

# A Buyer's Catalogue of Prepurchase Precautions to Minimize CERCLA Liability in Commercial Real Estate Transactions

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## I. INTRODUCTION

Since Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA),<sup>1</sup> fear of hazardous waste pollution liability has thwarted countless business deals.<sup>2</sup> In almost any commercial real estate transaction, the specter of astronomically high environmental liability haunts and often dictates the process and structure of these transactions.<sup>3</sup>

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1. Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified as amended at 42 U.S.C. §§ 9601-9675 (1988)).

For the legislative history of CERCLA, see SENATE COMM. ON ENVIRONMENT AND PUBLIC WORKS, A LEGISLATIVE HISTORY OF THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT OF 1980 (SUPERFUND), 97th Cong., 2d. Sess. (1983). In 1986, Congress amended CERCLA with the Superfund Amendment and Reauthorization Act (SARA). Pub. L. No. 99-499, 100 Stat. 1615 (1986) (codified as amended at 42 U.S.C. §§ 9601-9675 (1988)).

2. Several commentators have spoken on the rise in environmental liability and the effect of CERCLA on business deals. See, e.g., Ruth Simon, *Deals that Smell Bad*, FORBES, May 15, 1989, at 49 (describing CERCLA as "the harshest liability scheme around"); *Business Community Faces Liability Risks from Transactions Affected by Waste Laws*, 50 Banking Rep. (BNA) 347 (Feb. 29, 1988); Alison Kittrell, *Bigger Liability Risks Alter Business Routines*, BUS. INS., Jan 23, 1989, at 30; William Anderson, II & Melinda E. Taylor, *Representing Buyers*, 3 NAT. RESOURCES & ENV'T 3 (Fall 1988).

3. The prospect of CERCLA liability lurks in all sorts of land uses. The following list of businesses or industries may involve environmentally hazardous activities:

- a) agriculture: farms; orchards and groves; vineyards; nurseries; fertilizer and pesticide manufacturers and distributors; lumber, wood processing, pulp and paper mills; animal feed lots; grain mills; and meat, dairy, and food processing plants.
- b) manufacturing: foundries; iron and steel plants; heavy equipment, machinery and motor vehicle manufacturers and servicers; aerospace industries; electroplating industries; computer and semi-conductor manufacturers; glass and asbestos handlers and insulation manufacturers; textiles companies; cement plants; tanneries; rubber plants; battery manufacturers; and paint industries.
- c) petroleum and chemical manufacturing: oil refineries and tank farms; organic chemical producers and suppliers; plastics and synthetics manufacturers; soap and detergent producers; and industrial gas, acid, and caustics producers.

Although estimates of the scope of hazardous waste pollution and individual site cleanup costs vary widely, the estimates continue to increase. In 1980, one U.S. Representative speaking in support of CERCLA's enactment cited the Environmental Protection Agency's (EPA) \$44 billion estimate to clean up approximately 30,000 to 50,000 abandoned hazardous waste sites across the country.<sup>4</sup> Nine years later, a congressional report stated that "[o]ver many decades, spending by all parties on cleaning up toxic waste sites could total \$500 billion, unless there are major technological innovations that bring the costs of permanent remedies down."<sup>5</sup> Regarding individual sites, one commentator estimated that the average cost of cleaning up a contaminated site would be approximately \$8 million.<sup>6</sup> A more recent estimate of individual site cleanup costs indicates that "[a]s a national average, the cost of a federal Superfund site clean-up exceeds \$20 million."<sup>7</sup>

In light of these estimates, even the smallest environmental problem can turn a good bargain into a debilitating liability. Naturally, fears of environmental liability may profoundly influence bargaining table dialogue. Because the cost and incidence of hazardous waste contamination are soaring and because the courts favor broad interpretations of CERCLA's liability provisions,<sup>8</sup> counsel for prospective purchasers of com-

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d) transportation: airports; railroad yards; oil and gas pipelines; trucking terminals; harbors; and asphalt plants.

e) waste disposal: waste transfer stations; waste treatment facilities; landfills; and scrap yards.

f) commercial: photochemical laboratories; gasoline and automobile service/repair stations; car, truck, bus and heavy equipment fleet service facilities; dry cleaners; printing operations; paint distribution and sales outlets; and automobile dealerships.

g) energy: gas, oil-fired, and nuclear power plants.

Joyce Michelson, *Hazardous Waste in Real Estate Transactions: "Lenders' Concerns"* 700, 718-19 (1991 Environmental Law and Management Conference, University of Washington, Apr. 4-5, 1991) (on file with the *University of Puget Sound Law Review*).

4. 126 CONG. REC. 26,360 (Sept. 19, 1980) (statement of Rep. Railsback). See also *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 805 (S.D. Ohio 1983).

5. OFFICE OF TECHNOLOGY ASSESSMENT, U.S. CONGRESS, *COMING CLEAN, SUPERFUND PROBLEMS CAN BE SOLVED* . . . 6 (1989).

6. Steven Semeraro, *Toward an Optimal System of Successor Liability for Hazardous Waste Cleanup*, 6 STAN. ENVTL. L.J. 226, 238 (1986-87).

7. PRESTON, THORGRIMSON, SHIDLER, GATES, & ELLIS, *WASHINGTON ENVIRONMENTAL LAW HANDBOOK* 277 (Bradley M. Marten & Konrad J. Liegel eds. 1990).

See also Marianne Lavelle, *Setting Sights on Superfund*, NAT'L L.J., Feb. 18, 1991, at 1. The author states that the average site cleanup cost approaches \$25 million dollars.

8. See L. De-Wayne Layfield, *CERCLA, Successor Liability, and the Federal*

mercial real estate must take certain prepurchase precautions to minimize potential CERCLA liability. This Comment provides practical suggestions as to the aim and form of those precautions.

In Part II, this Comment first examines the basic statutory framework and liability scheme of CERCLA. Part III discusses the common law principles of successor liability and their relation to CERCLA's liability mechanism. Finally, in Part IV, this Comment presents a variety of preventive law steps to lessen exposure to hazardous waste liability under CERCLA.

Part IV begins by discussing buyers' and sellers' goals when negotiating a real estate purchase and the environmental risks that generally inhere in such a transaction. Part IV then demonstrates in successive subsections how to identify, evaluate, and allocate the risks of a specific purchase. This Comment provides examples of a condition, representations, and an indemnification clause, all of which may serve as protective devices in real estate contracts to allocate these risks. Part IV also considers how courts in four recent cases have responded to buyers' and sellers' attempts to enforce indemnity clauses to avoid CERCLA liability.

## II. THE LEGAL UNIVERSE OF CERCLA

### A. *The Purposes of CERCLA*

Congress enacted CERCLA in 1980 with two main objectives in mind. First, Congress wanted to provide the federal government with a powerful, effective device to secure the health and safety of the public and to protect the environment from the threat of hazardous waste mismanagement.<sup>9</sup> Second, through strong liability provisions, Congress intended to place the cleanup burden upon those responsible for existing contamination and to deter future contamination.<sup>10</sup>

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*Common Law: Responding to an Uncertain Standard*, 68 TEX. L. REV. 1237, 1244 (1990).

9. See 126 CONG. REC. 31,950 (Dec. 3, 1980) (statement of Rep. Florio); H.R. 7020, 96th Cong., 2d Sess. (Dec. 3, 1980); S. REP. NO. 848, 96th Cong., 2d Sess. 12-15, 31-34 (1980); *United States v. Reilly Tar & Chem. Corp.*, 546 F. Supp. 1100, 1112 (D. Minn. 1982) (noting Congress gave the federal government "the tools necessary for a prompt and effective response to [these environmental] problems.").

10. *Pennsylvania v. Union Gas Co.*, 109 S. Ct. 2273, 2277 (1989); *Mardan Corp. v. C.G.C. Music, Ltd.*, 804 F.2d 1454, 1455 (9th Cir. 1986) ("CERCLA was a response by Congress to the threat to public health and the environment posed by the widespread

In their attempts to honor these broad objectives, courts have recognized that Congress left the statute incompletely written and that Congress intended the judiciary to perform interstitial lawmaking.<sup>11</sup> In particular, the lack of congressional guidance regarding CERCLA's liability provisions has created a large degree of uncertainty among the courts and commentators, making it difficult to determine uniform standards regarding successor liability or environmental due diligence.<sup>12</sup> To accomplish Congress' policy objectives, the Act establishes two complementary enforcement mechanisms: public suits brought by the federal government<sup>13</sup> and private suits brought by individuals.<sup>14</sup>

### B. *The Liability Scheme of CERCLA*

#### 1. Potentially Responsible Parties

According to section 9607, CERCLA's main pronouncement on liability, the following four actors, known as "potentially responsible parties" (PRPs),<sup>15</sup> may be held liable for

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use and disposal of hazardous substances. Its purpose was to ensure the prompt and effective cleanup of waste disposal sites, and to assure that parties responsible for hazardous substances bore the cost of remedying the conditions they created." *Reilly Tar*, 546 F. Supp. at 1112; see also 126 CONG. REC. 31,951 (Dec. 3, 1980); S. REP. NO. 848, 96th Cong., 2d Sess. 12-15, 31-34 (1980).

11. See, e.g., *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86, 91-92 (3d Cir. 1988), cert. denied, 488 U.S. 1029 (1989); *United States v. Bliss*, 667 F. Supp. 1298 (E.D. Mo. 1987). See also Richard F. Chatfield-Taylor, *Successors Beware: Expanding the Liability Net Under CERCLA Section 9607(a) Through Application of Exceptions to the Traditional Common-Law Doctrine of Successor Nonliability in Asset Acquisitions*, 29 WASHBURN L.J. 442, 470 (1990).

Support for gapfilling by federal common law was buoyed by Congress's explicit authorization for courts to apply federal common law in contribution actions. See 42 U.S.C. § 9613(f)(3)(C) (1988), and for the Act's legislative history, see 126 CONG. REC. 30,932 (November 24, 1980).

12. See *Smith Land & Improvement Corp.*, 851 F.2d at 92; Layfield, *supra* note 8. See also text *infra* accompanying notes 46, 99, and 104.

13. 42 U.S.C. § 9607(a)(4)(A) (1988).

14. 42 U.S.C. § 9607(a)(4)(B) (1988). See also *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985).

15. 42 U.S.C. § 9607(a)(1)-(4) (1988). Section 9607 provides in relevant part:

(a) Covered persons; scope; recoverable costs and damages; interest rate; "comparable maturity" date

Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section —

(1) the owner and operator of a vessel or a facility,

(2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of,

(3) any person who by contract, agreement, or otherwise arranged for

toxic cleanup costs: (1) the owner/operator of the site at the

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disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances, and

- (4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance, shall be liable for—
  - (A) all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan;
  - (B) any other necessary costs of response incurred by any other person consistent with the national contingency plan; and
  - (C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release; and
  - (D) the costs of any health assessment or health effects study carried out under section 9604(i) of this title.

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(b) Defenses

There shall be no liability under subsection (a) of this section for a person otherwise liable who can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by —

- (1) an act of God;
- (2) an act of war;
- (3) an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant (except where the sole contractual arrangement arises from a published tariff and acceptance for carriage by a common carrier by rail), if the defendant establishes a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions; or
- (4) any combination of the foregoing paragraphs.

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(e) Indemnification, hold harmless, etc., agreements or conveyances; subrogation rights.

- (1) No indemnification, hold harmless, or similar agreement or conveyance shall be effective to transfer from the owner or operator of any vessel or facility or from any person who may be liable for a release or threat of release under this section, to any other person the liability imposed under this section. Nothing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this section.
- (2) Nothing in this subchapter, including the provisions of paragraph (1) of this subsection, shall bar a cause of action that an owner or

time of disposal,<sup>16</sup> (2) generators who arranged for disposal,<sup>17</sup> (3) transporters,<sup>18</sup> and (4) present owners of the site.<sup>19</sup> In the past, entities falling within these four categories have included individual plant supervisors,<sup>20</sup> parent corporations,<sup>21</sup> officers and stockholders,<sup>22</sup> successor corporations,<sup>23</sup> lessors,<sup>24</sup> lessees,<sup>25</sup> trustees,<sup>26</sup> realtors,<sup>27</sup> and lenders.<sup>28</sup> These PRPs may be liable for all removal and cleanup costs, including incidental related costs for the cleanup, and damages to the environment from the hazardous releases.<sup>29</sup>

This Comment focuses on the last of these four PRPs—present owners of the site. Liability may attach to a recent successor/purchaser (“a present owner”) by mere ownership without consideration of who actually polluted the site.<sup>30</sup> Because of CERCLA’s structure, the federal government may sue any PRP, including the PRP with the deepest pocket, for cleanup costs. Therefore, every buyer, soon to be a present owner, must be on the alert for possible contamination and

operator or any other person subject to liability under this section, or a guarantor, has or would have, by reason of subrogation or otherwise against any person.

16. 42 U.S.C. § 9607(a)(1) (1988). For an example of a court holding a former site owner liable for response costs, see *Idaho v. Bunker Hill Co.*, 635 F. Supp. 665 (D. Idaho 1986).

17. 42 U.S.C. 9607(a)(3) (1988). For an example of a court holding a generator liable for response costs, see *United States v. Ottati & Goss, Inc.*, 630 F. Supp. 1361 (D.N.H. 1985).

18. 42 U.S.C. 9607(a)(4) (1988). For an example of a court holding a transporter liable for response costs, see *United States v. Bliss*, 667 F. Supp. 1298 (E.D. Mo. 1987).

19. 42 U.S.C. 9607(a)(4) (1988). For an example of a court holding a current owner liable for response costs, see *United States v. Conservation Chem. Co.*, 619 F. Supp. 162 (C.D. Mo. 1985).

20. See, e.g., *United States v. Northeastern Pharmaceutical & Chem. Co., Inc.*, 579 F. Supp. 823 (W.D. Mo. 1984), *aff'd in relevant part*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).

21. See, e.g., *United States v. Nicolet, Inc.*, 712 F. Supp. 1193 (E.D. Pa. 1989).

22. See, e.g., *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985).

23. See, e.g., *In re Acushnet River & New Bedford Harbor Proceedings re Alleged PCB Pollution*, 712 F. Supp. 1010 (D. Mass. 1989).

24. *United States v. Argent Corp.*, 21 Env't Rep. Cas. (BNA) 1354 (D.N.M. 1984).

25. *United States v. South Carolina Recycling & Disposal, Inc.*, 653 F. Supp. 984 (D.S.C. 1986).

26. *United States v. Cauffman*, 21 Env't Rep. Cas. (BNA) 2167 (C.D. Cal. 1984).

27. *Tanglewood East Homeowners v. Charles-Thomas, Inc.*, 849 F.2d 1568 (5th Cir. 1988).

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

29. 42 U.S.C. § 9607(a)(4)(A)-(C) (1988).

30. 42 U.S.C. § 9601(35)(A), (D) (1988). See also *United States v. Argent Corp.*, 21 Env't Rep. Cas. (BNA) 1354, 1356 (D.N.M. 1984); *United States v. Waste Indus.*, 556 F. Supp. 1301, 1318 (E.D.N.C. 1982), *rev'd on other grounds*, 734 F.2d 159 (4th Cir. 1984).

CERCLA's strict liability standard.<sup>31</sup> This standard is the starting point for the drafting techniques discussed later in Part IV of this Comment.

## 2. Stating a Claim and the Burden of Proof

To state a claim under CERCLA, a plaintiff must allege that the defendant is (1) a person (2) who is in some way responsible for (3) a release<sup>32</sup> of (4) a hazardous substance<sup>33</sup> (5) in a facility<sup>34</sup> (6) from which there has been a release or threatened release of the substance (7) to which the plaintiff has taken the necessary response actions consistent with the National Contingency Plan.<sup>35</sup> In an action by the government to recover cleanup costs, the burden of proof is on the PRP to show that it was not responsible for the release or that the costs incurred by the government were not consistent with the National Contingency Plan.<sup>36</sup>

## 3. Defenses

The statute provides the PRP with the following three limited defenses to liability: (1) an act of God, (2) an act of war, or (3) an unforeseeable act or omission by an unrelated

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31. *United States v. Cauffman*, 21 Env't Rep. Cas. 2167, 2168 (C.D. Cal. 1984). See also Howard L. Shecter, *Acquiring Corporate Assets Without Successor Liability: Is It A Myth?*, 1 COLUM. BUS. L. REV. 137, 153 (1986); *Tanglewood East Homeowners v. Charles-Thomas, Inc.*, 849 F.2d 1568 (5th Cir. 1988).

32. CERCLA broadly defines "release" as "any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment." 42 U.S.C. § 9601(22) (1988).

33. CERCLA defines "hazardous substance" by reference to lists in other environmental statutes. 42 U.S.C. § 9601(14) (1988). *Nota bene*: this definition excludes petroleum and petroleum products.

34. CERCLA defines "facility" as "any building, structure, installation, equipment, pipe or pipeline (including any pipe into a sewer or publicly owned treatment works), well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock, or aircraft, or any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located . . ." 42 U.S.C. § 9601(a) (1988).

35. 42 U.S.C. § 9607(a) (1988). The National Contingency Plan (NCP), 40 C.F.R. §§ 300.1-.86 (1988), governs the cleanup of polluted sites. Issued by the EPA under Congress's directive in CERCLA at 42 U.S.C. §§ 9601(31), 9605 (1988), the NCP provides specific guidelines for responding to hazardous substance difficulties and for coordinating the remedial efforts of federal or state agencies and private persons.

36. *Philadelphia v. Stepan Chem. Co.*, 713 F. Supp. 1484 (E.D. Pa. 1989). The court held that the burden of proof is on the defendant to establish that removal or remedial actions undertaken by the federal or state governments were inconsistent with the National Contingency Plan. *Id.* A private party bringing an action must prove, as element of its prima facie case, that costs incurred were consistent with the plan.

third party.<sup>37</sup> In 1986, when Congress amended CERCLA, legislators attempted to develop another exception to the Act's liability provisions for innocent landowners.<sup>38</sup> By redefining the term "contractual relationship,"<sup>39</sup> Congress created the "innocent landowner" defense from the last of the three defenses in section 9607(b).<sup>40</sup>

As an affirmative defense, the innocent landowner provision places the burden on the defendant to establish six elements<sup>41</sup> by a preponderance of the evidence.<sup>42</sup> Since its

37. 42 U.S.C. § 9607(b) (1988). See *supra* note 15 for text of subsection (b).

38. Franklin C. Huntington, IV & Christopher P. Davis, *Liability Under CERCLA for Cleanup of Hazardous Waste*, in 2 THE LAW OF HAZARDOUS WASTE: MANAGEMENT, CLEANUP, LIABILITY, AND LITIGATION § 14.01(8)(b)(ii) (Christopher P. Davis & Jeffrey C. Bates eds., 1990).

39. 42 U.S.C. §§ 9601(35)(A) & (B) (1988) provide in relevant part:

(A) The term "contractual relationship," for the purpose of section 9607(b)(3) of this title, includes, but is not limited to, land contracts, deeds or other instruments transferring title or possession, unless the real property on which the facility concerned is located was acquired by the defendant after the disposal or placement of the hazardous substance on, in, or at the facility, and one or more of the circumstances described in clause (i) . . . is also established by the defendant by a preponderance of the evidence:

(i) At the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility.

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(B) To establish that the defendant had no reason to know, as provided in clause (i) of subparagraph (A) of this paragraph, the defendant must 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. For purposes of the preceding sentence the court shall 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.

40. "The innocent landowner defense is an amalgam of 42 U.S.C. § 9607(b)(3) and 42 U.S.C. §§ 9601(35)(A) and (B)." *United States v. Pacific Hide & Fur Depot, Inc.*, 716 F. Supp. 1341, 1346 (D. Idaho 1986).

41. In *Pacific Hide & Fur Depot*, the district court established the following six requirements for this defense, the first four of which are based on the text of the 1980 version of the Act and the last two on the 1986 amended version:

1. The release or threat of release of a hazardous substance and the resulting damages were caused solely by an act or omission of a third party;
2. The third party's act or omission did not occur in connection with a contractual relationship (either direct or indirect) with the defendants;
3. The defendants exercised due care with respect to the hazardous substance;



creation, few courts have issued rulings on this defense.<sup>43</sup> At first glance, the defense appears to be an attractive device to shield buyers from CERCLA liability; however, in cases raising the defense, most defendants have failed to meet its strict requirements.<sup>44</sup> This difficulty exists in part because of the courts' broad interpretation of the term "contractual relationship"<sup>45</sup> and because no accepted regulatory standard establishes the requisite level of "due diligence."<sup>46</sup>

The innocent landowner defense pertains directly to the subject of this Comment—minimizing a buyer's postpurchase liability for prepurchase contaminations of property. By following the measures suggested in Part IV of this Comment, one may possibly establish the requisite due diligence although no particular formula will always satisfy the due diligence requirements. Satisfaction depends upon a variety of factors and is decided on a case-by-case basis.<sup>47</sup> As a result, the buyer may rarely rest assured that he or she has met this strict stan-

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4. The defendants took precautions against the third party's foreseeable acts or omissions and the foreseeable consequences resulting therefrom.

5. That at the time [of purchase, the defendants] did not know and had no reason to know of that there were [hazardous substances on the property]; and

6. That [the defendants] made all appropriate inquiry into the previous ownership and uses of the property.

*Pacific Hide & Fur Depot*, 716 F. Supp. at 1346-48. See also PRESTON ET AL., *supra* note 7, at 280.

42. *Washington v. Time Oil Co.*, 687 F. Supp. 529, 531 (W.D. Wash. 1988).

43. J.B. Ruhl, *The Third-Party Defense to Hazardous Waste Liability: Narrowing the Contractual Relationship Exception*, 29 S. TEX. L. REV. 291, 300 (1988).

44. *United States v. Pacific Hide & Fur Depot, Inc.*, 716 F. Supp. 1341 (D. Idaho 1989). In *Pacific Hide & Fur Depot*, the court held that the defense was available to the defendants. *Id.* at 1350. For a case where the defense was inapplicable, see *Wickland Oil Terminals v. Asarco, Inc.*, 654 F. Supp. 955 (N.D. Cal. 1987). For other cases interpreting this defense, see *Time Oil Co.*, 687 F. Supp. at 529; *Jersey City Redev. Auth. v. PPG Indus.*, 655 F. Supp. 1257 (D.N.J. 1987); *United States v. Serafini*, 706 F. Supp. 346 (M.D. Pa. 1988); *United States v. Mottolo*, 695 F. Supp. 615 (D.N.H. 1988); *Philadelphia v. Stepan Chem. Co.*, 544 F. Supp. 1135 (E.D. Pa. 1982).

45. The term of art "contractual relationship" is found in CERCLA, 42 U.S.C. § 9601(35)(A) (1988). See *supra* text accompanying note 39. For a case in which courts interpret this term, see *O'Neil v. Picillo*, 682 F. Supp. 706, 728 (D.R.I. 1988), *aff'd*, 883 F.2d 176 (1st Cir. 1989), *cert. denied*, 493 U.S. 1071 (1990).

46. The requisite level of due diligence inquiry depends on the circumstances, including the purchaser's special knowledge or experience, commonly known or discoverable information about the site, the conspicuousness of the presence or likelihood of contamination, and the efficiency of an inspection. PRESTON ET AL., *supra* note 7, at 280.

47. See *Pacific Hide & Fur Depot*, 716 F. Supp. at 1347-48.

dard; the innocent landowner defense is not as safe a harbor as it might seem.

#### 4. Strict Liability, and Joint and Several Liability

Apart from the above defenses, courts now unanimously hold that section 9607 imposes strict liability for any release.<sup>48</sup> Also, nearly all courts have held that defendants are jointly and severally liable.<sup>49</sup> To fall within an exception to the rule of joint and several liability, a party must show that the harm is divisible or that some basis exists for apportioning the costs among the PRPs.<sup>50</sup>

#### 5. Third Party Contribution

Section 9613(f), entitled "Civil Proceedings—Contribution," also relates to liability.<sup>51</sup> Before 1986, courts debated whether a PRP could bring a third party suit for contribution against another actor who also may have violated CERCLA's provisions.<sup>52</sup> Originally, CERCLA made no specific mention of

48. "Congress intended that responsible parties be held strictly liable, even though an explicit provision for strict liability was not included." *New York v. Shore Realty*, 759 F.2d 1032, 1042 (2d Cir. 1985). See also *United States v. Monsanto Co.*, 858 F.2d 160 (4th Cir. 1988). CERCLA's legislative history reveals discussion and compromise regarding whether to impose strict liability. See 126 CONG. REC. 31,965 (1980).

49. *United States v. Wade*, 577 F. Supp. 1326, 1338 (D.C. Pa. 1983) (holding that joint and several liability should be imposed upon the defendants found responsible unless they can establish that a reasonable basis exists for apportioning the harms among all of them). See also *O'Neill v. Picillo*, 883 F.2d 176 (1st Cir. 1989); *United States v. Stringfellow*, 661 F. Supp. 1053 (C.D. Cal. 1987).

50. *O'Neill*, 682 F. Supp. at 724.

51. 42 U.S.C. § 9613 (1988) ("Civil Proceedings"). Subsection f provides in relevant part:

##### (1) Contribution

Any person may seek contribution from any other person who is liable . . . under section 9607(a) of the title, during or following any civil action under section 9606 of this title or under section 9607(a) of this title. . . . In resolving contribution claims, the court may allocate response costs among liable parties using such equitable factors as the court determines are appropriate. Nothing in this subsection shall diminish the right of any person to bring an action for contribution in the absence of a civil action under section 9606 or section 9607 of this title.

52. The majority of courts generally recognized an implicit right in CERCLA defendants to sue for contribution. See, e.g., *Wehner v. Syntex Agribusiness, Inc.*, 616 F. Supp. 27 (D.C. Mo. 1985) (recognizing a right to contribution among joint tortfeasors under CERCLA). Accord *Colorado v. ASARCO, Inc.*, 608 F. Supp. 1484 (D.C. Colo. 1985). But see *United States v. Conservation Chemical Co.*, 619 F. Supp. 162, 229 (D.C. Mo. 1985) (holding that neither federal common law nor CERCLA supported claims for contribution).

rights to contribution from other responsible parties.<sup>53</sup> After the 1986 amendments to CERCLA (entitled the Superfund Amendment and Reauthorization Act or SARA),<sup>54</sup> Congress codified an explicit provision for contribution claims for CERCLA defendants.<sup>55</sup> This new addition to the statutory scheme is significant; it allows the EPA to focus on prosecution without becoming entangled in finding all the PRPs.<sup>56</sup> The EPA may not want or need to pursue all of the PRPs. However, the right to contribution from other PRPs encourages a defendant to bring other PRPs into the suit with the hope of sharing response costs if they are held liable.

As a result of its breadth, CERCLA's liability scheme empowers the federal government as well as private parties to respond quickly to hazardous contaminations and then to allocate the costs to a large number of PRPs. The liability scheme is much broader than any of the other environmental statutes.<sup>57</sup> Because the statute was so hastily written,<sup>58</sup> the courts are still filling gaps after twelve years of litigation. Furthermore, because nearly all efforts by attorneys to create defenses to mollify the statute's effects have failed,<sup>59</sup> prepurchase, contractual allocation of risks is critical.

### III. SUCCESSOR LIABILITY DOCTRINE<sup>60</sup>

#### A. Common Law Rules and Policies

Any discussion of a buyer's guidelines to minimize expo-

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53. See 42 U.S.C. § 9607 (1988); see also *supra* note 15.

54. Pub. L. No. 99-499, 100 Stat. 1615 (1986) (codified as amended at 42 U.S.C. §§ 9601-9675 (1988)).

55. 42 U.S.C. § 9613(f)(1) (1988). See *In re Charter Co.*, 862 F.2d 1500 (11th Cir. 1989). See also *supra* note 51.

56. See *Charter*, 862 F.2d at 1502 (two parties against whom CERCLA § 9613 response cost suits were filed had not been named parties in all the related lawsuits).

57. Lewis M. Barr, *CERCLA Made Simple: An Analysis of the Cases Under the Comprehensive Environmental Response, Compensation and Liability Act of 1980*, 45 BUS. LAW. 923, 924 (May 1990).

58. See *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86, 91 (3d Cir. 1988); Lavelle, *supra* note 7, at 36-37.

59. Lavelle, *supra* note 7, at 36-37.

60. Successor liability doctrine has developed most elaborately in the corporate context. See 15 WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 7122-7133 (perm. ed. rev. vol. 1990). Although the focus of this Comment is to provide negotiation and drafting guidelines for all types of commercial real estate purchases, Part III-A discusses the rules of successor liability only in the context of corporate purchases. These rules bear on the topic of this Comment because a large portion of commercial real estate transactions will occur between corporate buyers and sellers. Many of the guidelines later presented in Part

sure to hazardous waste liability must include a discussion of successor liability in general and in relation to CERCLA. By definition, a buyer of commercial real estate becomes a successor to the seller's interest in that real estate. Depending on the form and process of the purchase, the buyer may or may not succeed to the seller's liabilities, including pollution liabilities.

The doctrine of successor liability developed outside of any statutory scheme. As a general rule, when one corporation sells or transfers all of its assets to another corporation, the buyer/transferee is not liable for the debts and obligations of the seller/transferor.<sup>61</sup> However, courts have traditionally recognized four exceptions to this rule of successor nonliability:<sup>62</sup> 1) when the purchaser expressly or impliedly agrees to assume the seller's liability,<sup>63</sup> 2) when the purchase is a de facto merger or consolidation,<sup>64</sup> 3) when the purchase is a mere continuation of the seller's activities,<sup>65</sup> or 4) when the transfer of

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IV have been culled from observations of the principles established in this corporate context.

61. See FLETCHER, *supra* note 60, at § 7122; See also *Smith v. Chesapeake & O. Canal Co.*, 39 U.S. 45 (1840); *Travis v. Harris Corp.*, 565 F.2d 443 (7th Cir. 1977); *Florum v. Elliot Mfg. Co.*, 629 F. Supp. 1145 (D. Colo. 1986); *Martin v. Abbott Lab.*, 102 Wash. 2d 581, 689 P.2d 368 (1984).

62. See FLETCHER, *supra* note 60. For a recent discussion of these exceptions, see *Conway v. White Trucks, Div. of White Motor Corp.*, 885 F.2d 90 (3d Cir. 1989).

63. For cases involving express assumptions of liability, see *Keller v. Clark Equip. Co.*, 715 F.2d 1280, 1289 (8th Cir. 1983), *cert. denied*, 464 U.S. 1044 (1984) (stating that terms of the agreement evidence express intent to assume liability); *R.J. Enstrom Corp. v. Interceptor*, 555 F.2d 277 (10th Cir. 1977) (generally discussing the exception). For a case in which the court found an implicit assumption of liability, see *Ladjevardian v. Laidlaw-Coggeshall, Inc.*, 431 F. Supp. 834, 839-40 (S.D.N.Y. 1977) (discussing factors that support finding an implicit assumption of successor liability).

64. See, e.g., *Bud Antle, Inc. v. Eastern Foods, Inc.*, 758 F.2d 1451, 1457-58 (11th Cir. 1985); *Knapp v. North American Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975); *Fehl v. S.W.C. Corp.*, 433 F. Supp. 939 (D. Del. 1977).

The following elements are required for a de facto merger:

- 1) continuity of business operations between the transferee and the transferor corporations, including continuity of management, employees, location, and assets;
- 2) continuity of shareholders;
- 3) cessation of operations by the transferor corporation and dissolution within a short time; and
- 4) uninterrupted assumption by the transferee corporation of those liabilities of the transferor corporation which are necessary for the continuation of normal business operations.

FLETCHER, *supra* note 60, at § 7124.20.

65. See, e.g., *Travis v. Harris Corp.*, 565 F.2d 443, 447 (7th Cir. 1977) (stating that the test is not the continuation of the business operation but the continuation of the corporate entity and indicating that the indicia of a continuation are: a) common identity of stock, directors, and stockholders, and b) existence of only one corporation

assets is for the fraudulent purpose of escaping liability.<sup>66</sup>

In more recent years, certain courts have expanded these exceptions to include two new theories to impose successor liability on purchasers: 1) the "product line" theory<sup>67</sup> and 2) the "continuing business enterprise" exception.<sup>68</sup> Courts in a few states, including Washington, have accepted these newer exceptions to the general rule of successor nonliability.<sup>69</sup> Most state and federal courts, however, continue to apply only the traditional exceptions.<sup>70</sup>

Although the doctrine of successor non-liability and the exceptions embody competing policies,<sup>71</sup> they do not preclude a

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at the completion of the transfer); *Goldstein v. Gardner*, 444 F. Supp. 581, 583 (N.D. Ill. 1978) (quoting *Leannais v. Cincinnati*, 565 F.2d 437 (7th Cir. 1977)).

66. See, e.g., *Schmoll v. ACandS, Inc.*, 703 F. Supp. 868 (D. Or. 1988) (reorganization begun with fraudulent intent to escape liabilities); *United States v. Plastic Electro-Finishing Corp.*, 313 F. Supp. 330 (E.D.N.Y. 1970) (finding that transaction intentionally undertaken to defraud creditors).

67. The product line theory is an exception developed by the Supreme Court of California in *Ray v. Alad Corp.*, 560 P.2d 3 (Cal. 1977). "[A] party which acquires a manufacturing business and continues the output of its line of products under the circumstances here presented assumes strict tort liability for defects in units of the same product line previously manufactured and distributed by the entity from which the business was acquired." *Id.* at 11. In Washington, the supreme court adopted the *Ray* product line exception in *Martin v. Abbott Lab.*, 102 Wash. 2d 581, 689 P.2d 386 (1984).

68. The continuing business enterprise theory was originally announced by the New Jersey Supreme Court in *Ramirez v. Amsted Indus.*, 431 A.2d 811, 822-23 (N.J. 1981). This theory imposes liability on a successor manufacturer that preserves the same management, employees, plant, and product. The test for this exception has been formulated to include such factors as:

- 1) continuity of employees, supervisory personnel, and physical location;
- 2) production of the same product;
- 3) retention of the same name;
- 4) continuity of general business operations;
- 5) purchaser holding itself out as a continuation of the seller.

*Mozingo v. Correct Mfg. Corp.*, 752 F.2d 168, 175 (5th Cir. 1985).

69. The states adopting the new exceptions are California, New Jersey, Pennsylvania, and Washington. See *Ray*, 560 P.2d at 3; *Ramirez*, 431 A.2d at 811; *Dawejko v. Jorgenson Steel Co.*, 434 A.2d 106 (Pa. 1981); *Martin v. Abbott Laboratories*, 102 Wash. 2d 581, 689 P.2d 386 (1984). These two new exceptions arose because the traditional exceptions were geared for corporate law principles rather than the particular circumstances of products liability claimants. *Martin*, 102 Wash. 2d at 609, 689 P.2d at 385.

70. FLETCHER, *supra* note 60, at §§ 7122-7123. Layfield, *supra* note 8, at 1247-48.

71. Generally, courts tend to protect corporate creditors and dissenting shareholders, although they also respect the policy recognizing separate and distinct corporate entities. See *Jackson v. Diamond T. Trucking Co.*, 241 A.2d 471, 477 (N.J. 1968); see also *Leannais v. Cincinnati, Inc.*, 565 F.2d 437, 439 (7th Cir. 1977).

Courts and secondary authorities have suggested several arguments in opposition to the imposition of successor liability. A buyer should not be held liable for the seller's prepurchase "sins." The buyer did not originally create the risk of injury of

buyer and seller from distributing the risks of a transaction.<sup>72</sup> Part IV of this Comment provides guidance on precisely how to distribute these risks.

### *B. Successor Liability Doctrine in the CERCLA Context*

Given CERCLA's broad liability scheme that may hold any and all PRPs liable, the courts' adoption of successor liability notions seems reasonable. At this point in CERCLA's common law history, however, no uniform standard exists to determine the liability of successor purchasers.<sup>73</sup> The statute gives no explicit direction regarding CERCLA's relation to successor liability.<sup>74</sup> The only formal discussion by the EPA of the relationship between successor liability and the statute appeared in a 1984 "Enforcement Memorandum."<sup>75</sup> In the

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which a party now complains. The buyer did not reap any of the profits obtained in the past from prepurchase sale of the seller's property, product, or service. The buyer was not in a position, prior to acquisition, to alleviate the risk or to take safety precautions. And, the buyer did not represent that the property, product, or service was safe. *FLETCHER, supra* note 60, at § 7123.05 and cases cited therein. *See also* *Domine v. Fulton Iron Works*, 395 N.E.2d 19 (Ill. 1979).

On the other hand, several arguments favor imposing successor liability. Perhaps most importantly, an inflexible application of the general rule would allow corporations to enter into transactions solely to avoid liability. Courts could not otherwise impose liability on the successor, generally the deeper pocket after the sale, despite the harmful effects of the service or product. Persons injured by the product or service have no recourse against the successor corporation. The buyer rather than the general public is better equipped to insure against these risks and to spread the costs of the product's or service's harms. If the predecessor's line of business is continued, the successor, having reaped the benefits of continuing the product/service line should bear the burden of continuity. No reason exists for distinguishing between the effects of a cash purchase of corporate assets and an acquisition of assets for stock. Without successor liability, the purchase of a predecessor's assets leaves a potential plaintiff with no remedy against the original manufacturer or wrongdoer. Public policy mandates the imposition of successor liability because the doctrine forces the seller and buyer to spread the risk of harm between themselves without letting it fall upon innocent third-parties. *See FLETCHER, supra* note 60, at § 7123.05 and cases cited therein.

72. *Grant-Howard Assoc. v. Gen. Housewares Corp.*, 472 N.E.2d 1 (N.Y. 1984).

73. *See Layfield, supra* note 8, at 1246 (discussing the "inability to predict whether CERCLA [successor] liability will attach"). The Layfield Comment recognizes three doctrinal approaches to the question of CERCLA successor liability: 1) no successor liability; 2) traditional successor liability in which assets and liabilities are transferred separately with the four exceptions; and 3) expanded successor liability, which includes the product line and continuing business enterprise theories (*see supra* text accompanying notes 65-66).

74. *See Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989).

75. Memorandum from Courtney M. Price, Liability of Corporate Shareholders and Successor Corporations for Abandoned Sites under the Comprehensive

memo, the agency stated that CERCLA successor liability could be established by several legal approaches: 1) the continuing business enterprise exception, under which a corporation continues the same business as the seller, and 2) the four traditional exceptions to the general rule of successor nonliability, as outlined above.<sup>76</sup>

Because of the limited statutory or agency guidance on how to hold successors liable under CERCLA, courts have acted to fill this void. Some courts have held successor purchasers liable when the transaction occurs in the context of a merger or consolidation.<sup>77</sup> Many courts have held successors liable when the transaction fits one of the four traditional exceptions to the rule of successor non-liability.<sup>78</sup> Only one court has held a successor purchaser liable when the transaction corresponded to the elements of the expanded product line exception.<sup>79</sup>

Since the decision of the Third Circuit Court of Appeals in *Smith Land & Improvement Corp. v. Celotex Corp.*,<sup>80</sup> courts generally apply the four traditional exceptions.<sup>81</sup> One cause for this trend was the court's plea in *Smith Land* that "[i]n resolving the successor liability issues . . . the court[s] . . . must consider national uniformity; otherwise, CERCLA aims may be evaded easily by a responsible party's choice to arrange a merger or consolidation under the laws of particular states which unduly restrict successor liability."<sup>82</sup>

For example, in a recent decision on CERCLA successor liability, *Louisiana-Pacific Corp. v. Asarco, Inc.*, the Ninth Circuit heeded this plea for national uniformity and applied only the four traditional exceptions.<sup>83</sup> Echoing the Third Circuit's

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Environmental Response, Compensation, and Liability Act (June 13, 1984) (on file with the *University of Puget Sound Law Review*).

76. *Id.*

77. See *Smith Land & Improvement Corp.*, 851 F.2d at 86.

78. See, e.g., *Philadelphia Electric Co. v. Hercules, Inc.*, 762 F.2d 303 (3d Cir. 1985) (applying both the "de facto merger" and "assumption of liabilities" doctrines).

79. *Dep't of Transp. v. PSC Resources, Inc.*, 419 A.2d 1151 (N.J. Super. Ct. Law Div. 1980).

80. 851 F.2d 86 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989). See also *supra* text accompanying note 74.

81. See Layfield, *supra* note 8, at 1246; see also Chatfield-Taylor, *supra* note 11, at 448-49.

82. *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86, 92 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989).

83. 909 F.2d 1260 (9th Cir. 1990) (holding that the facts did not justify finding the successor liable when none of the four traditional exceptions applied).

rationale, the Ninth Circuit stated: "A state law which unduly limits successor liability could cut off the EPA's ability to seek reimbursement from responsible parties for cleaning up a hazardous waste site under 42 U.S.C. §§ 9604 and 9607."<sup>84</sup> In *Asarco*, the Ninth Circuit also mentioned the expanded versions of successor liability but did not address their applicability because they were not raised on appeal.<sup>85</sup>

One court, however, has refused to apply successor liability doctrines in a CERCLA suit. In *Anspec Co. v. Johnson Controls, Inc.*, a Michigan district court rejected the traditional exceptions embraced in *Asarco* and earlier CERCLA cases.<sup>86</sup> After referring to the *Smith Land* call for the common law development of successor liability,<sup>87</sup> the district court proceeded to reject that plea, insisting that "the courts should not deviate from the four existing categories<sup>88</sup> of potentially liable parties which Congress clearly mandated under CERCLA."<sup>89</sup> The district court strictly interpreted CERCLA's liability framework:

Even though this Court may agree that successor liability is desirable, that is a legislative policy decision to be made by Congress . . . Congress must still be satisfied with the four categories since no changes were made to the basic structure of CERCLA during the 1986 amendments . . . While changes to the categories of potentially liable parties may be necessary, Congress must be the body to make such changes.<sup>90</sup>

By limiting the scope of liable parties, the *Anspec* court's approach certainly favors buyers of contaminated property, but few courts have accepted this narrow interpretation of the statute's liability provisions. Similarly, on the other extreme of

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84. *Id.* at 1263 n.2.

85. *Id.* at 1264 n.3. To this date, only one court has applied the nontraditional exceptions in the CERCLA setting. *Dep't of Transp. v. PSC Resources*, 419 A.2d 1151 (N.J. Super. Ct. Law Div. 1980) (noting the harsh consequences that had occurred from strict application of the traditional exceptions and applying the new product line exception).

86. 734 F. Supp. 793 (E.D. Mich. 1989), *appeal dismissed without opinion*, 891 F.2d 289 (6th Cir. 1989).

87. *Id.* at 795.

88. The four categories of parties subject to CERCLA liability are present owner/operators, past owner/operators, generators, and transporters. *See supra* notes 15-19 and accompanying text.

89. *Anspec Co.*, 734 F. Supp. at 796.

90. *Id.* at 795-96.



the liability spectrum represented by the product line and continuing business enterprise exceptions, few courts have accepted such a broad interpretation of section 9607. Most courts, like the Ninth Circuit in *Asarco*, have accepted the *Smith Land* approach, holding buyers liable if one of the four traditional exceptions applies.

By recognizing these four exceptions, courts have broadened the original scope of CERCLA liability and the class of PRPs. Therefore, when a corporate succession involves real estate, corporate buyers must be on the alert for the additional risks presented by these exceptions.<sup>91</sup>

#### IV. BUYER'S PREVENTIVE LAW MEASURES TO AVOID CERCLA LIABILITY

##### A. Introduction and General Transactional Setting

In one sense, negotiating the purchase of commercial real estate is a function of resolving the sellers' and buyers' conflicting aims. To some degree, each party must adjust its bargaining position to accommodate disparate objectives. Therefore, before taking affirmative steps toward buying property, a purchaser must be aware of the setting and climate in which the bargaining will take place, the risks facing each party, and the general objectives of each.<sup>92</sup>

Traditionally, real estate transfers occur in three major stages: 1) negotiation and execution of a purchase and sale agreement; 2) satisfaction of each party's conditions, including a title examination and financing arrangements; and 3) closing.<sup>93</sup> Each party's goals and expectations shape these milestones and the resulting agreement. Awareness of each side's

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91. In addition to the preventive law methods discussed in the next section of this Comment, corporate successors may also structure the acquisition to avoid successor liability. See, e.g., John P. Arness, L. Anthony Sutin, Teresa C. Plotkin, *Preventing Successor Liability for Defective Products: Safeguards for Acquiring Corporations*, 67 WASH. U. L.Q. 353 (1989); Howard L. Shecter, *Acquiring Corporate Assets Without Successor Liability: Is It A Myth?*, 1 COLUM. BUS. L. REV. 137 (1986).

92. Many of the following suggestions regarding the bargaining process pertain to other federal environmental protection statutes as well. See Federal Resource Conservation and Recovery Act, 42 U.S.C. § 6901 (1976); Federal Clean Air Act, 42 U.S.C. §§ 7401-7642 (1977); Federal Clean Water Act, 33 U.S.C. §§ 1251-1376 (1977); Federal Insecticide, Fungicide, and Rodenticide Act, 7 U.S.C. §§ 135-136w (1988); Federal Toxic Substances Control Act, 15 U.S.C. §§ 2601-2671 (1988).

93. GRANT S. NELSON & DALE A. WHITMAN, *CASES AND MATERIALS ON REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT* 3 (3d ed. 1987).

objectives prepares the buyer to negotiate effectively for a valuable purchase.

During these stages, two of the buyer's main goals are to purchase the land at a fair market value and to protect against hazardous waste pollution liabilities. To assist the buyer in reaching these two goals, the buyer's counsel must take several preliminary steps. Counsel must first pinpoint and evaluate any environmental risks that could affect the course of the negotiation. Counsel must then present the client with a variety of legal means to minimize the transfer of these risks after purchase. Counsel should confirm that the seller has notified the appropriate agencies of the upcoming sale and arranged for the transfer of all necessary agency permits. Lastly, counsel should establish a mechanism for resolving postpurchase disputes between the seller and buyer.

To achieve these broad goals, buyer's counsel needs full access and ample time to investigate the property, perform a complete assessment, and prepare for the negotiation stage. During the initial investigatory stage, the buyer should expect full disclosure and candid responses from the seller regarding the site's environmental compliance history. Later, during the negotiation stage, the buyer should seek the broadest possible representations and warranties from the seller as to the past and present condition of property and as to known and unknown liabilities.<sup>94</sup> The buyer's counsel wants to ensure that if the buyer is later sued, the seller will share any damages and have sufficient funds to cover those damages. Ultimately, buyer's counsel must use the information gathered during the investigation to advise the buyer whether to purchase the real estate and, if so, to suggest bargaining approaches to negotiate the fairest price.

The buyer's and seller's goals directly conflict. Generally, the seller aims to sell the property at the highest possible price and to leave all environmental liabilities behind after closing. When contemplating a postpurchase status, the seller seeks to maximize the transfer of risks, whereas the buyer endeavors to minimize these risks.

Before the buyer begins an investigation, the seller may have already investigated the property so that the buyer does not embarrass the seller by discovering some unknown contamination. Although the seller's inspection may not be as

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94. See *infra* Part IV, § B(2)b: "Representations and Warranties."

thorough as the buyer's, it will help prepare the seller for the bargaining table. The seller will want the buyer's inspection to proceed as quickly as possible. The seller may also consider requesting the buyer to keep any findings confidential.

Fear of alarming a prospective buyer may lead a seller to refrain from fully disclosing all information relating to releases. Instead, the seller may prefer to reveal only the minimum amount of material information required by CERCLA.<sup>95</sup> For instance, a past violation may have been thoroughly remedied so as to have no lasting impact upon a site. However, even the smallest violation could frighten a potential buyer and ruin efforts by the seller for a sale. The seller's reluctance to disclose pertinent information to the buyer will be tempered by a corresponding fear of liability for nondisclosure, misrepresentation, fraud, or deceptive trade practices.<sup>96</sup> Despite that fear, a seller will attempt to make the narrowest possible representations and warranties regarding the conditions of the property in order to maximize price and limit liability.<sup>97</sup>

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95. Regarding the seller's disclosure duties, the seller, as a person in charge of an onshore facility, must report any release of a hazardous substance to the National Response Center. 42 U.S.C. § 9603(a) (1988). Section 9603 establishes this reporting obligation and addresses other topics, such as penalties for failure to notify, § 9603(b), and the E.P.A.'s authority to establish recordkeeping requirements, 42 U.S.C. § 9603(d). CERCLA also provides for public access to these records. 42 U.S.C. § 9604(e)(2) (1988).

These two sections of the statute create no disclosure obligations in a seller/property owner to a prospective buyer. However, 42 U.S.C. § 9601 (35)(c) (1988) provides

... if the defendant [seller] obtained actual knowledge of the release or threatened release or a hazardous substance at such facility when the defendant owned the real property and then *subsequently transferred ownership of the property to another person without disclosing such knowledge*, such defendant shall be treated as liable under section 9607(a)(1) of the title and no defense under section 9607(a)(3) of this title shall be available to such defendant.

(emphasis added). Despite this provision, the onus rests upon the prudent buyer to 1) demand affirmative representations concerning the property and seller's activities, and 2) investigate the EPA's public records.

96. See *United States v. Charles George Trucking Co.*, 624 F. Supp. 1185 (D. Mass. 1986), *aff'd*, 823 F.2d 685 (1st Cir. 1987) (imposing penalties upon a party who failed to respond to questions of the EPA). See also Louis S. Zimmerman, *Environmental Issues in Sales Transactions: The Seller's Perspective*, 3 NAT. RESOURCES & ENV'T 7, 8 (1988).

97. Zimmerman, *supra* note 96, at 41.

*B. Buyer's Preventive Measures: Risk Analysis and Allocation*

The assortment of preventive strategies from which a buyer may choose to achieve its goals falls typically into two successive phases: 1) analysis of the general and particular risks associated with the purchase, and 2) distribution of these risks. The first step requires gathering the requisite information to locate and reduce risks. The second step involves allocating contractually to the seller as many of those risks as possible.

1. Risk Analysis—The Information Gathering Stage

From the buyer's point of view, more information will allow for more realistic expectations, more forceful negotiations, and fewer disputes. Therefore, the buyer must initially gather information in order to identify all past and present activities that could trigger a CERCLA suit. The buyer may then use this information when deciding whether to continue pursuing the deal and how to negotiate around contractual conflicts with the seller.

*a. The First Step: An Environmental Audit*

The first step of the information gathering stage is the environmental audit. Like any inspection that proceeds along a checklist of items, the environmental audit reviews and appraises the seller's compliance record, environmental control systems, and environmental assets and liabilities.<sup>98</sup> A thorough environmental audit helps to quantify the market value of the property, provides the specific factual bases for representations and warranties, and helps to satisfy CERCLA's due diligence requirements.<sup>99</sup> Perhaps most importantly, a thorough environmental audit could lead to a successful assertion of the innocent landowner defense.<sup>100</sup>

An environmental audit consists of several components that should be undertaken in increasing stages of intensity and

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98. For a thorough, preventive law discussion of environmental audits, see Courtney M. Price & Allen J. Danzig, *Environmental Auditing: Developing a "Preventive Medicine" Approach to Environmental Compliance*, 19 LOY. L.A. L. REV. 1189 (1986).

99. See 42 U.S.C. § 9601(35)(A) & (B) (1988).

100. See *supra* notes 38-47 and accompanying text for discussion of CERCLA disclosure and landowner purchaser provisions.

expense. If a significant problem is discovered at an early stage, the buyer may avoid the unnecessary expense of a more exhaustive audit. Likewise, if the preliminary phases reveal no cause for suspicion, more expansive and expensive procedures may not be necessary.<sup>101</sup>

The first component of the audit involves requesting information from the Environmental Protection Agency (EPA) regarding any past or present compliance problems on the property.<sup>102</sup> The buyer should directly inquire whether there are or have been any statutory violations on the site. The buyer should also investigate the EPA records of adjacent properties to determine whether any surrounding activities pose a threat of contamination. If the property for sale does appear on an agency list, the buyer should investigate the EPA's files for more information. If this simple check exposes potential liability, the buyer can walk away from the deal with little loss of time or investment and avoid the prospect of debilitating liabilities from ownership of a contaminated site.

Even if no problems appear during this first step, the buyer's investigation should proceed. The EPA's identification process is time-consuming and complex, and it has not identified all existing CERCLA violations. A buyer cannot rely on

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101. Bradley M. Marten, *Strategies for Minimizing Waste Liability in Real Estate Transactions* 646, 674 (4th Annual Hazardous Waste Law Management Conference, University of Washington (1987)) (on file with *University of Puget Sound Law Review*).

102. Hazardous waste sites are listed on the National Priorities List, otherwise known as the Superfund list. The EPA also tracks and lists *potentially* hazardous waste sites in the Comprehensive Environmental Response, Compensation, and Liability Information System (CERCLIS). This site-specific data base is valuable in assessing the compliance status. A CERCLIS listing does not mean the site is contaminated, only that a suspicion of contamination exists and that the EPA will be investigating. Of course, that a site is not listed on CERCLIS does not mean that it is contaminant-free. Information regarding the National Priorities List and CERCLIS may be obtained from local and regional offices of the EPA.

If a prospective buyer cannot visit the EPA office library to review the CERCLIS database, a buyer may request a copy of CERCLIS for the area of interest by mail. In Region X (Alaska, Oregon, Idaho, and Washington), the EPA headquarters and library are located at the United States EPA, Region 10, 1200 Sixth Ave., Seattle, WA 98101. For requests by mail, the EPA has ten days to respond. Requests should be sent to: Freedom of Information Office, United States EPA, 1200 Sixth Ave., M/S: MD13, Seattle, WA 98101.

Other valuable sources of information are assessor's records, building permit records, and title records. Although not discussed herein, the prospective purchaser should also consult the state and local authorities charged with managing hazardous waste pollution problems.

the lack of EPA violations as an indication that the property is not contaminated.

After the review of the EPA records, the environmental audit proceeds to other accessible sources of critical information: federal and state court and county and municipal government records. The buyer should scrutinize all cases to which the seller has been a party, checking whether environmental contamination of the property to be purchased was an issue.

After these preliminary checks, the buyer should obtain permission to review the seller's records relating to environmental matters generally, any activities involving hazardous substances, and possible contaminations of the property. This third step could include a review of laboratory files, corporate correspondence, or accounts receivable and payable. The seller, if cooperative, can obviously be a valuable information source. If the seller objects to any of the steps in the audit, the buyer should be wary. An objection could signal that the seller is trying to hide incriminating information. In conjunction with the third step, the buyer should interview past and present owners of the property and, if available, persons associated with the activities conducted on the property. People to interview include supervisors, plant managers, and other employees with knowledge of the seller's waste management practices.

To document and supplement the interviews, the buyer should present a detailed environmental questionnaire or disclosure statement for the seller to complete. This statement requests the seller to disclose in writing any information bearing on environmental issues, including:

- a) current/former owners, uses of the property, and activities on the property (the seller may have conducted activities involving hazardous substances on the property without causing a release; the disclosure questionnaire should request information about these activities even though they may no longer be a threat);
- b) presence, use, storage, and disposal of hazardous waste substances on the property, such as asbestos or PCBs,<sup>103</sup> in addition to the presence of chemical or other storage tanks and pipelines on the property;
- c) compliance history of the property generally and, specifi-

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103. "PCBs," polychlorinated biphenyls, are defined as "any chemical substance that is limited to the biphenyl molecule that has been chlorinated to varying degrees or any combination of substances which contains such substance." 40 C.F.R. § 761.3 (1990).

- cally, records regarding: 1) past inspection of storage tanks, groundwater, and soils; 2) any known spills or leaks; 3) studies, memoranda or inspection reports on waste management activities;
- d) status and copies of all permits or licenses relating to the handling of hazardous substances on the property;
  - e) activities involving water discharges and waste disposal.

The questionnaire should be tailored to the uses that occur on the property. For instance, if the property has been used for industrial purposes, the buyer should inquire about the storage and use of raw materials for the industrial process or the disposal of the industry's waste byproducts. If the property has been used for agricultural purposes, the buyer should investigate whether pesticides, herbicides, or other chemicals have been used, stored, or spilled.

Finally, the buyer, buyer's counsel, and an experienced environmental consultant should conduct a thorough on-site inspection of the property. Environmental consultants are best prepared to structure the course and content of the investigation. Although this inspection should proceed from a blank slate, it should be guided, in part, by any information revealed during the first three phases. Among other things, the inspection should include: a walking tour of the property; physical analysis of groundwater, soils, and other samples; leak testing of any underground storage tanks; and a review of geographical characteristics (e.g., the likelihood of floods, earthquakes or other dangerous natural phenomena that could cause a release of contaminants).

Once the audit is finished, the consultant should summarize all the findings in a report for consideration by the buyer. This report may serve another important function after the purchase. If a CERCLA violation appears, the report can serve as an evidentiary record of the buyer's due diligence, in an attempt to satisfy the innocent landowner defense.<sup>104</sup> Therefore, each step in the audit should be documented; even the most preliminary efforts on the buyer's part can reveal a good faith attempt to ascertain the possibility of contamination.

#### *b. The Second Step: Evaluation of Identified Risks*

With results of the environmental audit in hand, counsel

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104. See *supra* notes 38, 46, and accompanying text.

for the buyer should evaluate any identified liabilities, such as the cost of cleaning up a contaminated sewage drain or the cost of removing asbestos from a building. This evaluation should be performed in recognition of the transaction's price, financing, and timing. Equipped with these results, the buyer can make one of three choices: call the deal off, continue towards closing the transaction as planned, or renegotiate the terms in the purchase and sale agreement. Although hazardous waste liabilities are often difficult to quantify, environmental consultants may help ascribe a dollar figure to them. Although a consultant's time is expensive,<sup>105</sup> the consultant's services can be easily justified when the purchase is large.<sup>106</sup>

Of course, the final decision to purchase rests with the buyer. To assist the buyer with this decision, counsel may apply algebraic formulae in an attempt to evaluate the merits of a purchase. This evaluation process often involves a significant amount of forecasting, judgment, and conjecture about the possibility and extent of liability. Ultimately, the benefits of the purchase must outweigh the possible risks and the extent of liabilities for contamination. For purposes of this evaluation, the following two formulae are helpful:  $B > (R + L) \times P$  and  $D = M \times P$ .

The first formula considers any risks,  $R$ , as calculated by the environmental consultant plus any liabilities,  $L$ , as calculated by the buyer's counsel in light of the probability that these risks and liabilities will occur,  $P$ . This figure,  $(R + L) \times P$ , must fall significantly short of the total benefits,  $B$ , of the purchase, as judged by the buyer.

The second formula considers the magnitude of a release,<sup>107</sup>  $M$ , in light of the probability of its occurrence,  $P$ .  $M$ , which contemplates the volume and type of release, expresses the cleanup expense in dollars;  $P$ , which contemplates the likelihood of a release, expresses the possibility of a release as a percentage. The product of these two factors yields a figure

105. Environmental consultants in the Puget Sound Region of Western Washington charge, on the average, between \$85-100 per hour for environmental assessments. Because so many factors (including size, accessibility, history of ownership and uses, and degree of contamination of the property) affect the scope of an audit, it is difficult to state an average total cost of a typical audit.

106. For a complete review of the consultant's role, see Daniel H. Squire & Robert J. Martineau, Jr., *Environmental Consultants: Getting Your Money's Worth*, 3 NAT. RESOURCES AND ENV'T 23 (1988).

107. See *supra* notes 32 and 33 (containing statutory definitions of "release" and "hazardous substance").



with which, depending on the status of the negotiations, the buyer may negotiate to discount, *D*, the purchase price.

By no means do these formulae attempt to provide an exact means for judging the merits of a purchase. Rather, as counsel and client mull over whether to close a deal, the formulae provide a conscious, deliberate device to sketch the abstract, borderless economies of a real estate purchase where CERCLA liabilities may impend.

Using these formulae, the buyer must develop negotiation strategies, choose the highest acceptable price, and define any limits beyond which he or she will not go. In addition, the buyer should rank negotiation objectives so that during the negotiations the buyer knows which objectives may be dismissed or compromised for the sake of the purchase. In cases where CERCLA liabilities have been identified, the buyer should approach the bargaining table aware of certain options. Those options may include an elimination of certain sections of the property from the purchase, an adjustment of the price, or an arrangement where the seller performs a prepurchase cleanup. Without gathering sufficient information and delineating bargaining objectives, the buyer will approach the bargaining table at a significant disadvantage and could later be held responsible for disastrous hazardous waste liabilities.

## 2. Risk Allocation—The Contractual Drafting Stage

Because CERCLA allows parties to allocate risks between themselves, the buyer may use several malleable contractual devices to shield against future liability.<sup>108</sup> Contract interpretation governs the issue of liability for hazardous waste contamination transfers.<sup>109</sup> In reaching a decision, courts will review the parties' mutual intentions at the time the contractual allocation was made.<sup>110</sup> Most courts have held that state

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108. Congress recognized the value of certain contractual allocations of risk. See 42 U.S.C. § 9607(e)(1)(1988) ("Nothing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this section."). For a recent casenote on this subject, see Lynn E. Richter, *AM International v. International Forging Equipment: Does CERCLA Allow Private Parties to Contractually Allocate Liability for Cleaning up Contaminated Sites?*, 22 U. TOL. L. REV. 1065 (1991) (discussing *AM International, Inc. v. International Forging Equipment*, 743 F. Supp. 525 (M.D. Ohio 1990), where court forbade contractual allocation of CERCLA liability).

109. *Southland Corp. v. Ashland Oil, Inc.*, 696 F. Supp. 994, 1000-01 (D.N.J. 1988).

110. *Id.*

law governs such contracts.<sup>111</sup>

The following three subsections discuss three contractual devices to avoid exposure to hazardous waste liability: escape clauses, representations and warranties, and indemnification clauses.

*a. The Escape Clause: A Condition to Purchase*

The first type of protection against CERCLA liability that the buyer should include in the purchase and sale agreement is an "escape clause." An escape clause resembles a condition that allows a residential real estate buyer to inspect for termite damage or other defects. If the environmental audit reveals evidence of contamination, the clause gives the buyer the option to avoid the agreement without penalty. The value of the clause depends wholly on the quality of the environmental audit; without a thorough audit, the buyer will not know whether to proceed with the purchase. The following paragraphs provide one example of an escape clause:

RIGHT TO CONDUCT ENVIRONMENTAL INVESTIGATION AS A  
CONDITION TO PURCHASE

Seller agrees that Buyer may conduct an environmental investigation of the subject property. The investigation must be conducted no later than \_\_\_\_ days from the effective date of this agreement. During the investigation and while in the presence of the Seller or an authorized representative, the Buyer and his Consultants shall have the right of access to any portion of the subject property.

If the Buyer is dissatisfied with the results of the investigation, the Buyer may, in his sole discretion, elect to terminate this agreement. The election to terminate may be based only upon Buyer's dissatisfaction with the investigation results, not upon dissatisfaction with other aspects of the purchase.

To terminate this agreement, the Buyer must send to the Seller, or his attorney: 1) written notice of the intent to terminate, and 2) a complete copy of the results of the investigation, including reference to the specific findings that have caused the Buyer to elect to terminate the agreement.

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111. See *Lyncott Corp. v. Chem. Waste Management, Inc.*, 690 F. Supp. 1409, 1417 (E.D. Pa. 1988); *Mardan Corp. v. C.G.C. Music Ltd.*, 600 F. Supp. 1049, 1052-53 (D. Ariz. 1984), *aff'd*, 804 F.2d 1454, 1458 (9th Cir. 1986). Specific examples of how courts have interpreted representations and indemnification provisions are discussed in Part IV, section C.

This notice must be received by the Seller \_\_\_\_ days prior to the date of closing.

Upon termination, this agreement will be void in all respects. No liability shall attach to the Buyer by virtue of the election to terminate, and all rights of either party to this agreement shall cease.

This clause first establishes the right to and timing of an investigation or audit. The clause then establishes the mechanism and consequences of the buyer's termination. In addition to these subjects, counsel for the buyer may want to include provisions relating to two other topics: investigation expenses and earnest money deposits.<sup>112</sup> Given that an environmental audit is expensive<sup>113</sup> and that the seller will most likely request a copy of the investigation report for his records, the buyer may negotiate to have the seller share in the expenses. After all, if the buyer later walks away from the deal, the seller will still keep the investigation results.

If the buyer does elect to withdraw from the purchase, then he should receive the earnest money earlier deposited into escrow. Counsel should draft a provision stating that, if the buyer complies with the clause's timing and termination procedures, the earnest money deposit will be returned to the buyer.<sup>114</sup> On the other hand, if the buyer does not comply with these procedures, the seller may keep the earnest money. This twist should appeal to the seller and also serve as a means to liquidate damages for breach of the condition.<sup>115</sup>

### *b. Representations and Warranties*

When drafting representations and warranties, most of the subjects addressed reflect subjects investigated during the audit stage. The representations attempt to guarantee the reliability of the audit's earlier findings. Although the buyer cannot expect the seller to make representations extending beyond its control or knowledge, the buyer should seek to

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112. Ralph H. Palumbo, *Hazardous Waste Aspects of Negotiating and Drafting Real Estate Sales Agreements: The Seller's Point of View* 143, 175-79 (The Inaugural Northwest Real Estate Symposium, University of Washington, November 16-18, 1989) (on file with the *University of Puget Sound Law Review*).

113. See *supra* note 105.

114. *Purchase and Sale Documents* 37 (The Inaugural Northwest Real Estate Symposium, University of Washington, November 16-18, 1989) (on file with the *University of Puget Sound Law Review*).

115. *Id.*

maximize the seller's exposure. To give the representations some teeth, the representations must be made to survive closing. Although the seller will try to avoid making broad representations, there are several topics regarding the condition of the property on which the buyer should encourage the seller to represent and warrant:

- a) That, during the Seller's ownership of the property, there have been no releases of hazardous substances on the property in question and that Seller has no knowledge of any release on the property by any previous owners.
- b) That Seller and previous owners have reported to the EPA all leaks, spills, and other contaminations and that Seller has cleaned up these contaminations to the agency's satisfaction.
- c) That Seller has faithfully responded to Buyer's disclosure questionnaire and that the information reported therein is true and correct to the best of Seller's knowledge.
- d) That Seller is not or has not been a party to any action, civil, criminal, or administrative (except as listed) involving the breach of CERCLA or other environmental statutes and that Seller has not received any notice concerning the violation of CERCLA provisions or future suits involving these statutes.
- e) That Seller has complied with all applicable environmental laws, rules, and regulations and that Seller's books and records accurately reflect Seller's environmental compliance history.
- f) That Seller has given all required notifications and acquired all the permits or licenses necessary for the lawful operation of Seller's business upon the property. Seller has fully complied in all material respects with the requirements of these authorizations. None of Seller's activities on the property for sale will affect the renewability of these licenses and permits. Seller has no knowledge of any changes or events that will substantially alter Buyer's ability to comply with environmental laws and to obtain the necessary permits.
- g) That neither Seller nor its predecessors has participated in the disposal of any hazardous substance from the property for sale, at an off-site location or at a designated Superfund site (except as listed).

If any of these representations needs to be modified to account for an exception, such as an instance of regulated dumping of hazardous substances at a Superfund site, then the

buyer must draft the representation for factual accuracy. Not only should the subjects of the representations follow the subjects addressed in the audit, the language of the representations should follow the precise language of the statute. This suggestion applies equally to other sections of the agreement that address CERCLA, including any conditions and indemnification provisions. For instance, if the representations discuss "releases," "hazardous substances," "enforcement actions," or "natural resources damages," then the contract should define these terms consistently with CERCLA.

### *c. Indemnification Provisions*

In an indemnification clause, the indemnitor undertakes to secure or hold harmless and to restore or compensate the indemnitee in the case of a loss or liability. Indemnification is an indispensable element in the buyer's purchase agreement. One court explained the value of indemnification clauses in CERCLA actions: "[I]ndemnity is a fault-shifting mechanism, available to a defendant who is held liable to a plaintiff by operation of law, but who seeks recovery from the party actually responsible for the loss."<sup>116</sup>

The buyer, as the indemnitee rather than the indemnitor, should not rely on general clauses when drafting an indemnification provision.<sup>117</sup> Rather, the buyer should specify in the clause those liabilities that the seller will assume. Because such provisions are typically strictly construed against the indemnitee's interests, the provision's success will depend upon its clarity and precision.<sup>118</sup> Moreover, when drafting these clauses, the buyer and seller must remember that their agreement can only allocate liability between themselves: the agreement cannot "affect rights of a stranger to the contract."<sup>119</sup>

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116. *Con-Tech Sales Defined Ben. Trust v. Cockerham*, 715 F. Supp. 701, 705 (E.D. Pa. 1989) (citing to *Sirianni v. Nugent Brothers, Inc.*, 506 A.2d 868, 871 (1986)).

117. Caveat: Given the unlimited variety of circumstances that may exist when drafting, every transaction demands well-tailored language. All drafters must craft clauses that answer all the factors of the situation at hand; drafters should not rely on the following clauses as sufficient in every case.

118. *Pickhover v. Smith's Management Corp.*, 771 P.2d 664, *cert. denied*, 795 P.2d 1138 (Utah 1989); *Straub Clinic and Hosp., Inc. v. Chicago Ins. Co.*, 665 P.2d 176 (Haw. 1983); *Transamerica Ins. Co. v. Parker Henry Glass Co.*, 7 Wash. App. 208, 499 P.2d 21 (1972).

119. *Grant-Howard Assoc. v. General Housewares Corp.*, 482 N.Y.S.2d 225 (Ct. App. 1984). By virtue of § 9607(e)(1), "strangers to the contract" includes the federal government. *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86, 89 (3d Cir. 1988), *cert. denied*, 448 U.S. 1029 (1989).

Below is a sample indemnification clause favoring the buyer:

Seller agrees to indemnify and hold harmless Buyer from and against any liability, civil or criminal or administrative, and any expense, including attorneys' fees and disbursements, which:

1) is asserted against or incurred by Buyer, its successors, assigns, and lenders by any party, including federal, state, county, and municipal authorities or private parties; and

2) arises directly or indirectly as a consequence of any contamination of any property, including the subject property, by a release of hazardous substances.<sup>120</sup>

This indemnity applies to contaminations that:

1) cause or result in any adverse environmental effect, injury or death to any person, or other violation of CERCLA; and

2) exist at or before the date of closing.<sup>121</sup>

Seller's obligation to indemnify Buyer shall survive the date of closing and exists in addition to any representations or warranties made by Seller regarding the subject property and this transaction as a whole.

A sophisticated seller will probably balk at the breadth of this clause. From a buyer's point of view, however, it is best to draft broadly. Then, when negotiating, the buyer may appease the seller's reservations about a broad indemnity by offering certain concessions, such as a monetary or temporal limit to the indemnification. These limits, or bargaining tools, allow the buyer to placate the seller while preserving a valuable deal in which the buyer is protected. In addition, the buyer can point out that the seller should not have any qualms about a reasonable indemnification if 1) the seller faithfully responded to the questionnaire, 2) the audit revealed no contamination, and 3) the seller does not indemnify the buyer for any releases *caused by the buyer*.

One last important point regarding indemnification is that the value of even the most watertight clause rests upon the

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120. This clause or the whole purchase agreement should incorporate the definitions of these and other statutory terms by reference.

121. Note: The Seller's indemnity does not apply to contaminations that occur after closing. If the time at which a contamination occurred is not ascertainable, the Seller and Buyer could negotiate to share equally in any responsibilities that flow from the contamination.

seller's ability to pay when the clause is invoked.<sup>122</sup> Thus, the buyer must ensure that the seller has committed sufficient finances to secure the seller's promises after closing. Several means exist to secure the seller's ability to pay. Traditional methods include letters of credit, escrow, deposits, or bonds.<sup>123</sup> The parties can also negotiate for the seller to purchase insurance. Although courts have largely construed "comprehensive general liability" (CGL) insurance policies as excluding coverage for pollution,<sup>124</sup> certain "environmental impairment liability" (EIL) policies are available.<sup>125</sup>

A strong funding provision not only ensures that money exists to pay for the cleanup, but also removes any incentive the seller may have to make an opportunistic breach. An opportunistic breach could occur if the penalty provisions are less than the costs anticipated in an environmental cleanup cost recovery action. The indemnification and funding mechanism must financially bind the seller and make breaching the clause economically unwise, thereby forcing the seller to honor the contractual obligation to reimburse the buyer for CERCLA cleanup expenses.<sup>126</sup>

Because of the disabling size of hazardous waste pollution liability, however, the buyer will encounter significant resistance to any broad indemnification provision or any seller commitment to maintain funding after closing. Therefore, the buyer may be forced to consider creative and alternative funding mechanisms, such as captive insurance policies, insurance pooling arrangements, and trust funds.<sup>127</sup>

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122. See generally J. Phil Carlton & M. Guy Brooks III, *Corporate Director and Officer Indemnification: Alternative Methods for Funding*, 24 WAKE FOREST L. REV. 53, 58 (1989).

123. *Id.* at 55.

124. *Cincinnati Ins. Co. v. Milliken and Co.*, 857 F.2d 979 (4th Cir. 1988); *Continental Ins. v. Northeastern Pharmaceutical*, 842 F.2d 977 (8th Cir. 1988); *Maryland Casualty Co. v. Armco, Inc.*, 822 F.2d 1348 (4th Cir. 1987). *But see* *Independent Petrochemical Corp. v. Aetna Casualty & Sur. Co.*, 944 F.2d 940 (D.C. Cir. 1991); *Hazen Paper v. U.S. Fidelity & Guar.*, 555 N.E.2d 576 (Mass. 1990); *Boeing v. Aetna Casualty & Surety Co.*, 113 Wash. 2d 869, 784 P.2d 507 (1990).

125. Prospective buyers may consider the Pollution Liability Insurance Association or the American Insurance Group as sources of EIL insurance policies. For a review of insurance issues in this context, see Thomas A. Gordon & Roger Westendorf, *Liability Coverage for Toxic Tort, Hazardous Waste Disposal and Other Pollution Exposures*, 25 IDAHO L. REV. 567 (1988-89).

126. See Carlton & Brooks, *supra* note 122, at 56-57.

127. The discussion of the intricacies of these funding mechanisms is beyond the scope of this Comment. For an introduction to traditional and alternative funding mechanisms, see Carlton & Brooks, *supra* note 122.

*C. Case Law Interpretations of Private Party  
Indemnification*

In many cases, well drafted indemnification provisions have served to immunize parties from CERCLA liability. This section analyzes actual clauses from four cases. Judicial interpretations of these clauses provide instructive guidance for drafting enforceable contractual transfers of CERCLA liability.

CERCLA sections 9607(e)(1) and (2) address the subject of private indemnification provisions.<sup>128</sup> As a general rule, when interpreting sections 9607(e)(1) and (2), courts across the country have held that indemnification agreements are not enforceable against the government but that they are enforceable against private parties.<sup>129</sup>

In *Jones-Hamilton Co. v. Kop-Coat, Inc.*, the Northern District of California court explained the rule and its policy:

[P]rivate parties are free to contract among themselves with respect to indemnification and contribution. . . . [P]arties are jointly and severally liable with respect to the government in order to insure that the taxpayers are not forced to bear the cost of responding to the illegal disposal of hazardous substances. . . . [This] rule . . . has great appeal in that it assures that responsible parties rather than taxpayers will bear the cost of responding to the illegal dumping of hazardous substances without unduly limiting the freedom of private parties to contractually distribute the risk of liability.<sup>130</sup>

The indemnity provision in *Jones-Hamilton* provided as follows:

[Plaintiff—Jones-Hamilton Co.] agrees to comply with all applicable Federal, State and local laws, ordinances, codes, rules and regulations and to indemnify [defendants—Kop-Coat, Inc.] against all losses, damages and costs resulting

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128. See *supra* note 15. *Channel Master Satellite Sytems, Inc. v. JFD Elec. Corp.*, 702 F. Supp. 1229 (E.D.N.C. 1988) ("The thrust of § 107(e) is that although one may not deny liability for response costs by virtue of an indemnity or hold harmless agreement, such agreements to indemnify are not eliminated by the strict liability provisions of CERCLA.").

129. *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86 (3d Cir. 1988), *cert. denied*, 448 U.S. 1029 (1989); *Mardan Corp. v. C.G.C. Music, Ltd.*, 804 F.2d 1454 (9th Cir. 1986); *Jones-Hamilton Co. v. Kop-Coat, Inc.*, 750 F. Supp. 1022 (N.D. Cal. 1990).

130. *Jones-Hamilton Co. v. Kop-Coat, Inc.*, 750 F. Supp. 1022, 1026 (N.D. Cal. 1990) (interpreting the Ninth Circuit rule announced in *Mardan Corp.*, 804 F.2d at 1454).



from any failure of [plaintiff] or any of its employees [sic], agents or contractors to do so.<sup>131</sup>

This clause was written to indemnify Kop-Coat, suppliers of hazardous raw materials, from any liabilities arising out of Jones-Hamilton's facility that fabricated wood preservation compounds. The court generously upheld the clause as a valid transfer of risk from all damages, including CERCLA liability, even though the clause was written ten years before CERCLA was enacted.<sup>132</sup>

In contrast to the court's broad and forgiving construction in *Jones-Hamilton*, the Eastern District of North Carolina applied, to one seller's detriment, a rigid and merciless construction of a similar indemnification clause in *Channel Master Satellite Systems, Inc. v. JFD Electronics Corp.*<sup>133</sup> After Channel Master purchased thirteen acres of real estate from JFD Electronics in 1985, it elected to spend over three million dollars to clean up groundwater and soil contamination as a step toward obtaining state and federal permits. Despite an indemnification clause in the sales agreement protecting JFD Electronics, Channel Master sued for indemnification and contribution for the cleanup expenses pursuant to CERCLA section 9607(a). The indemnification language provided that:

All notes or notices of violations of law or municipal ordinances, orders or requirements noted in or issued by the Departments of Buildings, Fire, Labor, Health or other *state or municipal* departments having jurisdiction (collectively "*Violations*") affecting the Property at the date of this contract shall be conveyed free of the same; . . . Buyer agrees to indemnify and to hold Seller and its respective successors and assigns harmless from and against all actions, claims, penalties, damages and expenses, including attorneys' fees, incurred by Seller resulting from any *Violations* against or affecting the Property . . .<sup>134</sup>

Channel Master argued that JFD Electronics was liable as a previous owner/operator of a facility at which contamination had occurred. JFD Electronics' attempt to use the indemnification clause as a defense were to no avail. Despite the clause's obvious intent to relieve JFD Electronics of certain liabilities

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131. *Jones-Hamilton Co.*, 750 F. Supp. at 1023.

132. *Id.* at 1028.

133. 702 F. Supp. 1229 (E.D.N.C. 1988).

134. *Channel Master Satellite Systems*, 702 F. Supp. at 1230 (emphasis added).

after the sale, the court ruled that "[t]he indemnity clause, by its language, [was] not related to violations of federal law, and therefore [was] not applicable to Channel Master's claim."<sup>135</sup>

Although courts traditionally construe indemnification clauses against the drafter's interests,<sup>136</sup> *Jones-Hamilton* and *Channel Master* demonstrate that one cannot predict whether a court will interpret such a clause generously or rigidly. As a result, buyers aiming to limit their liability must draft the clause as broadly yet precisely as possible.

Two other cases involving real estate transactions provide guidance for drafting indemnification provisions and how to secure their enforcement by the courts. In *Versatile Metals, Inc. v. Union Corp.*, the vendor-lessor agreed to indemnify the purchasers-lessees if any hazardous waste contamination occurred on the property before the date the purchasers took possession of the property.<sup>137</sup> Specifically, the "Asset Purchase Agreement" provided that:

Seller . . . represent[s] and warrant[s] to Buyer that as of November 26, 1984 the land included in the Leased Premises was free of contamination in violation of any applicable federal, state, or local law or regulation relating to the protection of health, safety, and environment. Seller . . . agree[s] to indemnify and hold Buyer harmless from any and all costs, damages, liabilities and expenses resulting from hazardous waste . . . provided that . . . Buyer acts in the following manner:

(a) Buyer shall keep all Inventory purchased hereunder segregated from any other inventories of Buyer;

(b) Buyer shall give seller [sic] prompt telephone notice . . . upon discovery of capacitors or other items in such inventory that may contain hazardous waste and shall at the sole expense, risk and liability of Seller cooperate with Seller in Seller's removal and shipment of such items; and

(c) Buyer shall act in a reasonable manner both before and after discovery of items containing hazardous wastes in order to prevent leakage and otherwise minimize contamination or other damage.<sup>138</sup>

After the purchaser, *Versatile Metals*, took possession, it found the property was heavily contaminated. In reviewing

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135. *Id.* at 1232.

136. See *supra* note 118 and accompanying text.

137. *Versatile Metals, Inc. v. Union Corp.*, 693 F. Supp. 1563 (E.D. Pa. 1988).

138. *Id.* at 1568.

Versatile Metals' claim to recover response costs from Union Corp., the court acknowledged that the above provision could serve as a valid transfer of risk. The court found, however, that Versatile Metals had failed to comply with the indemnification's conditions (a), (b), and (c). As a consequence, the court barred Versatile Metals from invoking the provision's protection despite the clause's explicit allocation of responsibility to the seller. Therefore, the court held Versatile Metals responsible for any contamination occurring from its actions after the purchase.<sup>139</sup>

The *Versatile Metals* decision provides two obvious lessons. First, the purchaser should satisfy all conditions in the indemnification clause. Second, the purchaser should consider drafting an indemnification provision free from conditions that may make compliance difficult.<sup>140</sup>

In *Emhart Industries, Inc. v. Duracell International, Inc.*, the buyer, Emhart Industries, had been negotiating the purchase of real estate and manufacturing plants in three different states when it learned the seller had used PCBs in their manufacturing processes.<sup>141</sup> As a result, Emhart Industries insisted on contractual protection from liability for PCB pollution. The sellers agreed to indemnify Emhart Industries for

Any obligation, liability, loss, damage or expense, of whatever kind or nature, contingent or otherwise, known or unknown, incurred under, or imposed by, any provision of Federal, state or local law or regulation, or common law, pertaining to health, safety or environmental protection and arising out of any act or omission by Seller, its employees or representatives prior to the Closing Date, including, without limitation, such laws or regulations pertaining to the storage, transportation, handling, disposal, discharge, presence or use of polychlorinated biphenyls (PCB) or any substance containing PCBs.<sup>142</sup>

Later, after Emhart began operating the purchased plants, the amount of PCBs discharged at one of the plants had not

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139. *Id.* at 1573.

140. On the other hand, if the seller is unwilling to agree to an unconditional indemnification provision, conditions can serve as a buyer's valuable bargaining tools. The buyer must remember to offer conditions that will not interfere with the buyer's later use of the property and that will not be difficult to satisfy.

141. *Emhart Industries, Inc. v. Duracell International, Inc.*, 665 F. Supp. 549 (M.D. Tenn. 1987).

142. *Id.* at 555-56.

diminished. The discharge levels were high enough to endanger the health of the plant's employees and to force Emhart to shut the plant down.<sup>143</sup> Because neither seller was eager to honor the indemnification agreements, Emhart sued. The Tennessee district court upheld the risk transfer provisions, entitling Emhart to recover all PCB cleanup costs.<sup>144</sup>

As in *Channel Master*, however, the court strictly construed the indemnification provision and therefore rejected another of Emhart's claims for indemnification. On the issue of whether Emhart's response measures were economically efficient, the district court stated that "the indemnity does not require that Duracell underwrite the most economically productive solution to the . . . PCB problem."<sup>145</sup>

These four cases illustrate that environmental problems rarely come in manageable sizes and shapes. Moreover, they are typically concealed from easy observation, often not manifesting themselves until years after closing. Unfortunately, no indemnification provisions for minimizing hazardous waste liabilities have been universally accepted. Therefore, unless the seller agrees to a sweeping indemnity, which is unlikely, a buyer's counsel must explicitly specify those liabilities from which the buyer is protected. Otherwise, as occurred in *Channel Master* and *Versatile Metals*, the courts most likely will construe the indemnity strictly, favoring the indemnitor—the seller.

#### *D. General Drafting and Negotiation Techniques*

When drafting and negotiating indemnification clauses, as well as all elements of the purchase agreement, the buyer should be aware of certain points on which compromise may turn, such as the temporal and financial objectives of each party. The process of negotiation is not a question of choosing between discrete options. Rather, the risks, responsibilities, and profits rest upon a continuum between the seller's and buyer's opposing objectives.

The central elements of the transaction—price, timing and risk allocation—can all be manipulated to varying degrees in order to consummate the purchase. A well-informed buyer is better situated during the negotiation process. When bargain-

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143. *Id.* at 562, 566-67.

144. *Id.* at 574-75.

145. *Id.* at 571.

ing, the buyer will then be able to present a variety of options to the seller.

For instance, if hazardous waste pollution is known or likely, one option might be a large price reduction with limited post-closure obligations on the seller. Another option might involve no price reduction but relatively unlimited post-closure obligations on the seller. If some portion of the property is contaminated, the purchase could exclude that area from the transaction. A seller, understandably, will be averse to bear any post-closure responsibility for CERCLA liability. In order to protect its own interests, the buyer must assuage the seller's aversion by carefully arranging the dimensions and scope of the purchase agreement.

## V. CONCLUSION

No buyer can completely protect itself from liability for hazardous waste contamination. The prospect of huge environmental liability need not, however, discourage all real estate transactions. By means of thorough preparation, informed negotiation, and precise drafting, buyer's counsel can shift many of the risks of CERCLA liability. The prophylactic strategies and devices discussed in this Comment can shield a buyer's interests against crippling CERCLA liabilities.

As environmental risks become more prominent, these techniques will become more valuable as a means to minimize the buyer's exposure to CERCLA liability. Manipulation of these and other approaches eases the bargaining process and protects the buyer from another party's hazardous waste mismanagement. Buyers must still approach certain real estate transactions with extreme caution and patience, keeping in mind that the statute and accompanying case law have not yet reached a state of equilibrium. Considerable variation remains in the legal community's interpretation of this imposing statute. Nevertheless, these prepurchase precautions can help avoid postpurchase obligations.