and prior use of commercial and industrial properties in Southern California, including the region’s numerous and vast oil fields (and related operations like refineries, tank farms, and gas stations), the aerospace industry, metal plating operations, circuit board manufacturing, and defense-related operations and manufacturing, means that contaminated sites are often the rule here, not the exception. Few commercial or industrial properties—including manufacturers, dry cleaners, hospitals, gas stations, office buildings, and even undeveloped properties—are immune from being impacted by contamination whether from an on-site or off-site source. At the same time, federal and state environmental statutes have broad reach, covering past and present owners of contaminated real property, as well as lessors, lessees, and operators.

The potential, and often actual, liabilities involving contaminated properties, while sometimes not obvious, can result in tremendous cleanup costs, long delays in the property’s reuse or development, decreased value or use of the property, and claims from employees, lessees, and adjacent property owners. A prime example of such damages and liabilities can and often have resulted from a dry cleaner shop that is part of a strip mall. Long-term operational spills or leaks of the chemicals often used in the dry cleaning process can migrate into the soil and groundwater, spreading throughout the property and onto adjacent properties. This can result in expensive site assessment and remediation costs as well as expose the operator of the business and the property owner to toxic tort claims from individuals—including employees—who allege adverse impacts from the chemical vapors. Such contamination can also adversely impact the value and marketability of the parcel on which the dry cleaner store is located. Thus, it is incumbent to recognize the environmental liabilities that may arise in purchasing, selling, developing, and leasing real property, and to develop a strategy to avoid, or at least minimize, these liabilities.

Thorough due diligence is essential in any real estate transaction. Many sources exist to obtain information and documentation on the environmental condition and history of a given property. These include Internet-accessible databases like the State Regional Water Resources Control Board’s GeoTracker database that tracks and archives compliance data on waste discharges to land and groundwater and releases of hazardous substances from underground storage tanks. EnviroStor, the California Department of Toxic Substances Control’s (DTSC) data management system, tracks DTSC cleanup, permitting, enforcement, and investigative actions into hazardous waste facilities and sites with known contamination. Aerial photographs may also help reveal evidence of past operations or spills. Phase I environmental reports that the current or prior owner, operator, or lessee may have had prepared are another source. A Phase I Environmental Site Assessment is designed to identify recognized environmental conditions based upon a review of available public records, interviews and visual inspections but

Gary A. Meyer is a principal of the law firm of Parker, Milliken, Clark, O’Hara & Samuelian and the founding chair of his firm’s environmental law department. He was recently selected as Environmental Attorney of the Year by the Los Angeles Business Journal.

REAL ESTATE LAW ISSUE

MCLE ARTICLE AND SELF-ASSESSMENT TEST

By reading this article and answering the accompanying test questions, you can earn one MCLE credit.

To apply for credit, please follow the instructions on the test answer sheet on page 29.
Because contamination does not respect property boundaries, it is also prudent to obtain information about the environmental condition of adjacent properties through GeoTracker, EnviroStor, or other sources. For example, if a neighboring site has a soil or groundwater problem, it is valuable to know if this contamination may have migrated onto or under the subject site. This contamination may have numerous impacts on a client’s property, including groundwater contamination flowing toward the property or soil vapor contamination arising from the subsurface into buildings, thus posing a potential health threat.

Site Testing

A prospective buyer, lessee, or developer should consider conducting tests on the property. The nature and scope of environmental testing will depend on many variables, including the buyer’s willingness to incur this expense, an owner’s cooperation in allowing the testing, and the parties’ negotiation on the time granted for this investigation. Generally, conducting and completing environmental due diligence testing exceeds initial estimates. Accordingly, parties are advised to allow a sufficient due diligence period and provide options to extend the closing date so the buyer may thoroughly evaluate the test data and conduct further testing as needed. Assuming the owner permits a buyer, lessee, or developer to proceed with an environmental investigation, several important factors must be determined and evaluated.

First, what are the types and characteristics of contaminants impacting the property? Are these impacts limited to the soil or does it extend to indoor air or groundwater or both? A buyer may encounter a vast range of contamination conditions from those that are manageable as to time and money to those that are long-term, high risk, and expensive to remediate. For example, environmental agencies often consider soil contaminated by low levels of total petroleum hydrocarbons (i.e., gasoline-related contamination) as posing a “low threat” to human health and the environment; therefore, these agencies are usually amenable to relatively inexpensive remedial options such as natural attenuation, excavation, and soil vapor extraction. By contrast, chlorinated solvents such as tetrachloroethylene (PCE) or trichloroethylene (TCE)—chemicals commonly associated with dry cleaners, circuit board production, and metal plating operations—often result in contamination to soil, soil vapor, and groundwater. Remediation of solvent contamination often takes several years, is very expensive, and may pose health risks to on-site employees due to soil vapors migrating onto the property or the indoor air of on-site buildings or both. Accordingly, a determination that property is “contaminated” is a wholly insufficient evaluation of its environmental condition. Knowledge and understanding of the chemicals impacting the property, the media (i.e., soil, soil vapor, air, or groundwater) which may be or is affected, the cost and time of remediation options, and the health risk factors to on-site employees or off-site neighbors are important factors to be considered.

Second, integral to determining what chemicals may be present on the property is learning the nature and extent of both past and current operations conducted on it. “Out of sight, out of mind” is not a good strategy. This investigation should include evaluating if there were or still are any subsurface “buried treasures” at the property. Underground structures such as tanks, sumps, clarifiers, and their attendant piping that were or are on-site must be identified. Were any underground structures abandoned in place or were they removed? What chemicals—gasoline products or potentially more problematic solvents—were stored or used in these tanks? Does documentation exist, e.g., disposal records or removal permits? An investigation of environmental operations, both those conducted below and above ground, must be made. Did the facility have storage areas, whether inside the building or out in the “back forty” near a fence line, where drums or other waste products may have been stored? Are there indicia of past spillage from drums or leaks from vehicles such as forklifts that may have been operated on-site? Is there evidence of chemical releases from or near the site’s manufacturing areas or equipment? Is there any evidence of past fires or flooding that may have caused or exacerbated an environmental condition?

Examining the building itself is sometimes overlooked in investigations. When dealing with older, pre-1980 buildings, testing for asbestos-containing building materials (ACMs) should be done in the roof, ceiling, flooring, dry wall, or insulation areas. Any ACMs in good condition should not pose a problem but those in poor condition can cause exposure to friable asbestos, especially during remodeling, building construction, or demolition. All ACMs require special handling when being removed from the property. Older buildings may also contain other potentially hazardous materials or chemicals like lead or polychlorinated biphenyls (PCBs) that will require similar treatment.

Third, agency actions relating to the property must be researched. Has the local regional water quality control board, the DTSC, the South Coast Air Quality Management District, a local hazardous material agency, a certified unified program agency, or the U.S. Environmental Protection Agency (EPA) been involved with the site by issuing a permit, a cleanup and abatement or compliance order, or notice of violation? Has a closure or no further action letter been issued regarding the property? The issuance of either letter is beneficial but the scope and protection offered by it must also be evaluated and completely understood. Some prospective buyers may incorrectly assume that a closure letter necessarily covers the entire site and, thus, no further environmental due diligence is required. This assumption can be a big mistake because a closure letter may only apply to one aspect of a past operation like underground tanks but may not cover others with different environmental implications at other locations on the property.

Alternatively, a closure letter may only apply to soil contamination and not groundwater contamination. Further, a letter issued by a local agency may not be recognized by a state agency that has taken over as the site’s lead agency. Also, most closure letters contain “re-opener” language allowing an agency to seek more testing or additional remediation if new information becomes available or if cleanup standards applicable to the relevant contaminants change. For example, because of the recent focus by many agencies on vapor intrusion inside buildings, which results from volatile chemicals emitting gases upward from below surface soil or groundwater, it is now not uncommon for a closure letter to be reopened by an agency to require testing for indoor vapor intrusion.

A thorough environmental assessment should include establishing a baseline of a property’s contamination levels before a transaction closes. Important risk and liability allocations can often depend on this environmental baseline. For example, if a lessee demonstrates through a baseline report that it never used a certain chemical or product in its operations that has now become the focus of an environmental investigation or cleanup order, the lessee may avoid liability to the government or a third party seeking redress due to a chemical used by the lessee’s predecessor. Similarly, a former owner may be able to rely on an environmental baseline report as evidence that that owner never handled a chemical that is now the subject of a cleanup order or lawsuit by an adjacent
1. Contaminated sites throughout Southern California are primarily a result of the pervasiveness of gas stations in the region.
True. False.

2. Federal and state environmental statutes can hold responsible current owners, past owners, lessees, and operators.
True. False.

3. Environmental agencies such as the California State Regional Water Quality Control Board do not make accessible online database information about contaminated sites they regulate.
True. False.

4. A Phase I report identifies environmental conditions and also includes site sampling for contaminants.
True. False.

5. A seller of property is obligated to allow a prospective buyer to conduct site testing for contamination.
True. False.

6. It is more likely for petroleum-related contamination to be determined to pose a low threat to human health than contamination from chlorinated solvents.
True. False.

7. Operations that use PCE or TCE, e.g., dry cleaners, can often result in contamination to soil, soil vapor, and groundwater.
True. False.

8. When considering the purchase of a commercial or industrial building, it is not necessary to inspect any of the building materials themselves for potentially hazardous materials.
True. False.

9. A closure or no further action letter may be “reopened” by an agency.
True. False.

10. The recent focus of environmental agencies on the issue of indoor vapor intrusion has led to closed sites being reopened for further testing.
True. False.

11. Allowing for preclose environmental testing by the prospective buyer is always a good idea for the seller because it will help to close the transaction.
True. False.

12. It is prudent for a seller and buyer to enter into a site access agreement before a buyer conducts testing on the seller’s property.
True. False.

13. Environmental indemnifications between a buyer and seller can be tailored as to scope of time and specific contaminants and chemicals that are included or excluded within the indemnification.
True. False.

14. Insurance policies from the early 1980s are no more valuable than recent policies with regard to providing protection from environmental claims.
True. False.

15. It is a good idea for an owner to conduct an environmental prescreen of a prospective tenant’s operation and chemical usage because an owner may be held liable for its tenant’s contamination.
True. False.

16. It is prudent for a lessor to establish an environmental baseline of the condition of its property and past chemical usage before the commencement of a lease.
True. False.

17. Certain environmental agencies offer a cost oversite agreement whereby an owner can have the agency review and approve its remediation plans for a cost.
True. False.

18. Cleanup standards do not vary between commercial uses and residential or school uses.
True. False.

19. If a seller is aware of its property’s contamination, it need not disclose it to the buyer if the deal is an “as-is” transaction.
True. False.

20. The California Land Reuse and Revitalization Act provides bona fide purchasers and innocent landowners a process to conduct site assessment and implement a cleanup action in exchange for being provided with governmental immunity against agency action.
True. False.
landowner. Thus, in litigation among various parties (i.e., between and among past and current owners and operators) involving the allocation of responsibility for cleanup costs, a strong defense can often turn on a party’s ability to produce evidence that during its ownership or operation it did not use those chemicals that caused the contamination. Detailed record-keeping and past environmental reports can be an important part of such an evidentiary showing.

**Owner/Seller Perspective**

An owner of contaminated property has certain options to limit its liability when selling or leasing the property. A buyer will likely want to do a thorough environmental investigation, including conducting on-site testing of the soils or groundwater or both. The owner has the right and discretion to allow or disallow this request. If prior testing has already been conducted, the owner may ask the buyer to rely on that test data by providing a copy of the existing environmental report or other documentation in the owner’s possession. Indeed, even in an “as is” transaction, an owner who knows or has reasonable cause to believe hazardous substances have been released on its property may be obligated statutorily to disclose this condition to the buyer.13

Allowing the prospective buyer to conduct testing has both rewards and risks. The former is new test data that may be obtained showing no new or unforeseen contamination. In turn, this new data becomes an important part of the property’s environmental baseline. In addition, the baseline may enable the seller to refute future claims that erroneously allege certain contamination existed when the transaction occurred. Perhaps most beneficial of all, allowing the buyer to conduct preclosing testing provides an incentive to move forward with the transaction. In contrast, a risk of permitting preclosing testing is that additional contamination will be discovered, resulting in the buyer’s seeking to reduce the purchase price or terminating the deal altogether. Also, the owner may then face the prospect of incurring unanticipated cleanup costs for a property that has now become less valuable or even unmarketable. Finally, the owner will have to disclose this new contamination information to the next buyer.

If an owner permits preclosing testing, a well-drafted access agreement is beneficial. An access agreement can allocate liability to the buyer for damage caused by its testing, including exacerbating any existing environmental conditions. Second, the buyer must return the property to its pretesting condition. Third, the buyer must engage an environmental consultant who is experienced in these investigations and holds any required licenses while maintaining certain mutually agreed upon insurance coverage. The owner should request to be named as an additional insured and that the consultant’s insurance coverage not be limited to the cost of the subject testing. Fourth, the owner may want to request splits of the testing samples to decide whether to retain its own environmental consultant to check the test data for any discrepancies or false positives. Alternatively, the owner may request that the buyer conduct the testing and ask the buyer not to share the test results with the owner so the latter remains unaware of facts that it would have to later disclose to other prospective buyers if the transaction does not close. Further, the owner should also carefully review and approve the scope of testing being requested by buyer. Subsurface testing may be viewed as overly intrusive (i.e., inside the building or underneath the building’s foundation or surrounding property). Also, a reasonable deadline by when the buyer must complete testing needs to be set. Test results can be inconclusive thus leading to requests for more testing. One consideration to mitigate time delays and test result uncertainty is to ask the buyer to make agreed upon nonrefundable payments for due diligence time extensions or for other inconveniences or delays due to preclosing testing.

**Mitigation Strategies**

An owner also has other risk mitigation strategies that can be followed. On one end of the spectrum, the seller can market the transaction as is and request the buyer indemnify the owner for any new contamination caused by the buyer or its successors after they take possession of the property. An as-is transaction, however, will likely result in the buyer’s getting a less-than-market-value purchase price offer because the buyer is assuming the risk if the property is contaminated. Although an as-is transaction for contaminated properties is the exception, it should not be summarily ruled out under the right circumstances. For example, a sophisticated buyer may want a contaminated site due to its location, size, infrastructure, or other factors and will have the resources to make a reasonably accurate evaluation of the property’s environmental condition and, thus, may be willing to assume certain risks in obtaining that site.

In lieu of an as-is deal, the owner may seek to minimize future liability by negotiating that the indemnification provided to the buyer be restricted in scope or by time or restricted to a certain dollar amount. Indemnification can be tailored so if an environmental claim arises within five years of the closing date, the owner would bear the entire responsibility for any claims or losses. However, the owner’s liability could be reduced, for example, to 75 percent at seven years and then to 50 percent at 10 years, and so on. If—based on the property’s environmental baseline report prepared during the transaction—it is determined the owner’s operations only included contaminants referred to as “heavy metals” such as lead, nickel, copper, or cadmium, indemnification may be limited only to cover future claims related to those contaminants. In lieu of a complete indemnity, an owner can offer to assign its rights under any comprehensive general liability insurance policies that the owner held during its ownership if a third party claim later materialized. This could be especially favorable to a buyer for policies from 1986 or before since these policies did not contain the absolute pollution exclusion language that is included in more recent policies. An insurance assignment can be offered as an alternative to other monetary concessions that the seller may otherwise need to provide to the buyer. Similarly, an owner may offer to assign its rights to claims it may have against prior property owners or operators in the chain of title. This assignment of an owner’s insurance rights or its claims against its predecessors can replace offering more stringent indemnification language to the buyer.

If the buyer’s plan to redevelop the property includes excavating for subterranean parking in areas in which there is known contamination, the owner may consider an agreement whereby its responsibility is limited to the incremental costs the buyer incurs in treating, remediating, handling, transporting, and disposing of the contaminated soil or groundwater. This limits seller’s future costs to the differential between the cost of excavating and handling, including treating, remediating, transporting, and disposing of, contaminated materials and the cost that the buyer would otherwise incur for excavating and handling the same materials if not contaminated. This is an equitable allocation formula for both buyer and seller.

**Lessors’ Minimization Strategies**

A lessor of commercial or industrial property must become fully aware of the business operations that a prospective tenant or its subtenants intend to conduct, espe-
cially their potential environmental impacts. The tenant should be asked if its business uses or generates hazardous waste as a by-product of its operations. Will the tenant use or install underground storage tanks on the property or emit air pollutants? Will chemicals be used, stored, treated, or otherwise handled as a part of the tenant’s business? An affirmative answer to any of these questions raises a distinct possibility of significant risk or exposure. A good tenant prescreening device is to require all tenants to complete a prelease comprehensive environmental checklist that requires them to disclose detailed information on the materials that they plan to use in waste management practices, a past environmental compliance history, and insurance information and claims history. In addition, tenants need to provide copies of any environmental permits they have or applications for permits needed to operate on the property. Too many red flags or uncertainties revealed in this prelease checklist may provide a valid reason to pass on certain prospective tenants. Obtaining this type of information is good protocol for large and small tenants alike. Indeed, “mom and pop” operations such as dry cleaners or small tooling shops can create large environmental problems because of the chemicals used, and these tenants usually do not have the assets necessary to remediate the environmental problems their operations may cause.

Lease provisions related to environmental issues also must be reviewed carefully. What may seem like an otherwise favorable, lessor-oriented lease may leave a lessor wide open to environmental liabilities for the tenant’s activities. Some standard commercial and industrial leases still do not include language specifically referring to issues and liabilities related to hazardous waste and hazardous materials. Accordingly, it is important to include specific language in the lease that addresses these issues. However, even if the tenant is considered responsible for environmental liabilities under the lease, these assurances may be of little moment if the tenant is financially incapable of assuming the liabilities. An extra month’s rental deposit will not begin to cover the expense of a cleanup. Thus, a landlord should consider requiring the tenant provide some alternative form of financial assurance demonstrating it will have the resources to actually indemnify the lessor if an environmental problem arises. This is especially important since a lessor/owner can be held liable for the tenant’s contamination just based on ownership status.15

Just as in the purchase and sale context, a lessor should establish an environment-
whether vapor intrusion exists at the site or in any construction at the site. A related determination is whether the risk of subsurface vapors can be managed by installing vapor barriers or other on-site engineering mechanisms. The cost of doing this can then be factored into the purchase price. If the buyer recognizes that some post-purchase remediation will likely need to occur, consideration should be given to what the cleanup levels will need to be based on the property’s intended use. If the property is intended for a mixed residential-commercial use, cleanup levels will likely need to conform to more stringent residential remediation standards.

The buyer should also determine if a particular environmental agency has previously been involved with the property based on prior events at the site. If so, the buyer should conduct due diligence on that agency’s remediation requirements, its general time frames for reviewing remediation plans, and the agency’s protocols for its issuance of closure letters. Some agencies offer a cost over-site option whereby a property owner or operator can enter into an agreement for the agency to review remediation plans and closure letter requests, for a cost.

A buyer needs to be mindful of whether and to what extent adjacent properties may have been impacted by the subject site or may be impacting the subject site. For example, if the subject property has groundwater contamination that is migrating off-site, it is important to determine not just that fact but whether any off-site properties impacted include areas zoned residential, for school use, or for recreational/open space. Agencies consider these types of properties to be “sensitive receptors” so if remediation of these sites is required, the cleanup standards may be more stringent than for the subject property. Similarly, it is advisable to know if an off-site property has contamination that is migrating onto the subject site and, if so, if an agency has already ordered the off-site owner or operator to engage in remediation. This fact could make less likely the subject property owner’s being named a responsible party. Moreover, it is important to learn if the migrating contamination may lead to the placement of monitoring wells or other remediation equipment on the subject site. In addition, the prospective buyer should try to determine if the off-site contamination does or may pose an actual or potential risk to the subject property.

The purchase and sales agreement for a contaminated site should contain detailed provisions directed to the property’s environmental condition. For the buyer’s protection, the seller should provide environmental representations and warranties related to the site’s contamination; current and past operator’s use of and identity of chemicals; the status of activities undertaken by the seller or past operators or both to comply with all applicable federal, state, and local environmental statutory and regulatory requirements; whether there are pending environmental investigations, notice of violations, cleanup, and abatement orders or other environmental civil, criminal, or administrative proceedings related to the property; the identity and status of any and all environmental permits; and the seller’s compliance status regarding these permits. If the buyer intends to continue with the same business or operations conducted by the seller, determination should be made if the seller’s environmental permits are transferable, and, if so, the buyer should become familiar with the timeframe required for such transfers to become operative.

In addition to the parties’ representations and warranties, the scope of indemnification being provided is perhaps the most actively negotiated and important provision in a purchase and sales agreement. The indemnification that a buyer can or should obtain will depend on the details of each transaction and the parties’ respective bargaining power as well as risk tolerance levels. Sales of contaminated properties can run the gamut from as-is transactions to a full and complete indemnification whereby the seller agrees to defend, save, indemnify, and hold harmless the buyer from and against any and all losses, claims, and lawsuits resulting from or arising out of the environmental condition of the property. Indemnification may be limited by time, dollar amounts, the types of contamination included, and whether, for example, the indemnity includes soil only, groundwater only, only on-site contamination, all contamination on, to, or from the property.

If a known environmental condition exists at the property that requires remediation, but the parties do not want to delay closing until remediation has been completed, one option is for the seller to commit to completing the remediation through its receipt of a no-further-action letter and holding back a portion of the purchase price until this letter is received from the lead agency.

A buyer may also seek protection under various government programs related to purchase of contaminated sites. For example, the California Land Reuse and Revitalization Act (CLRRA) of 2004 promotes the cleanup and redevelopment of blighted contaminated properties by providing liability protection to bona fide purchasers, innocent landowners, and contiguous property. It establishes a process for eligible property owners to conduct a site assessment and implement a response action, if necessary, to ensure the property is ready for reuse. In return, property owners will receive governmental immunity against agency actions. This act has been extended to include prospective purchasers and bona fide ground tenants with a lease term of at least 25 years.

Similar to CLRRA, DTSC makes available a prospective purchaser agreement (PPA) to certain qualifying buyers of contaminated properties, including a covenant not to sue from the DTSC. A PPA is limited to certain circumstances and requirements, which have been delineated in a fact sheet on the PPA compiled by the DTSC. (See Summary of the Prospective Purchaser Agreement Fact Sheet on page 31.)

The EPA offers programs for qualified purchasers of contaminated sites, including its Brownfields and Land Revitalization Programs, which are designed to empower states, communities, and other stakeholders in economic redevelopment to collaborate to prevent, assess, safely clean up, and sustainably reuse brownfields. Under these programs, the EPA offers funding and grants to local governmental entities and private parties for site assessments and cleanup activities. These programs seek to encourage private redevelopment, public-private redevelopment and public-led redevelopment.

All parties involved in real estate transactions related to commercial and industrial properties must be conscious of contamination issues. Obtaining information regarding the property’s environmental condition and understanding the nature and extent of the contamination that is or may be impacting the site is an important step in developing a strategy to best protect a party’s interests. Also, establishing an environmental baseline of the property’s environmental condition before a transaction is completed is important so it is clear what the nature of the contamination is before a deal closes.

Inclusion of indemnification and representation and warranties language in a transaction document, determining the existence and/or applicability of environmental insurance, and the pursuit of immunity protections offered under statutory provisions such as CLRRA are among the other devices a party can use to minimize its liabilities.

1 The State Water Resources Control Board’s Geo-Tracker database includes records relating to over
15,000 cleanup sites in the County of Los Angeles alone.


4 See e.g., 42 U.S.C. §9607(a); HEALTH & SAFETY CODE §25323.5(a).


8 Fact sheets relating to many toxic chemicals, including PCE and TCE, can be found at ATSDR Toxic Substances Portal, Agency for Toxic Substances and Disease Registry, available at https://www.atsdr.cdc.gov/substances/index.asp.

9 See generally HEALTH & SAFETY CODE §§25359.7.

10 By way of example, any person who at the time of disposal of any hazardous substance owned any facility at which such hazardous substances were disposed may be a responsible party under CERCLA. See 42 U.S.C. §9607(a).

11 Business litigation is increasingly complex. That is why we believe valuation issues must be addressed with the same meticulous care as legal issues. Analysis must be clear. Opinions must be defensible. Expert testimony must be thorough and articulate. HML has extensive trial experience and can provide legal counsel with a powerful resource for expert testimony and litigation support.

For More Information Call 213-617-7775
Or visit us on the web at www.hmlinc.com

BUSINESS VALUATION • LOSS OF GOODWILL • ECONOMIC DAMAGES • LOST PROFITS