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Managing Environmental Liabilities in Transactions

Moderator: Cassie Roberts, Perkins Coie LLP

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This session will cover:

How to effectively manage environmental liabilities in transactions from conducting the environmental assessment to negotiating a prospective purchaser agreement and obtaining environmental insurance to mitigate risk.

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Phase I Environmental Site Assessments and Due Diligence

Sean Ragain, RG

NEBC Business & Environment Conference 2023

Geosyntec consultants

I. What is “Environmental Due Diligence”?

- Due Diligence definition (Merriam Webster)
  - 1: the care that a reasonable person exercises to avoid harm to other persons or their property
  - 2: ***research and analysis of a company or organization done in preparation for a business transaction*** (as a corporate merger or purchase of securities)
- Practical definition – our Environmental vernacular
  - ***Efforts undertaken to identify whether a piece of real estate is contaminated and the resulting effect that contamination will have on the economics of the transaction***

(Adapted from Environmental Aspects of Real Estate and Commercial Transactions; 3rd Ed. 2004)

I. An Overview

- What are common types of EDD…
  - Transaction support/portfolio analysis
  - Owner internal diligence/audit
  - Desktop evaluations
  - ***Phase I ESA in accordance with ASTM Std. E1527-21***
  - Phase II ESA
  - Phase I with Limited Environmental Compliance Review
- Why do Buyers need EDD…
  - Identify environmental liabilities
  - Comply with All Appropriate Inquiry (AAI) Rule (more on this later)
  - Satisfy dealmakers, lenders, insurers
  - Improve the understanding of risk and the bottom line

I. What is a typical “Phase I Environmental Site Assessment (ESA)”?

- Environmental assessment of a property which…
  - Uses ***existing information*** sources (i.e., not creating new data)
  - Focuses on ***hazardous substances*** (HS) and ***petroleum products*** (PP)
  - Allows for environmental ***professional judgement*** and discretion
  - Intended for commercial ***real estate transactions***
- Does Not:
  - Include ***sampling and testing*** (that’s a Phase II ESA)
  - Constitute a ***regulatory compliance audit*** (that’s a common add-on)
  - Provide a comprehensive ***basis for remediation (remedy) costs***
- Is Never:
  - A guarantee regarding impacts or contamination
  - An assessment of value or marketability of a property
  - A complete risk elimination process

What is the Purpose?

- Establishes a standard for good commercial and customary practice for compliance with the ***All Appropriate Inquiry (AAI) Rule*** - *"the assessment or evaluation of a property to identify potential environmental contamination and assess potential liability for any contamination present at the property"*
- Qualifies the User (purchaser, tenant, owner, or lender) for Federal liability protections
- Identifies Recognized Environmental Conditions (RECs) at a Site

II. The All Appropriate Inquiry (AAI) Rule

- EPA All Appropriate Inquiries/CERCLA Liability Protection
  - ***"The assessment or evaluation of a property to identify potential environmental contamination and assess potential liability for any contamination present at the property"***
  - Signed into law in January 2002 under the Small Business Liability Relief and Revitalization Act ("***the 2002 Brownfields Law***")
  - Codified under 40 CFR Part 312 in November 2006
  - More information: http://www.epa.gov/brownfields/brownfields-all-appropriate-inquiries

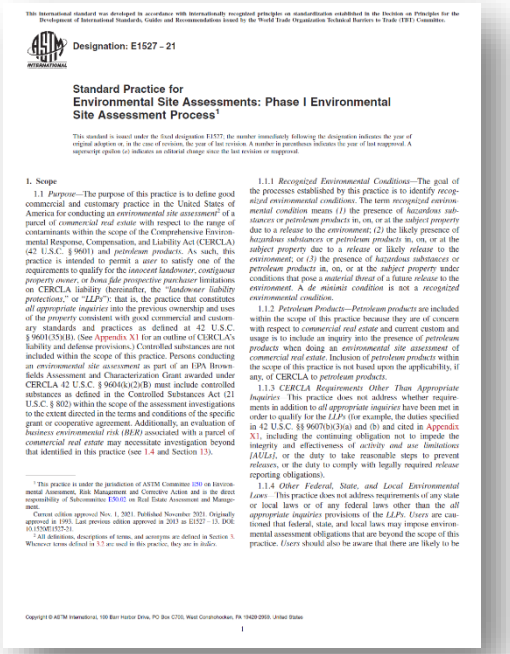
Landowner Liability Protections (LLP)

- Contiguous Property Owners (3.2.17)
- Bona Fide Prospective Purchasers (BFPP) (3.2.8)
- Innocent Landowners (3.2.44)
  - All three LLPs are contingent on AAI, continuing obligations, and the following threshold criteria:
  - Landowner conducted AAI at time of acquisition (e.g. the Phase I ESA)
  - Landowner has no affiliation with the responsible party
  - Landowner did not cause, contribute or consent to the release

II. ASTM E1527 Overview

Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process

- ***1993: First published***
- 1997 and 2000: Revisions (not overhauls)
- 2002: Brownfields Act – cites E1527 as meeting interim standard to gain AAI protection
- ***2005: Significant changes*** – introduces the REC. Officially recognized as meeting AAI
- 2013: Expansion over 2005 version - Vapor migration consideration (NOT VI), Regulatory file reviews required, Revised REC definition, updates Historical RECs & added Controlled RECs
  - ***2021: Released in November/December - Cleaned up definitions of many elements*** (Controlled Recognized Environmental Conditions [CRECs], Historical Recognized Environmental Conditions [HRECs], Material Threat, *De Minimis* Conditions, Business Environmental Risk [BER] and Environmental Professional [EP])***; introduced new definitions, more clearly touches on Non-Scope Considerations (evaluating for emerging contaminants)***



This international standard was developed in accordance with internationally recognized principles on standardization established in the Decision on Principles for the Development of International Standards, Guides and Recommendations issued by the World Trade Organization Technical Barriers to Trade (TBT) Committee.

Designation: E1527 – 21

Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process[1]

This standard is issued under the fixed designation E1527; the number immediately following the designation indicates the year of original adoption or, in the case of revision, the year of last revision. A number in parentheses indicates the year of last reapproval. A superscript epsilon (ε) indicates an editorial change since the last revision or reapproval.

1. Scope

1.1 *Purpose*—The purpose of this practice is to define good commercial and customary practice in the United States of America for conducting an *environmental site assessment*[2] of a parcel of *commercial real estate* with respect to the range of contaminants within the scope of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) (42 U.S.C. § 9601) and *petroleum products*. As such, this practice is intended to permit a *user* to satisfy one of the requirements to qualify for the *innocent landowner*, *contiguous property owner*, or *bona fide prospective purchaser* limitations on CERCLA liability (hereinafter, the "*landowner liability protections*," or "*LLPs*"); that is, the practice that constitutes *all appropriate inquiries* into the previous ownership and uses of the *property* consistent with good commercial and customary standards and practices as defined at 42 U.S.C. § 9601(35)(B). (See Appendix X1 for an outline of CERCLA's liability and defense provisions.) Controlled substances are not included within the scope of this practice. Persons conducting an *environmental site assessment* as part of an EPA Brownfields Assessment and Characterization Grant awarded under CERCLA 42 U.S.C. § 9604(k)(2)(B) must include controlled substances as defined in the Controlled Substances Act (21 U.S.C. § 802) within the scope of the assessment investigations to the extent directed in the terms and conditions of the specific grant or cooperative agreement. Additionally, an evaluation of *business environmental risk* (*BER*) associated with a parcel of *commercial real estate* may necessitate investigation beyond that identified in this practice (see 1.4 and Section 13).

1.1.1 *Recognized Environmental Conditions*—The goal of the processes established by this practice is to identify *recognized environmental conditions*. The term *recognized environmental condition* means (*1*) the presence of *hazardous substances* or *petroleum products* in, on, or at the *subject property* due to a *release* to the *environment*; (*2*) the likely presence of *hazardous substances* or *petroleum products* in, on, or at the *subject property* due to a *release* or likely *release* to the *environment*; or (*3*) the presence of *hazardous substances* or *petroleum products* in, on, or at the *subject property* under conditions that pose a *material threat* of a future *release* to the *environment*. A *de minimis condition* is not a *recognized environmental condition*.

1.1.2 *Petroleum Products*—*Petroleum products* are included within the scope of this practice because they are of concern with respect to *commercial real estate* and current custom and usage is to include an inquiry into the presence of *petroleum products* when doing an *environmental site assessment* of *commercial real estate*. Inclusion of *petroleum products* within the scope of this practice is not based upon the applicability, if any, of CERCLA to *petroleum products*.

1.1.3 *CERCLA Requirements Other Than Appropriate Inquiries*—This practice does not address whether requirements in addition to *all appropriate inquiries* have been met in order to qualify for the *LLPs* (for example, the duties specified in 42 U.S.C. §§ 9607(b)(3)(a) and (b) and cited in Appendix X1, including the continuing obligation not to impede the integrity and effectiveness of activity *and use limitations* [*AULs*], or the duty to take reasonable steps to prevent *releases*, or the duty to comply with legally required *release* reporting obligations).

1.1.4 *Other Federal, State, and Local Environmental Laws*—This practice does not address requirements of any state or local laws or of any federal laws other than the *all appropriate inquiries* provisions of the *LLPs*. *Users* are cautioned that federal, state, and local laws may impose environmental assessment obligations that are beyond the scope of this practice. *Users* should also be aware that there are likely to be

[1] This practice is under the jurisdiction of ASTM Committee E50 on Environmental Assessment, Risk Management and Corrective Action and is the direct responsibility of Subcommittee E50.02 on Real Estate Assessment and Management.

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[2] All definitions, descriptions of terms, and acronyms are defined in Section 3. Whenever terms defined in 3.2 are used in this practice, they are in italics.

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II. ASTM E1527 Applicability to Emerging Compounds

- The AAI Rule and ASTM apply to **only hazardous substances** (HS) and **petroleum products** (PP) as these are defined **Federally under CERCLA**
- Contaminants of Emerging Concern are potentially not currently HS or PP under CERCLA, CWA, CAA, etc.
- Therefore, until regulated at the **Federal** level, chemicals such as PFAS cannot be the sole substance to trigger a REC
- These should be considered under a Business Environmental Risk (BER)

Key Definitions

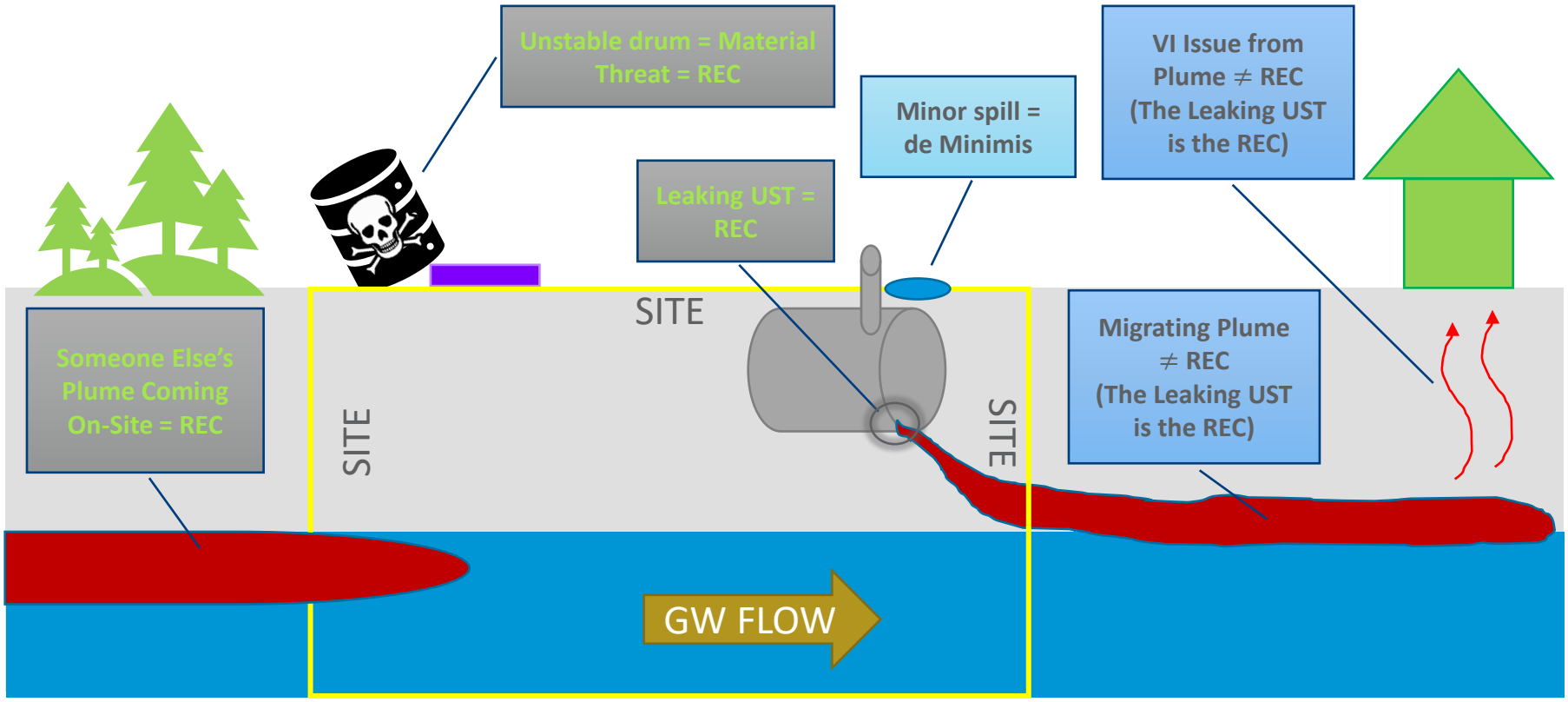
- ***Recognized Environmental Conditions (RECs)***
- Controlled Recognized Environmental Conditions (CRECs)
- Historical Recognized Environmental Conditions (HRECs)
- Material Threat
- *De Minimis* Conditions
- Business Environmental Risk (BER)
- Environmental Professional (EP)
- New definitions in 2021 version

Note:
These definitions and others in the Standard should be specifically used to outline the rationale for characterizing each finding

Recognized Environmental Condition (REC):

- *2021: (1) the presence of hazardous substances or petroleum products in, on, or at the subject property due to a release to the environment; (2) the likely* presence of hazardous substances or petroleum products in, on, or at the subject property due to a release or likely* release to the environment; or (3) the presence of hazardous substances or petroleum products in, on, or at the subject property under conditions that pose a material threat of a future release to the environment.*

II. Phase I ESA Findings Illustrated



Special Mention: BER and the Applicability to non-HS/P and Emerging Contaminants.

Business Environmental Risk

"a risk which can have a material environmental or environmentally-driven impact on the business associated with the current or planned use of a parcel of commercial real estate, not necessarily limited to those environmental issues required to be investigated in this practice. Consideration of business environmental risk issues may involve addressing one or more ***non-scope considerations****, some of which are identified in Section 13."*

- Manner in which we identify concerns posed by the site but not specifically covered as a hazardous substance or petroleum product
- Should be carefully discussed between buyer/consultant and other stakeholders [in the ESA process] before committing to incorporating into the report (careful what you ask for)
- Notably ***could*** include emerging contaminants/issues not captured as HS or PP

II. Key Definitions: BER

- BER for non HS or PP:
- Discussion found in Appendix Section X6.10:
  - *"…There are some substances that non-environmental professionals and others may assume to be hazardous substances that are not defined (or not yet defined) as hazardous substances under CERCLA … are not included in the scope of this practice"*
  - BUT – the section goes on to state that if the assessment is being conducted to satisfy both federal and state laws, it is permissible to include analysis and/or discussion as a Non-Scope Consideration

Additional Issues

- Asbestos-Containing Building Materials
- Biological agents
- Cultural and historical resources
- Ecological resources
- Endangered species
- Health and safety
- Indoor air quality
- Industrial hygiene
- Lead-Based Paint
- Mold or microbial growth conditions
- Naturally-occurring radon
- Regulatory Compliance
- *Substances not defined as HS or PP (including emerging contaminants) [this was new in 2021]*
- Wetlands

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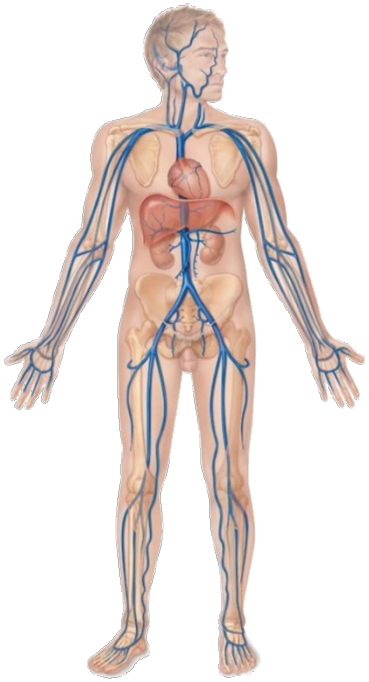
II. Elements of an ASTM Phase I ESA

Four Primary Parts

1. Records Review
2. Interviews
3. Site Reconnaissance
4. Reporting



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1. Review of historical records
2. Interview past and present owners/occupants and authorities
3. Site reconnaissance
   - Define past and present operations on/near site
   - Determine whether contamination may exist on/migrate to site
4. Draft report outlining methods and conclusions

Questions Later?

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engineers | scientists | innovators

Managing Environmental Liabilities in Transactions

Prospective Purchaser Agreements

DEQ Cleanup Program

December 5, 2023

2022 Business & The Environment Conference

Statutory Directive – ORS 465.327(1)

"In order to facilitate cleanup and reuse of contaminated property, the Department of Environmental Quality may… provide a party with a release of liability…"

Objective is to Negotiate

Liability Protection

In Exchange For

Substantial Public Benefit

Types of PPAs

- Administrative Agreement
  - Liability protection from the state
  - No 3rd party liability protection
  - Filed with County Clerk
  - No public comment period
- Consent Order
  - Liability protection from the state AND 3rd parties
  - 30-day public notice period beginning on 1st of the month
  - Requires notarized signature and filed with County Clerk
- Consent Judgement
  - Liability protection from the state AND 3rd parties
  - 30-day public notice period beginning on 1st of the month
  - Filed with the circuit court of jurisdiction

Eligibility Criteria – ORS 465.327(1)(a)-(d)

- Prospective Purchaser is not currently liable
- Removal or remedial action is necessary to protect human health or environment
- Redevelopment or reuse will not make the situation worse
- Substantial public benefit will result

Substantial Public Benefit – ORS 465.327

Statutory examples:

- Generation of substantial funding to facilitate remedial measures at facility
- Commitment to perform substantial remedial measures at facility
- Productive reuse of vacant or abandoned industrial or commercial facility
- Development of facility by government or nonprofit to address “important public purpose”

PPA Pre-Application Meetings

Who attends PPA pre-apps?

Purchaser decides on their attendees:

- Usually: Purchasing entity reps, environmental consultant, legal counsel
- Sometimes: Current owner/seller, lender, partner

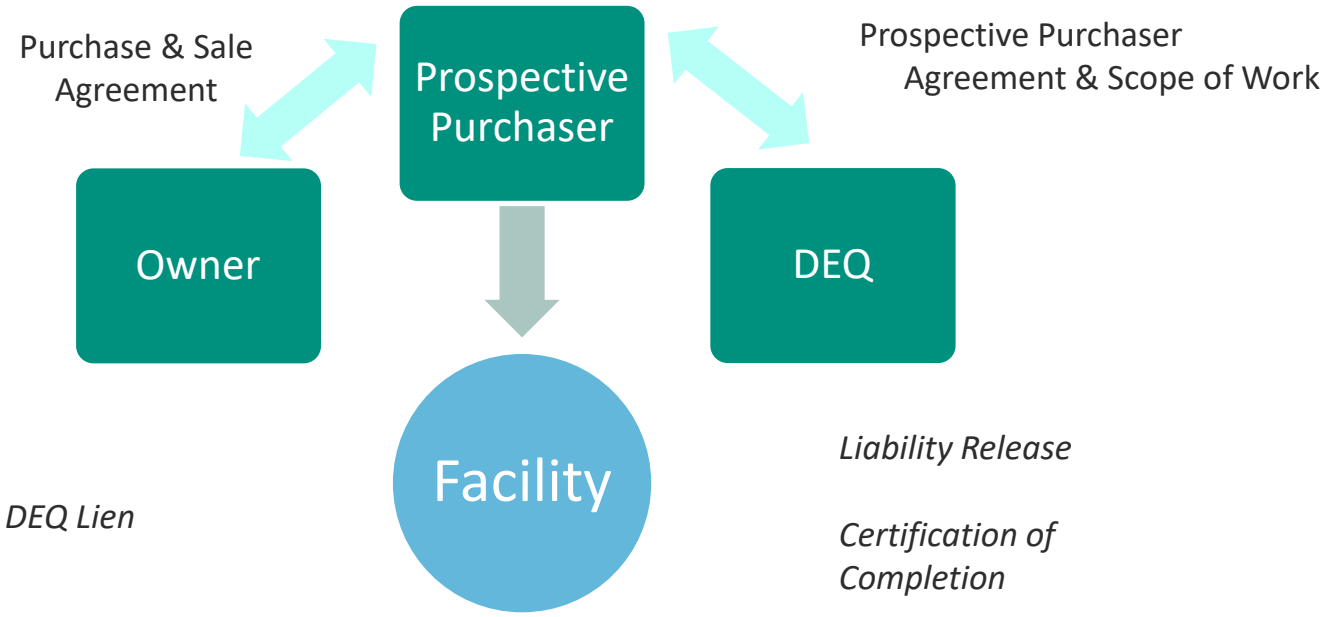
DEQ attendees include:

- Usually: PPA Coordinator, Regional Cleanup Manager, Lead Worker &/or Project Manager (core DEQ “team”)
- Sometimes: HQ Cleanup Manager, Regional Solutions Team, DOJ Attorney, DEQ specialist

What do we talk about?

- Purchaser’s Vision
- Site Information
- Scope of Work concepts
- PPA Program requirements, types, timelines, costs
- Special issues or questions
- Wrap up and next steps

PPA Process:
Who's Negotiating What?



Certificate of Completion

- Documents “satisfactory completion of obligations” of PPA
- Confirms protection from liability
- May be recorded on title to property
- PPA continues to “run with the land” as a property interest, transfers to new owners
- Ongoing obligations may be carried by Easement and Equitable Servitude (EES)

PPA vs. No Further Action (NFA) Letter

PPA:

- Provides statutory liability protection
- Recorded on title
- Property interest that runs with the land
  - Protection extends to future owners

- NFA:
- States DEQ's view that no further remedial action is necessary
- Not a property interest
- No legal bearing
- Can be withdrawn
- Comfort letter may be written to restate original NFA

Bend Mill site to Commercial Development

ECSI
1891

Rose City Plating to Sellwood Public Library and Lofts

ECSI
269

Prospective Purchaser Agreements

Thank you!

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Using Insurance to Manage Environmental Risk in Transactions

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Agenda

- Environmental Risk in Transactions
- Risk Transfer Options Available
- Emerging Contaminants
- Environmental Insurance Marketplace Update
- Final Thoughts
- Questions

Environmental "Transactional Risk" Contrasted

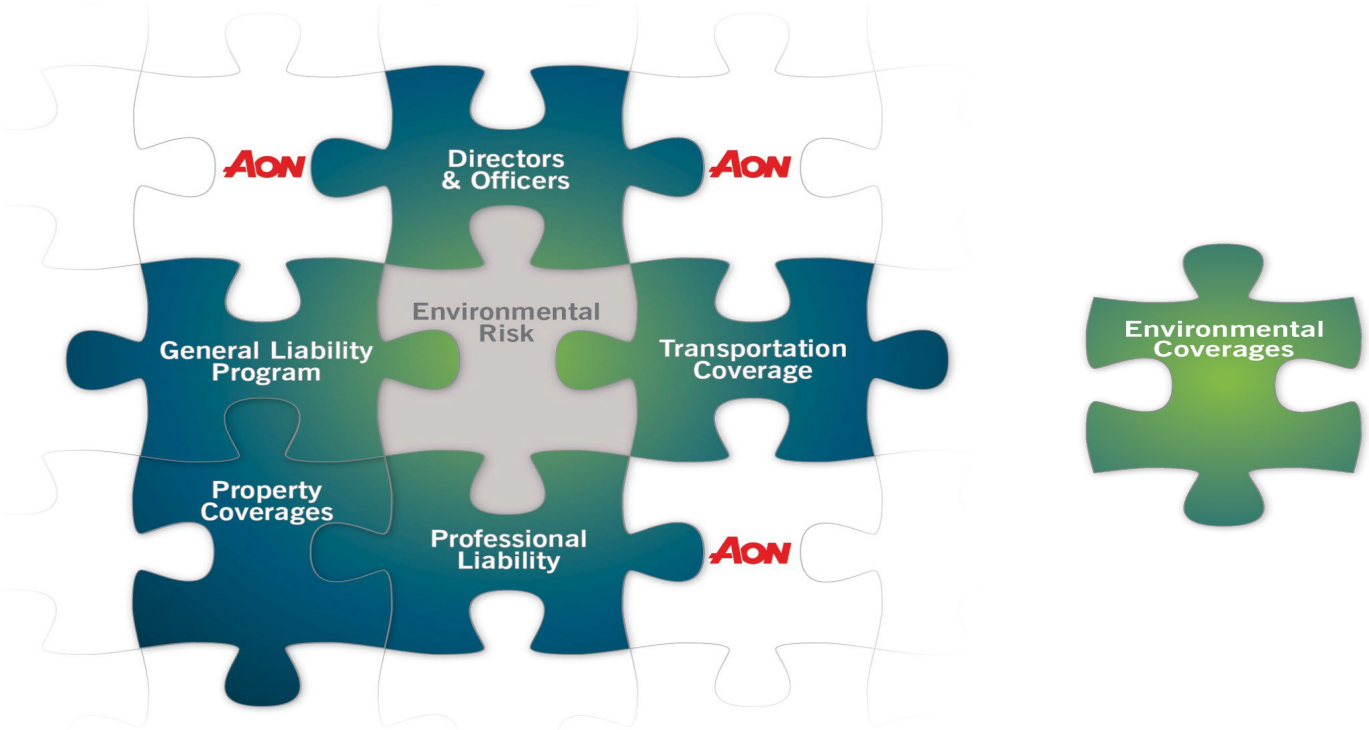
- **"Transactional Risk"** – Environmental risks associated with "deals".
  - Arise out of pre-existing conditions in soil and groundwater unrelated to current or planned operations of the purchaser
  - Typically involve allocations of risks for environmental conditions between the parties
  - Environmental matters may not be addressed by Reps & Warranties Insurance

- **"Passive Risk"** – Environmental risks that are present in all activities regardless of operations or activities of an organization
  - Example: Smog in LA, Water Pollution in Mississippi River, Climate Change, etc.

- **"Operational Risk"** – Environmental risks associated with operations and activities of an organization that could result in an environmental release; legacy product liability

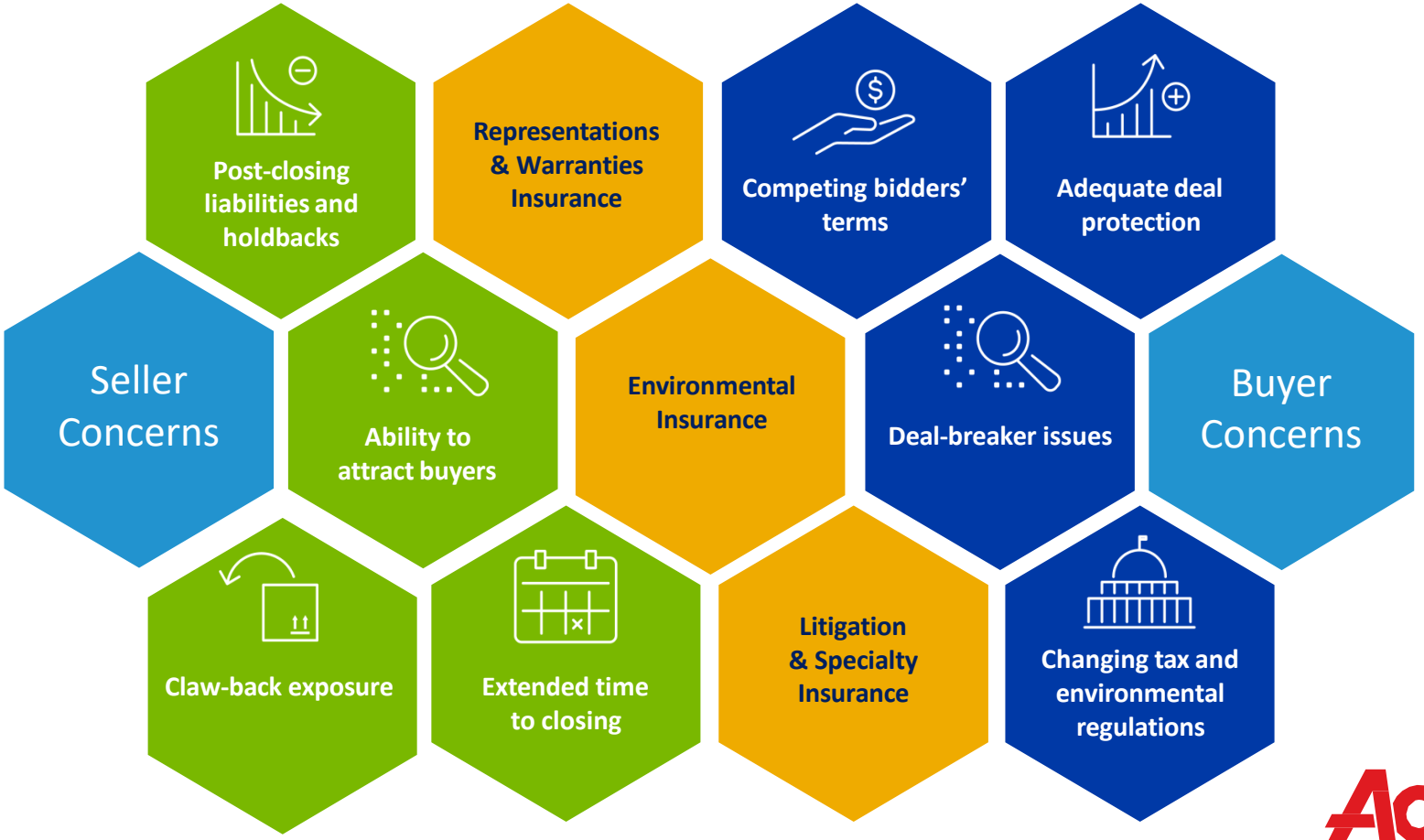
Coverage and Risk Issues in traditional policies

- Environmental Insurance evolved after 'Sudden & Accidental' and 'Total Pollution Exclusions' were added to CGL policies in late 1970's and early 1980's
- Today, many Policies **EXCLUDE** Pollution / Environmental Risk:



Deal Risk Challenges…Environmental Liability Insurance Solutions

The strategic use of Environmental Insurance can help buyers and sellers reach their goals



Advantages to Sellers

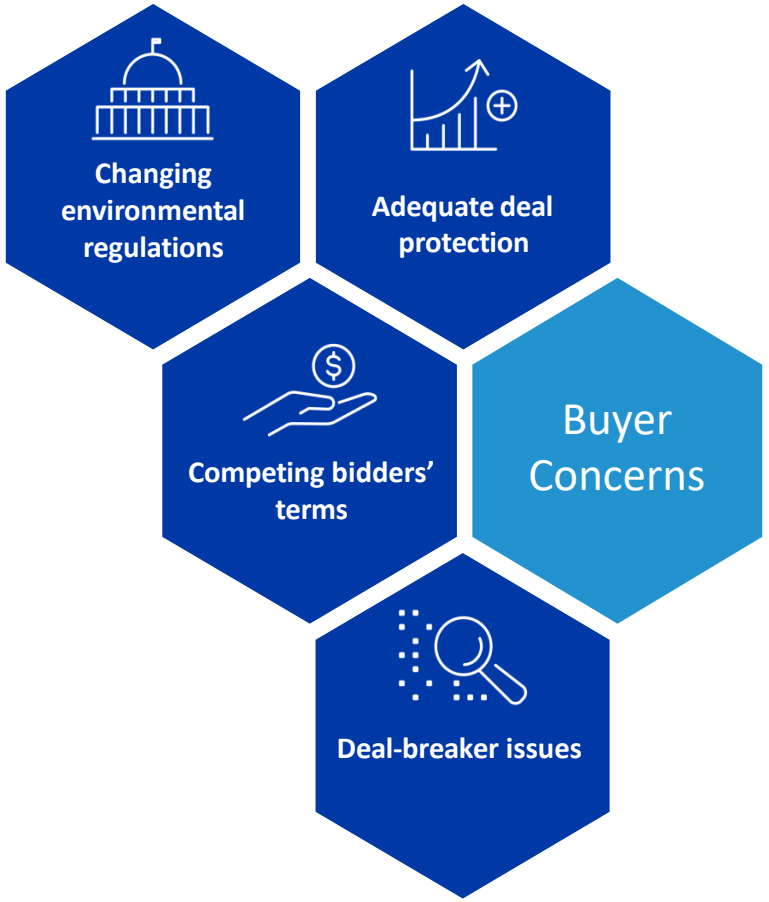
Environmental Liability Insurance may help Sellers

- Expedite the sale process
- Exit deal with increased funds
- Attract best offers
- Reduce or eliminate post-closing indemnity obligations
- Reduce contingent liabilities

Advantages to Buyers

Environmental Liability Insurance helps Buyers

- Transfer exposure to tort liability arising from known environmental liabilities to insurer
- Be viewed as a more attractive bidder
- Avoid credit risk of seller indemnity
- Provide recourse to address unknown environmental issues
- Provides an entrance and exit risk strategy
- Assist with obtaining financing/lender comfort



Environmental Insurance for Transactional Risks

There are several basic types of environmental insurance (and variations of each) that are typically purchased to address operational & transactional environmental risks:

- **Site-specific Pollution Legal Liability Insurance**
  - Most Flexible policy allowing customization
- **Contractors Pollution Liability Insurance**
  - Practice policies for individual contractors
  - Owner-controlled policies for all contractors on a project
  - Contractor-controlled policies for all contractors on a project
- **Underground Storage Tank Insurance**
  - Usually driven by a regulatory requirement for financial responsibility

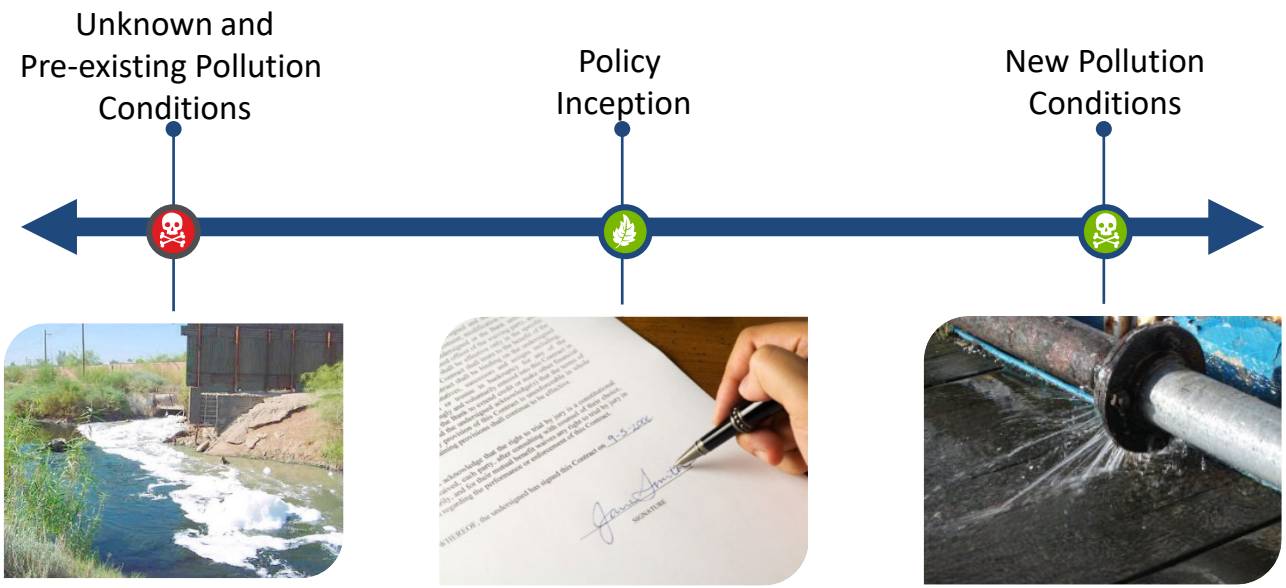
Other transactional insurance solutions include:

- **Cost-Cap Insurance**
  - Manage cost overrun related to known existing remediation obligations
  - Provided by limited number of insurers; Tetra Tech on a Guaranteed Fixed Cost Basis “TetraCap”
- **Liability Buyouts (this is a non-insurance approach that can be backed by insurance)**
  - Third Party Specialty organizations provide options to assume liability, sometimes with a transfer of the property.
- **Combined General Liability & Pollution Insurance**
  - Manage environmental liability for specific operations in conjunction with standard GL exposures

Environmental Insurance in a Transaction

- Coverage is tailored to the specific environmental issues associated with a property or portfolio of properties
- Coverage may be provided in lieu of an indemnity for unknown pre-existing conditions or in excess of indemnity for known conditions
- Policy terms of up to ten years are available
- Policies can be assigned in a transaction to a future purchaser in lieu of an indemnity and are an important component of an entrance and exit strategy for an asset or operation
- Premiums increase based on number of sites insured, policy limit and retention structure, however cost is often nominal in a transaction and may mitigate any large purchase price adjustment

Timeline of Coverage



Policies can be designed to cover the entire timeline

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Environmental Insurance Coverage & Construction

- First Party Property Coverage
  - **Remediation / Clean Up Costs***
  - Business Interruption*

  **Loss must arise from unknown pre-existing contamination*

- Policy Triggers
  - Discovery
  - Third Party
  - Governmental

- Third Party Legal Liability Coverage
  - **Bodily Injury & Property Damage – arising from known & unknown conditions**
  - Diminution of Value
  - Loss of Use
  - Transportation
  - Non-Owned Disposal Site

Coverage Extensions – Menu Driven Coverage

Non-Owned Disposal Sites Transportation

Mold, Legionella Pneumophilia Illicit Abandonment

Business Interruption

Defense outside policy limits

Fines, Penalties, Punitive Damages

Lender Coverage Enhancements

Underwriting Pollution Insurance – What is required, How long does it take?

- **Site Pollution Liability Coverage**
  - Schedule of locations with occupancy information
  - Description of operations/hazardous materials
  - Tank Schedule
  - Environmental management protocols
  - Any available environmental reports, Phase I/Phase II or equivalent
  - PPA Documentation, if available
  - Claims/litigation history
  - Draft copy of PSA, including any indemnities, if available
- **Contractors Pollution Liability Coverage – Owner Interest (if development is planned)**
  - Scope of work including delivery method
  - Project term
  - Project hard costs
  - Design Professional available limits
- **Cost Cap**
  - Site liability submission information
  - Remedial Action Work Plan, including all regulatory correspondence and approvals
  - Contractor bid documents

Representations & Warranties + Environmental Insurance = A Perfect Pair

Elements of Transaction

Seller makes statements regarding the business being sold → **Reps & Warranties**

Buyer wants financial recourse against the Seller if statements aren't accurate & buyer sustains a loss → **Indemnification**

Seller seeks to:

- Limit the length of time it's on the hook for breaches of R&W → **Survival Period of R&W**
- Define the maximum amount of indemnification → **The Cap**
- Make sure the Buyer pays a minimum amount before requesting indemnification → **The Basket**

Buyer wants security that there will be financial resources to back up Seller's indemnification obligations → **Escrow** And/or **R & W Policy**

Emerging Contaminants – Per- and polyfluoroalkyl substances (PFAS)

Environmental Insurance policies do not have blanket PFAS exclusions

- Certain classes of operations can expect to see a PFAS exclusion: airports, landfills, oil terminals, many manufacturing exposures…
- Office, retail, residential, warehouse/distribution operations generally do not have a PFAS exclusion, unless historical environmental data identifies a potential exposure
- Depending on the specific data and contracts, insurers are willing to consider providing limited coverage or wraps around indemnities, where supported.
- What about products pollution liability? Very small market for products pollution. Must be able to demonstrate that product is PFAS-free. No coverage available for certain classes such as potable water.

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What happens if PFAS is suspected or known?

- For all insurers, any detection from an onsite source will likely result in an exclusion – unless there is an indemnity or PPA to consider. Some insurers may craft coverage around exposure if PFAS originates from an offsite source.
- Is there a responsible party already on the hook? Underwriters can craft coverage around agreements/indemnities in place. This applies to onsite and offsite sources.
- Historical insurance archeology – Commercial general liability insurance without a pollution exclusion (pre-1985) may be a viable solution for industrial targets/responsible parties

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Environmental Insurance Market

Market Trends

- Pricing hardening but still a competitive market
- Market retreat from the 10 year deal
- Some markets reducing policy limits/capacity
- New markets continue to enter the space - *Berkshire Hathaway, Ascot, Sompo, Sirius/Distinguished, Enviant, Markel, Launch*
- Totaling almost 50 to 60 markets now offering some form of pollution coverage (retail and wholesale)

Industries Experiencing Hardening Market Most Acutely:

- Manufacturing/Energy
- Real Estate Development
- Healthcare
- Hospitality

Environmental Market/Industry Projection 2024

Capacity	Coverage	Claims & Losses	Limits / Retention	Pricing
Capacity is disrupted as some markets are limiting deployment to $10M on a single risk making it necessary to build single risk capacity with excess.	**Coverage continues to evolve and become more responsive to Insured's unique needs. However, new restrictions and exclusions are being used to cope with emerging constituents.**	**Unique losses are being addressed – legionella, mold, bacterial and virus, PFAS – as well traditional exposures. Claims volume and severity are steadily increasing.**	**Underwriters are scrutinizing risks carefully deploying limits and increasing retentions in an effort to manage overall loss experience.**	**Pricing trends are increasing with the tightening of the environmental market and changes by the Biden Administration in the US**
▪ Over 35 unique Insurers provide environmental capacity including new entrants. ▪ Capacity is available domestically and limited capacity available in the UK, EU and in Bermuda. ▪ There is over $500M in theoretical capacity available in the environmental marketplace	▪ Pollution policies are typically manuscript and tailored to needs of Insured. ▪ Markets require more underwriting and detailed information and loss review. ▪ Multiple year policy terms are still typical for site pollution coverage, however policy terms are of shorter length ▪ Coverage for mold, particularly for habitational exposure, is more restrictive.	▪ Claims volume has increased as more companies buy coverage and understand how to use it properly. ▪ Carriers have been mixed on claim responses – some pushing for delay and detailed coverage reviews while others have been responsive with minimal imposition on Insured. ▪ Plaintiff's bar supported by litigation funding continues to push an Environmental Justice agenda fueling claims.	▪ High policy limits may be available in the market, and can vary greatly based on industry class, size and unique exposures. ▪ Several insurers are very receptive to stacking of limits. ▪ Retentions can impact overall pricing and terms. ▪ Retentions have shifted upward and now are typically $50,000 or more. ▪ Sub-limits and exclusions are being utilized for specific coverage including business interruption, mold, and emerging constituents.	▪ Depending on loss history and claims experience, pricing which was stable in the past has started to increase. ▪ Renewal premiums are also increasing as exposures are re-evaluated. ▪ Large increases are seen for higher risk industries such as manufacturing, energy and mining. ▪ Indoor air quality risks related to residential or habitational use are commanding higher premiums.

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Final Notes

- **Every transaction presents unique risks and unique solutions**
- **Every organization has some operational environmental risks**
- **Environmental risks may not be addressed by Reps and Warranty Insurance**
- **Insurance is a good solution for most organizations since the coverage is comprehensive and costs are competitive**
- **Aon ERS & Transactional Solutions deliver creative, transaction specific solutions incorporating both insurance and non-insurance tools to manage environmental risk**