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Watch Your Language

Avoid 5 common mistakes in contract environmental clauses.

by Tom Mounteer

For decades, I've advised financial and strategic commercial real estate buyers and sellers in connection with the environmental aspects of their transactions. I review scores of acquisition agreements each year. Objectives of the parties are oftentimes quite similar.

- Buyers want to leave responsibility for historic waste disposal with sellers, or sellers want to have buyers expressly assume that responsibility.
- The parties want their agreement to be all-encompassing with respect to the apportionment of environmental liabilities between them and extinguish common law or statutory causes of actions that might otherwise exist.
- They want to define the extent of the cleanup obligations of the party who has assumed those obligations and assure those obligations remain only with that party.
- They want to define how long their contractual remedies remain viable.

While contract language divvying up environmental liability has generally improved over my decades of practice, there are five common mistakes that I still frequently see.

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Five Pitfalls

1. Because environmental liability can be strict, retention or assumption of responsibility for "violations" of law may not apportion hazardous substance release liability.

Parties agreeing on language where sellers retain or buyers assume responsibility for pre-closing "violations" of environmental law may be unaware that such language may not apportion liability risk for hazardous substance releases. For example, in a case relating to cleanup of PCBs in river bed sediments, the buyer agreed to assume liability for pre-closing violations of environmental law. In construing this contract language, the court noted that, at the time the PCBs were released, their release violated no environmental or pollution control law. The court ruled that the contract language did not mean that the buyer assumed liability for cleaning up the contaminated sediments in the river bed.

2. An "as is" clause will be sufficient to extinguish a buyer's common law rights of action against the seller for environmental conditions, but it won't extinguish the buyer's statutory rights.

Real estate purchase and sale agreements often include as-is clauses to eliminate the buyer's right to bring claims against the seller based on real property conditions. Courts have held, however, that as-is clauses do not curtail the buyer's statutory rights to seek recovery of cleanup costs. If it is the parties' intent to extinguish all buyer's rights against the seller, then they need to use different language in addition to the as-is clause.

3. Because the degree of cleanup differs for industrial, commercial, and residential property, it may not be enough to make getting a government agency's

"no further action" determination as the cleanup endpoint.

In order to receive a no further action ruling, buyers and sellers first need to be more specific as to the property's use. Even setting a site-use parameter, such as industrial or residential, may not be sufficiently specific under current risk-based cleanup rules. You likely need to specify whether the party conducting the cleanup can implement institutional prohibitions, such as groundwater well installation, or engineering controls, such as paved surfaces, in order to attain the requisite degree of risk avoidance under the state cleanup statute.

4. Making environmental liabilities "at purchaser's sole cost and expense" may inadvertently extinguish the buyer's contribution rights against third parties.

When contract language states the buyer assumes site cleanup costs at its sole cost and expense, I assume no environmental lawyer has reviewed the language. Such sole-cost language may inadvertently eliminate the buyer's rights to recover the cleanup costs from third parties, such as the facility next door. Even in cases where the transaction agreement also contains a clause eliminating any third-party beneficiaries, a court may interpret such sole-cost language to extinguish statutory contribution rights. That may not have been the parties' intent. The seller may have no objection to the buyer's bringing an environmental contribution action against the owner of the property next door for contamination that migrated onto the buyer's property.

5. "Survival" clauses that purport to endure for the length of the corresponding statute of limitations for the indemnified environmental liability might endure indefinitely.

Acquisition agreements sometimes set the survival period for indemnity claims for breaches of the environmental representations at "the expiration of the statute of limitations applicable to" the representation, including the representation that there had been "no release of hazardous materials." There could be many bases for asserting claims based on breach of the "no release" representation: a couple federal statutes, one or more state statutes, and several common law theories. Under one federal statute, causes of action would be evergreen as long as the plaintiff could show that there was the threat of a release of hazardous materials. So it is possible that the survival period could endure indefinitely.

Where environmental liability is a material risk, and the parties intend to apportion it between themselves, they need to take care in drafting the contract provisions to give effect to their intent.

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