility. The court reasoned that Fleet's involvement during this period did not rise to a level sufficient to impose CERCLA liability.<sup>72</sup> The court, however, denied the parties' cross motions for summary judgment on the issue of liability arising from Fleet's activities instituted through its putative agents, Baldwin and Nix.<sup>73</sup>

Taken together, these cases constitute a framework within which secured lenders may evaluate their risk of liability under CERCLA. Under *Maryland Bank & Trust*,<sup>74</sup> a lender that forecloses

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66. *Id.* at 579.

67. 29 Env't Rep. Cas. (BNA) 1011 (S.D. Ga. 1989).

68. *Id.* at 1012.

69. *Id.* at 1012-13. Fleet never foreclosed on their security interest in the plant or property. *Id.* at 1013.

70. *Id.*

71. *Id.* at 1015.

72. *Id.* at 1014-15. The court explicitly adopted the *Mirabile* court's reasoning, stating that a secured creditor can "provide financial assistance and general, and even isolated instances of specific, management advice to its debtors without risking CERCLA liability if the secured creditor does not participate in the day-to-day management of the business or facility either before or after the business ceases operation." *Id.* at 1014.

73. *Id.* at 1015.

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

upon its security interest, thereby converting its "indicia of title" into a full title, could be held liable as an owner under CERCLA.<sup>75</sup> However, the *Maryland Bank & Trust* court, in distinguishing *Mirabile*, suggests that a lender that acts promptly to assign its interest may not be liable as an owner or operator.<sup>76</sup>

Under *Mirabile*, a lender that enters into a workout arrangement with the borrower may become liable if it assumes day-to-day control over the operations of the borrower.<sup>77</sup> *Fleet* apparently extends this concept to include the period of control exerted by the lender over assets after a borrower's operations have ceased. Unlike Mellon's action in *Mirabile*, *Fleet* did not participate in the daily affairs of the borrower while the company's operations were ongoing.<sup>78</sup> However, by selling and removing equipment after the borrower has ceased operations, a creditor such as *Fleet* may be moving beyond the bounds of merely protecting its security interest and could be held liable as an owner or operator.<sup>79</sup>

As previously discussed, direct liability is only one of the concerns facing lenders. The timing of the environmental investigation is important both to avoid the problems inherent in a loan secured by contaminated collateral and to allow a reasonable opportunity for invoking the innocent purchaser defense.<sup>80</sup> In any case, an appropriate investigation should be conducted prior to making the loan commitment. Should subsequent events require foreclosure or participation in the borrower's activities, then an appropriate investigation should be made to ensure that the borrower's activities have not altered the status quo respecting environmental liability.

Lenders should also consider including provisions in the loan agreement to protect against potential liability arising from future activities by the borrower. For example, there may be prohibition

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75. *Id.* at 579.

76. *Id.* at 581.

77. 15 *Env'tl. L. Rep. (Env'tl. L. Inst.)* 20994, 20995 (E.D. Pa. 1985).

78. *United States v. Fleet Factors Corp.*, 29 *Env't Rep. Cas. (BNA)* 1011, 1012 (S.D. Ga. 1989) (borrower stopped operations six months prior to the creditors possible involvement with the daily operation of the site).

79. *Id.* at 1014.

80. The innocent purchaser defense creates a dilemma for the secured creditor. To establish the defense, the party must show that it undertook appropriate inquiry "at the time of acquisition." 42 U.S.C. § 9601 (35)(B) (Supp. IV 1986). If the lender has made appropriate inquiry prior to acquiring its security interest, and the property subsequently becomes contaminated or knowledge of contamination becomes evident, then the lender cannot make the statutory showing at the time of foreclosure.

or notification requirements for process changes or use of certain types of chemicals. Such provisions will help protect against the contamination of property and the accompanying depreciation of collateral throughout the life of the loan.

#### 5. Liability in Corporate Mergers, Consolidations and Asset Acquisitions

Corporate mergers and consolidations present a far greater risk of CERCLA liability than an asset acquisition.<sup>81</sup> Under common law, when two corporations merge, liabilities become the responsibility of the surviving company.<sup>82</sup> Similarly, when a new company is created through a consolidation, the debts and liabilities of the constituent companies are assumed by the new company.<sup>83</sup> These principles are equally applicable to liabilities arising under CERCLA and RCRA. Therefore, a surviving corporation will be vulnerable to liability for improper hazardous waste generation, transportation or disposal by its predecessor corporations.<sup>84</sup>

In *Smith Land & Improvement Corp. v. Celotex Corp.*,<sup>85</sup> a successor corporation to a statutory merger was held a proper party to a CERCLA action where the predecessor company had bought land contaminated with asbestos waste.<sup>86</sup> The court stated that although Congress had not specifically dealt with the problem of successor corporation liability in CERCLA, congressional intent was that the "general doctrine of successor liability in operation in most states should guide" the courts in this area.<sup>87</sup>

While the acquisition of corporate assets usually limits a purchaser's liability to occurrences connected to the specific site purchased, courts generally recognize four exceptions where asset acquisitions give rise to general liability: (1) where "the purchaser of assets expressly or impliedly agrees to assume obligations of the transferor;" (2) when "the transaction amounts to a consolidation

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81. See Varnum & Achterman, *Toxic Waste Liability a Risk in Acquisitions*, NAT'L L.J., Oct. 28, 1985, at 15 col. 1.

82. 15 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 7121 (rev. perm. ed. 1983).

83. *Id.* § 7117.

84. See *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86 (3rd Cir. 1988).

85. 851 F.2d 86 (3rd Cir. 1988).

86. *Id.* at 91-92.

87. *Id.* at 92; see also Comment, *Successor Corporate Liability for Improper Disposal of Hazardous Waste*, 7 W. NEW ENG. L. REV. 909 (1985) (discussing congressional intent to create federal common law under CERCLA).

or *de facto* merger;" (3) when "the purchasing corporation is merely a continuation of the transferor corporation;" or (4) when "the transaction is fraudulently entered into to escape liability."<sup>88</sup> The EPA has taken the position that a successor corporation is liable for the acts of its predecessors under a "continuity of business" approach.<sup>89</sup>

From the perspective of avoiding unknown pre-existing environmental liabilities, the buyer is far better off with an asset purchase. In the extreme case, a corporate successor can be found jointly or severally liable for a multimillion dollar cleanup under CERCLA when only a single container from a predecessor company is found at a disposal site slated for cleanup by the EPA. Any past violation of section 6973 of RCRA by a corporate predecessor, which is currently causing imminent and substantial endangerment, can give rise to successor corporation liability.<sup>90</sup> Thus, in the context of either a statutory merger or asset acquisition falling under one of the exceptions above, the past activity of all predecessor companies must be examined thoroughly.

#### B. *Environmental Laws Restricting Purchaser Use*

Without a permit from the appropriate federal or state authority, certain activities such as filling, construction and placement of utility or road crossings in wetlands, subaqueous lands and floodplains are prohibited or may be conducted only in accordance with

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88. Philadelphia Elec. Co. v. Hercules, Inc., 762 F.2d 303, 308-09 (1985) (defendant was a proper party in public and private nuisance action because it expressly agreed to assume the predecessor's liability and because of the theory of *de facto* merger). See also Crawford Harbor Assoc. v. Blake Const. Co., Inc., 661 F. Supp. 880 (E. D. Va. 1987) (discussing the exceptions to limited successor corporation liability under Virginia law).

89. See Memorandum from Courtney M. Price, EPA Assistant Administrator for Enforcement and Compliance Monitoring, *Liability of Corporate Shareholders and Successor Corporations for Abandoned Sites Under CERCLA* (June 13, 1984), cited in Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 91 n.2. (3rd Cir. 1988).

The continuity of business approach to successor liability is discussed in *Crawford*, 661 F. Supp. at 884-85. The factors taken into account are: (1) continuity of management, personnel, physical location, assets, and general business operations; (2) continuity of ownership; (3) prompt cessation of the seller corporation's operations; and (4) assumption by the purchaser of the obligations ordinarily necessary for the uninterrupted continuation of normal business operations of the seller. *But see* New Jersey Dep't of Transp. v. PSC Resources, Inc., 175 N.J. Super. 447, 454, 419 A.2d 1151, 1154 (Super. Ct. Law Div. 1980) (finding a corporate successor liable under the New Jersey Spill Compensation and Control Act even though there was neither a *de jure* merger or a traditional exception under which the successor could be held liable).

90. See 42 U.S.C. § 6973(a) (1982 & Supp. IV 1986).



applicable restrictions and regulatory requirements. The permitting process may be time consuming and often provides adversaries to a project an opportunity to intervene and impose procedural delays. There is also the risk that a permit will be denied, frustrating a project entirely. Therefore, purchasers seeking to develop a parcel of land may decide to conduct a pre-acquisition site assessment to determine whether their project will require federal or state permits or be subject to regulatory restrictions beyond those ordinarily imposed at the local level. A pre-acquisition site assessment is also the appropriate stage to determine whether design changes can be incorporated to avoid regulatory requirements.

### 1. Section 404 of the Clean Water Act<sup>91</sup>

Any dredge and fill activity undertaken in the "waters of the United States" is subject to the jurisdiction of the United States Army Corps of Engineers ("Corps").<sup>92</sup> The definition of "waters" includes all waters which are currently used or were used in the past or may be susceptible to use in interstate and foreign commerce (including all waters subject to the ebb and flow of the tide); all interstate waters including interstate wetlands; all other waters such as intrastate lakes, rivers, streams, etc., the use, degradation, or destruction of which could affect interstate or foreign commerce; all impoundments of waters otherwise defined as waters of the United States; tributaries of waters that are defined by regulation; the territorial seas; and wetlands adjacent to waters defined by regulation.<sup>93</sup> Wetlands are defined as "those areas that are inundated or saturated by surface or ground water at a frequency and duration sufficient to support, and that under normal circumstances do support, a prevalence of vegetation typically adopted for life in saturated soil conditions."<sup>94</sup>

Pursuant to the Clean Water Act, the Corps is responsible for issuing permits for dredge and fill activity involving wetlands.<sup>95</sup> The permit program is overseen by the EPA, which has veto power

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91. 33 U.S.C. §§ 1251-1387 (1986 & Supp. 1988).

92. 33 U.S.C. § 1344 (1982).

93. 33 C.F.R. § 328.3(a) (1988).

94. *Id.* § 328.3(b). The Supreme Court has upheld the Corps' broad interpretation of navigable waters to include wetlands. *United States v. Riverside Bayview Homes*, 474 U.S. 121, 135 (1985).

95. 33 U.S.C. § 1344(a) (1982).

over the Corps' decisions.<sup>96</sup> Before granting a permit, the Corps must also receive certification from the state in which the project is to be located that the discharge will comply with all applicable water quality standards and effluent limitations promulgated by that state.<sup>97</sup>

In deciding whether to grant a permit under section 404, the Corps must determine if there is a "practicable alternative" that would have a less adverse environmental impact and would not require use of wetlands.<sup>98</sup> The Corps' review must take into account "economics, aesthetics, effects on wetlands, historic preservation, fish and wildlife values, effects on flood plains, land use, navigation, recreation, energy needs, and 'in general, the needs and welfare of the people.'"<sup>99</sup> The Corps' review must also include consideration of related federal statutes.<sup>100</sup>

## 2. Transactional Limitations Created by Section 404

For the purchaser and developer of wetlands property, the "alternatives test" imposes a serious handicap of unpredictability on the outcome of the Corps' permitting decision.<sup>101</sup> In recent years, the Corps routinely granted permits based upon the applicant's

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96. *Id.* § 1344(c); see *Newport Galleria Group, Inc. v. Deland*, 618 F. Supp. 1179 (D.D.C. 1985).

97. 33 U.S.C. § 1341 (1982).

98. 40 C.F.R. § 230.10(a) (1988). The Corps may also reject the application for a permit based upon the determination that the proposed discharge will have significant degradation on the wetlands ecosystem. *Id.* § 230.10(c).

99. Steinberg & Dowd, *Economic Considerations in the Section 404 Wetland Permit Process*, 7 VA. J. NAT. RESOURCES L. 277, 282 (1988) (summarizing 33 C.F.R. § 320.4(a)(1) (1988)).

100. The statutes that must be taken into account when the Corps conducts a permit pursuant to 33 U.S.C. § 1344 are listed at 33 C.F.R. § 320.3. They include:

- a) National Environmental Policy Act of 1969 (NEPA), 42 U.S.C. §§ 4321-4347, 4361-4370 (1982 & Supp. IV 1986);
- b) Fish and Wildlife Act of 1956, 16 U.S.C. §§ 742(a)-(j)(2) (1982 & Supp. II 1986);
- c) Migratory Marine Game-Fish Act, 16 U.S.C. §§ 760(c)-(g) (1982);
- d) Fish and Wildlife Coordination Act, 16 U.S.C. §§ 661-666(c) (1982);
- e) National Historic Preservation Act of 1966, 16 U.S.C. § 470 (1982);
- f) Interstate Land Sales Full Disclosure Act, 15 U.S.C. §§ 1701-1720 (1982 & Supp. IV 1986);
- g) Endangered Species Act, 16 U.S.C. §§ 1531-1543 (1982 & Supp. IV 1986).

It is apparent from this extensive list that the application for a dredge and fill permit creates multiple opportunities for a development project to be impeded or stopped if other federal environmental statutes are involved.

101. See Tripp & Herz, *Wetland Preservation and Restoration: Changing Federal Priorities*, 7 VA. J. NAT. RESOURCES L. 221, 241 (1988).

own statement of purpose and analysis of alternatives.<sup>102</sup> However, the EPA has become much more active in the permitting process, independently assessing alternatives and exercising its veto powers over the Corps.<sup>103</sup>

Other factors facing the developer of property containing wetland areas are the time involved in obtaining a permit and the potential for unforeseen expenses due to the cost of mitigation required by EPA policy.<sup>104</sup> In *Bersani v. Robichaud*, the developer filed an application for a dredge and fill permit in August of 1984. After almost four years of administrative and judicial deliberation, the Corps finally denied the permit in March of 1988.<sup>105</sup>

The determination of whether to develop a target property containing wetlands should be made early in the planning of the project. The developer should investigate the existence of alternatives before investing in a wetlands site. As in *Bersani*, the project may be denied a permit for the developer's failure to review alternatives prior to acquisition.<sup>106</sup> Furthermore, purchasing the property and then undertaking a time consuming analysis of alternatives with the Corps and the EPA, ties up capital in property the owner cannot utilize. In the meantime, other investment opportunities may be lost due to the unavailability of funds. The purchaser should also consider the added costs of a protracted permit procedure and construction of new wetlands for mitigation purposes.

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102. See, e.g., *Korteweg v. Corps of Eng'rs*, 650 F. Supp. 603 (D. Conn. 1986).

103. See, e.g., *Bersani v. Robichaud*, 850 F.2d 36, 38 (2d Cir. 1988).

104. The EPA has a policy of "no net wetlands loss." Therefore developers who fill wetland areas for their project will often be required to mitigate this loss by constructing new wetland areas.

Mitigation measures include "minimizing, rectifying, reducing, or compensating for resource losses." 33 C.F.R. § 320.4 (r)(1) (1988). Mitigation can include the construction of artificial wetlands. See *Bersani v. Environmental Protection Agency*, 674 F. Supp. 405, 410-11 (N.D.N.Y., 1987), *aff'd* 850 F.2d 36 (2d Cir. 1988) (discussing the construction of artificial wetlands in a nearby gravel pit).

Courts can also order a party who fills wetlands without a permit to restore the environment to a condition approximating its natural state. See *United States v. Weisman*, 489 F. Supp. 1331 (M.D. Fla. 1980). See generally Comment, *Restoration of Wetlands Under Section 404 of the Clean Water Act: An Analytical Synthesis of Statutory and Case Law Principles*, 15 B.C. ENVTL. AFF. L. REV. 295 (1988).

105. *Bersani*, 850 F.2d at 38, 41.

106. *Id.* at 39.

#### IV. THE ENVIRONMENTAL INVESTIGATION: AN OVERVIEW

As the preceding discussion reveals, environmental concerns figure in many commonly encountered corporate and real property transactions. Environmental regulations may result in unanticipated liability for a purchaser, loss of collateral by a lender, and frustration of plans to use and develop property. In any situation involving ownership, possession or control of real property, or a business entity changing ownership, an appropriate environmental investigation should be part of the transaction.

Every transaction does not need to be preceded by a full-scale environmental audit. However, the parties should give adequate consideration to environmental issues that reasonably can be expected in the context of their particular transaction. The agreement of the parties should be adequate to address those issues, and above all, they should incorporate their consideration of environmental factors at a point sufficiently early in their deliberations to allow for an appropriate response. As a general proposition, the contract should provide specifically for such items as: the time allowed for the investigation; responsibility for providing information (e.g., records, access to knowledgeable personnel); access to premises; and responsibility for costs and provisions for dealing with contingencies (e.g., delay of closing if further investigation is found necessary).<sup>107</sup>

In a growing number of transactions, an environmental investigation may be required. Lenders, for example, will often insist on an investigation and opinion of counsel prior to loan commitment. In several states, but not Virginia, investigation is required by statute prior to certain property transfers.<sup>108</sup> Regardless of statutory mandate, the investigation is desirable for several reasons. Providing information about the property at the time of the transaction may aid the purchaser if the "innocent purchaser" defense must be invoked under CERCLA.<sup>109</sup> An investigation will allow the seller to establish a defense against liability in the event future activities

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107. If factors such as time or cost preclude an appropriate investigation, the contract should incorporate adequate provisions reflecting these reasons. Such a provision can protect the seller, for example, in a case where the purchaser chooses to forego an investigation prior to closing, and contamination is later discovered on the property.

108. *See, e.g.*, N.J. Stat. Ann. § 13: 1K-9 and -11 (Cum. Annual Pocket Part 1989).

109. Even though the investigation proves adequate to invoke the defense, the purchaser may still suffer considerable financial loss if the property should later prove to be contaminated and incapable of being developed or sold without cleanup.

result in contamination. Furthermore, an investigation will enable the attorney to determine which regulatory requirements apply to the operation and whether the current operation is in compliance with the regulations, and to make timely arrangements for transfer or reissuance of necessary permits. Finally, an investigation will supply the information necessary to protect the interests of the parties in the context of the transaction.<sup>110</sup>

In practice, an environmental investigation is typically divided into two phases. Phase I, which is essential to any investigation, consists of obtaining information about the site or facility by means of documents, interviews, site visits and other similar sources.<sup>111</sup>

Phase II consists of sampling and analyzing soil, groundwater, air, waste water and waste materials, and building components. A

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110. For example, the purchaser may wish to acquire the property regardless of environmental problems. Adequate knowledge of conditions existing at the time of sale enables the seller to protect himself from liability for future activities by the purchaser, assists the parties in the allocation of costs and responsibilities for site conditions, and allows the parties to incorporate language accurately reflecting their intentions.

111. The Phase I investigation includes the following:

1. Prior ownership and uses of the property;
2. Materials used or stored at the site;
3. Waste treatment processes;
4. Wastes generated (past and present) and their disposition;
5. Permits and other regulatory requirements applicable to the property and conditions affecting transferability;
6. Compliance with permit requirements, enforcement history, past and/or outstanding violations and their status or disposition, and regulatory investigations;
7. Compliance with record keeping, monitoring and reporting requirements;
8. Upcoming changes to permits or other regulatory conditions applicable to the facility;
9. Complaints, oil spills, chemical releases, and similar incidents;
10. Presence and condition of underground storage tanks and the contents of such tanks;
11. Information about building components (e.g., presence and condition of materials containing asbestos, contents of transformers, and capacitors that may contain polychlorinated biphenyls ("PCBs"));
12. Past or current practices or operations that may warrant close scrutiny as possible sources of contamination (e.g., fueling areas, machine shops, vehicle maintenance facilities, chemical storage, abandoned buildings, waste disposal areas, and uncontrolled access routes that may have resulted in unauthorized dumping);
13. Evidence that may indicate contamination or factors affecting the future development of the property. Examples include areas of disturbed or discolored soil, evidence of debris, construction rubble or other waste materials on the surface, blighted vegetation, filled-in or highly eroded areas, streams, marshes, ponds or other bodies of water;
14. Status of the site with regard to programs for protection of historic resources, endangered species, scenic rivers, and the like.

Phase II investigation is far more expensive and time consuming than a Phase I investigation. The Phase II investigation may not be necessary unless the nature of the site or adjacent properties or the results of the Phase I investigation indicate otherwise. Lenders may nonetheless require a Phase II study out of an abundance of caution.

The Phase I investigation varies widely in scope and complexity. Obviously, a manufacturing facility will require a more extensive review than an office building, a fast food store, or a vacant tract. Nonetheless, the investigation must be adequate to disclose necessary information. An office building may contain asbestos or transformers filled with polychlorinated biphenyls. A fast food store may harbor a leaking underground gasoline tank. A vacant tract may contain an undiscovered waste dump or incorporate wetlands subject to federal jurisdiction. The extent of the Phase I study should not be based on assumptions derived from the subject of the transaction, but should proceed from a desire to avoid the consequences of incorrect assumptions. It cannot be overemphasized that the scope of any investigation should be determined by a person or persons with sufficient knowledge to understand the nature of the property being acquired and the problems that may be encountered. Responsibility for discrete portions of the review should be given to persons who are knowledgeable in the area of environmental investigation and audit. Thus, an outside consultant may be required.

## V. SOURCES OF INFORMATION FOR THE PHASE I INVESTIGATION

A Phase I investigation consists of two components: (1) information review and (2) site inspection. The extent, availability and usefulness of information will vary depending on the subject, its present uses, and past history. This information can be obtained from the federal and state government.<sup>112</sup>

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112. Agencies from which information can be obtained include:

A. *Federal*

1. U.S. Environmental Protection Agency, Region III, 841 Chestnut Street, Philadelphia, Pennsylvania 19107, (215) 597-9815 (CERCLA list; National Priorities List; enforcement actions and investigations).
2. U.S. Army Corps of Engineers, Information Management, Casimir Pulaski Building, 22 Massachusetts Avenue, N.W., Washington, D. C. 20314, (202) 272-0273 (wetlands information; enforcement and investigations pursuant to dredge and fill permit requirements of section 404 of the Federal Water Pollution Control Act, 33 U.S.C. § 1344 (1982)).

## A. *Sources of Information*

### 1. Title and Tax Records

Title and tax records disclose useful information about prior ownership and uses of the property. Identification of prior owners is useful to obtain information from local or state governmental agencies about permits, licenses, and other documents that may indicate previous uses.

### 2. State Agency Records

If a facility requires a permit, state agencies may possess information about the site's history and its present status. Agency files contain documentation of past violations or complaints, investigations, permit transfers from prior owners, and information about

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3. U.S. Fish & Wildlife Service, Department of the Interior, C Street between 18th & 19th Streets, Washington, D. C. 20240, (202) 343-1100 (national wetlands inventory and endangered species information).

#### B. *State*

1. Department of Waste Management, Monroe Building, Richmond, Virginia 23219, (804) 225-2667 (hazardous waste management reports and other hazardous waste information, SARA Title III information; CERCLA List and information, site investigations and assessments, National Priorities List, solid waste information, permits, and enforcement actions and investigations).

2. State Air Pollution Control Board, P.O. Box 10089, Richmond, Virginia 23240, (804) 786-6035 (permit requirements, enforcement action, investigations and regulations concerning air quality; status of area with respect to Clean Air Act attainment).

3. State Water Control Board, P.O. Box 11430, Richmond, Virginia 23230, (804) 367-0056 (surface and groundwater permit requirements, enforcement and investigations regarding National Pollutant Discharge Elimination System pursuant to 33 U.S.C. § 1342 (1982) and Virginia Pollution Abatement Program, discharge monitoring reports, groundwater standards and investigations, water quality standards and data, underground storage tank notification, fish kill and oil spill investigations, and State Certification requirements for federal license required by 33 U.S.C. § 1341 (1982)).

4. Virginia Marine Resources Commission (compliance with standards respecting wetlands, dune and subaqueous permits).

5. Department of Conservation and Historic Development, Division of Historic Landmarks, State Historic Preservation Officer, 221 Governor Street, Richmond, Virginia 23219, (804) 786-3143 (information concerning listing or eligibility for listing of sites or areas under National Historic Preservation Act).

6. Department of Health, Toxic Substances Information Agency, James Madison Building, 109 Governor St., Richmond, Virginia 23219, (804) 786-1763 (reports on chemical use submitted by commercial establishments under the Virginia Toxic Substance Information Act, VA. CODE ANN. § 32.1-239 to -245 (Repl. Vol. 1985 & Cum. Supp. 1988)).

7. Virginia Department of Transportation, 1221 East Broad Street, Richmond, Virginia 23219, (804) 786-2575 (aerial photographs).

present uses of the site. They will disclose the current terms of permits in force, the expiration dates and compliance status, any outstanding enforcement actions or ongoing investigations, and obligations that the facility may be under to upgrade its capabilities. Assuming that the facility is in compliance, state agency records provide useful information such as the transferability of permits, the amount of time necessary for permit transfer (useful to determine at the contract negotiation stage), and any current or pending regulations or regulatory changes that may affect the requirements applicable to the facility.

Other useful information available from state agencies includes: aerial photographs of the site, records and reports about hazardous waste generation and the disposition of wastes generated at the facility, a list of sites suspected of hazardous waste contamination, notification of underground storage tanks, and records of oil spills and fish kill investigations. State agencies can also provide information about whether the site is listed on, eligible for or under consideration for inclusion in the National Register of Historic Places or included in a Historic District.

Federal agency records may indicate whether the area is included in the National Wetlands Inventory;<sup>113</sup> designated as or under consideration as an endangered species habitat; subject to a federal cleanup order, enforcement action, or lien under CERCLA; incorporated in the list of sites suspected of hazardous waste contamination; or the subject of any enforcement action or investigation for environmental violations.

### 3. Transferor's Records

The current property owner is expected to provide all relevant data in his possession that will assist in the investigation. These may include internal reports or reports submitted pursuant to regulatory requirements; site plans, maps, and aerial photos and schematics; information compiled in accordance with SARA Title

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113. The National Wetlands Inventory is compiled by the United States Fish and Wildlife Service and can be obtained by writing the agency: Monroe Building, Suite 101, 9720 Executive Center Drive, St. Petersburg, Florida 33702. Lack of inclusion in the National Wetlands Inventory is not conclusive of federal jurisdiction under § 404 of the Clean Water Act. 33 U.S.C. § 1344 (1982). See *United States v. Riverside Bayview Homes*, 474 U.S. 121 (1985) (discussing the broad jurisdiction of the Corps and the EPA under § 404 of the Clean Water Act).



III requirements<sup>114</sup> or, in Virginia, submitted under the Toxic Substances Information Act,<sup>115</sup> surface and groundwater monitoring data; discharge monitoring reports submitted in accordance with National Pollutant Discharge Elimination System ("NPDES")<sup>116</sup> permit requirements; records of environmental inspections or audits; manifests and other records of hazardous waste management; locations and data concerning underground storage tanks and waste disposal areas; permit applications and supporting data; effluent studies and evaluations; in-stream water quality data; records of asbestos inspections; records concerning compliance with fire protection requirements for PCB transformers; correspondence with state and local agencies having jurisdiction; any activities conducted pursuant to agency directive or enforcement action; and cleanup activities and any pending or threatened action by public or private entities for environmental violations or claims.

Surrounding property owners, former owners and former industry employees may be able to provide information about a possible history of environmental problems or incidents at the site.

#### B. *Site Inspection*

A site inspection should be conducted as part of the Phase I review, preferably after review of available documents. The extent of the site investigation will be determined to a large degree by the nature of the site and the information disclosed by the document review. However, lack of documentation does not justify a cursory site review because when documentation is sparse, a site review becomes even more important. Illegal dumping activity on vacant property is an example of a potentially serious problem that is unlikely to be documented in the seller's records. Activities conducted on a site before the advent of record keeping requirements<sup>117</sup> or activities on adjoining properties, may also be the

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114. 42 U.S.C. §§ 11001-50 (Supp. IV 1986). An owner or operator of a facility that handles toxic substances must file Material Safety Data Sheets, Emergency and Hazardous Chemical Inventory forms, and Toxic Chemical Release Forms. *Id.* §§ 11021-23.

115. Virginia Toxic Substance Information Act, VA. CODE ANN. §§ 32.1-239 to -245 (Repl. Vol. 1985 & Cum. Supp. 1988).

116. Under the Clean Water Act, state discharge elimination systems must meet state approval. If the state has no such program, the EPA will enforce a system in obtaining an NPDES permit, the states must consider and enforce all applicable effluent limitations established by the Clean Water Act. 33 U.S.C. § 1342 (1982). *See generally* 1 F. GRAD. TREATISE ON ENVIRONMENTAL LAW 3-221 (1988).

117. Records of hazardous waste disposal were not required by federal or Virginia law

source of unwanted surprise. The determination of wetlands subject to federal jurisdiction may require on-site evaluation by a specialist. Unless the property has been previously evaluated for that purpose, it is unlikely that documentation will exist.

Although some problems may be obvious, the site inspection should be conducted by a person or persons with sufficient expertise and objectivity to perform an adequate evaluation. Where the investigation involves several different areas (e.g., a manufacturing facility, the surrounding property, and the waste treatment facilities), care should be taken to ensure that the appropriate persons are assigned to each area. The cost of a consultant is usually small compared to the potential for liability or loss inherent in an inadequate inspection.<sup>118</sup>

The Phase II investigation should be considered if warranted by information gathered during Phase I, assuming that the parties still want to proceed with the transaction. It is important to note that the Phase I investigation cannot establish an absence of contamination. It can only provide information to assist in determining whether, under the particular circumstances, further investigation is necessary. Phase II investigation involves sampling and analysis of soils, groundwater, and possibly other media. Costs will be commensurate with the degree of effort, the turnaround time, the number of analyses and the difficulty of obtaining samples. If time permits, it is advisable to obtain at least two estimates, and the consultant's records and qualifications should always be checked. If a Phase II investigation is necessary, time will be required to hire a consultant, design the study and perform sampling and analyses. Delay of the closing may be necessary, and the contract should provide for this possibility. The contract should also make provisions for bearing the cost of the study in the event that the parties decide not to proceed with the closing.

Finally, it is important to remember that unreported releases discovered previously during the Phase I or Phase II investigation may be subject to mandatory reporting requirements under fed-

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until late 1980. See 42 U.S.C. §§ 6901-91 (1982 & Supp. II 1984). Although CERCLA required a "one-time" disclosure of prior disposal, absence of such disclosure is not conclusive of a particular site's condition. 42 U.S.C. § 9603(c) (1982).

118. Checklists of items to be looked for in a typical inspection can be found in J. MACHLIN & T. YOUNG, *supra* note 18, § 18.02; DeMeester, *Practical Guidance for Due Diligence Environmental Auditing*, 18 *Env'tl. L. Rep.* (Env'tl. L. Inst.) 10210 (1988).

eral<sup>119</sup> or state law.<sup>120</sup> Failure to report may subject the owner and possibly the purchaser to severe penalties and liability. The parties should make provisions for this possibility in their discussions prior to commencement of the investigation.

## VI. CONCLUSION

Environmental concerns are not confined to major new developments in pristine areas, but are present in a variety of corporate and real property transactions. Purchasers may acquire unforeseen liability, sellers can retain liability after the conclusion of a transaction and lenders may unwittingly assure liability or lose the value of their collateral. Environmental regulations may also restrict or frustrate plans to develop property. Therefore, an early awareness of potential liability and limitations created by environmental laws and regulations is essential to most significant corporate and real property transactions.

The environmental investigation is an effective tool for identifying and responding to potential environmental liability and restrictions. There are numerous sources of information available to evaluate the environmental risks involved in a real property transactions, including state and federal agencies and inspections of the property itself. By gathering information early enough through an environmental investigation, the parties can make knowledgeable decisions regarding the structure of a transaction. In addition, the risk of environmental liability may be avoided or at least allocated by the parties. The pre-transaction environmental review should be an integral part of every significant transaction involving real property or corporate control.

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119. *See, e.g.*, 42 U.S.C. § 9603 (1982 & Supp. IV 1986).

120. *See, e.g.*, VA. CODE ANN. § 62.1-44.34:4 (Repl. Vol. 1987).