ENVIRONMENTAL BREAKOUT:
ALLOCATION OF RISK THROUGH CONTRACT AND INSURANCE

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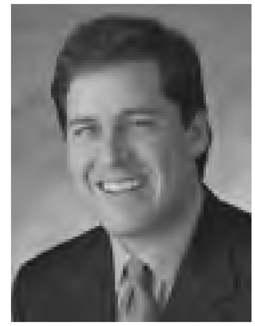

Practices

- Environment, Land Use & Natural Resources
- Environmental Litigation

Mr. Strong joined the firm in May 2005 as a partner in the Houston office, following his work as the managing partner with Campbell, George & Strong, LLP. Mr. Strong represents clients in resolving complex environmental and natural resource problems. Applying his background as an environmental engineer and experience as a consultant, he approaches legal problems from the perspective of making the science work first and then developing the legal arguments or approaches to support the science.

Mr. Strong represents clients litigating environmental disputes in state or federal courts and at the negotiation table with state and federal agencies. He has particular experience in matters involving sites that have been affected by releases of oil and/or hazardous substances, which often result in a myriad of legal issues including claims for natural resource damages, agency enforcement, site investigations and risk assessments, and litigation. He has represented Fortune 50 clients in federal and state court litigation and administrative proceedings across the nation on matters involving, for example, CERCLA and OPA cost recovery, natural resource damages claims, CWA and RCRA citizen suits, water rights, contested permits, toxic torts and property loss associated with subsidence and erosion. Mr. Strong has also been involved in many complex permitting, compliance and enforcement matters involving air emissions, waste management practices and wastewater discharges.

Mr. Strong has been active in working with youth and the needy in the Houston area and across the state. He recently served as on the Executive Committee of the State Bar of Texas and as the President of the Texas Young Lawyers Association, and is also an officer and/or board member of the State and Houston environmental law sections. For the past four years, Mr. Strong was recognized by his peers as a Texas Superlawyer. His work in the community earned Mr. Strong recognition from the Points of Light Foundation in Washington, D.C. and he was honored as one of the Five Outstanding Young Houstonians. He was also very active in the legal community's response to Hurricanes Katrina and Rita and trained over 500 lawyers on provided legal services to the victims of these disasters.

Education

J.D., South Texas College of Law, 1994
Editor-in-Chief, *Environmental Crimes Manual* (1993 and 1994)
Environmental Law Society, President (1993 and 1994)

B.S., Civil Engineering, Texas A&M University, 1989
Tau Beta Pi and Chi Epsilon (engineering honorary societies)

Affiliations

Admitted to practice: State of Texas, State of Louisiana

Admitted in: U.S. District Courts for the Southern and Eastern Districts of Texas, Western District of Louisiana, and Colorado

Member of:
State Bar of Texas – Executive Committee/Board of Directors (2001 to 2004); Budget, Finance, Strategic Planning, Public Service (2000 to 2004); Katrina Task Force member (2005 to Present); Chair, Standing Committee for Legal Services to the Poor in Civil Matters (2006 to

Present).

State Bar of Texas, Environmental & Natural Resource Law Section – Board Member and Executive Council Member (2003 to Present); Planning Committee (1999 to 2004)

Texas Bar Foundation – Board Liaison (2001 to 2003); Life Fellow; Nominating Chair (2003)

Houston Bar Association – Chair (2007), Officer and member of Board of Directors (2000 – 2006) of the Environmental Law Section; Co-Chair, Disaster Relief Committee (2001 to 2002)

Houston Young Lawyers Association – Board Member (ex offico) (2000 to 2004); Committee Chair for Crossing the Line and Aspiring Youth (1997 to 2000); Fellow of HYL Foundation

American Bar Association, Section of Environment, Energy and Resources – Member (1994 to Present); Natural Resources Committee, RCRA/Superfund Committee

Aspiring Youth of Houston – Officer/Executive Committee (1999 to Present), Board Director (1998 to Present); College-for-a-Day Instructor (1999 to Present)

Crime Stoppers of Houston – Executive Committee and Board Member (2005 to Present), Advisory Board Member (2003 to 2005); By-Laws & Safe Schools Committees (2003 to Present)

Leadership Houston – Member of Class XIX

Children At Risk – Advisory Board Member, Public Policy and Law Center; Chair, Immigration Committee (2006 – Present)

Honors, Awards and Recognition

Chambers USA Ranking, Environment – Texas (2007)

"Texas Superlawyer" (2003 through 2006), selected by *Texas Monthly* magazine and *Law & Politics* as a Texas Superlawyer in environmental and natural resource law.

Francis William Advocacy Award, Houston Lawyers Association (2006), selected as recipient of pro bono award for work with Hurricanes Katrina and Rita victims.

Texas Practice Series, Environmental Law, Thomson/West Pub (2005), contributing author on treatise.

"Best Lawyers Under 40," *H Texas Magazine* (September 2004), selected as one of Houston's Best Lawyers under 40.

Five Outstanding Young Texans (August 2004), selected as one of the Five Outstanding Young Texans by the Texas Junior Chamber of Commerce.

Five Outstanding Young Houstonians (July 2004), selected as one of the Five Outstanding Young Houstonians by the Houston Junior Chamber of Commerce.

Parade/National Football League (December 2003), one of 10 finalists for Community Quarterback Award for work with Aspiring Youth of Houston and local at-risk youth.

Points of Light Foundation, Daily Point of Light Award (October 2003), nominated for an received with wife, Denise, the Daily Point of Light Award for work with at-risk youth.

Points of Light Foundation, National Family Volunteer Award (June 2003), received National Family Volunteer Award with wife, Denise, at Points of Light Foundation National Conference in Baltimore, MD for work with at-risk youth in Texas.

American Bar Association, Young Lawyers Division, 1st Place in National Awards of Achievement (August 2003), received national award for projects implemented during year as President of TYLA.

ALLOCATION OF RISK THROUGH CONTRACT AND INSURANCE

The word "environmental" in the real estate world is often not met with a great deal of enthusiasm. It usually means additional complexities in negotiating the sale or purchase of property and is almost certain to delay the closing. It can also have an effect on the sale price of the property in that "environmental" can mean a stigma on the property, access for investigation and clean up activities and potential long-term liability exposure to the federal and state regulatory authorities.

That being said, once the "environmental" issue is in play and it is an unavoidable reality, it becomes a deal point and can be a major consideration in closing on the property. In most cases this consideration can be equated to dollars which can be factored into the purchase price for the property or the establishment of a special escrow account. There are many steps to be taken in addressing the environmental aspect of a property transaction including a review of the environmental data or information available regarding the property being sold and surrounding property, future property cleanup obligations, cost implications, interaction with state and federal agencies as well as negotiating who bears the responsibility.

The responsibility for the investigation and clean up of the property is the main subject of the environmental provisions of a purchase sale agreement. Whether you are the buyer or seller, you have a common interest to shift potential liability exposure to the other side or, at the very least, to accept whatever exposure you may have with your "eyes wide open," that is, with full knowledge. So that you are well-equipped to do this going forward, we provide below a discussion of the legal sources of liability under the federal and state statutes and the common law and follow that with observations regarding how to shift risk through the purchase sale contract or through environmental risk insurance.

I. Legal Sources of Liability

A. Federal Statutes

1. Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)

a. CERCLA §§ 106, 107, 113(f)

CERCLA establishes liability for past owners or operators of a facility or real property that has been impacted by a release of a hazardous substance.[1] Under CERCLA § 107, a property owner can be held strictly, jointly and severally liable for the contamination on the property if the source of the contamination originated on the property.[2] Today, liable parties who have spent a disproportionate share of money cleaning up a site may pursue other liable parties through a private contribution action under Section 113 to recover all or part of its excess Superfund response costs.[3]

Originally, CERCLA did not specifically provide for Section 113 contribution actions. Prior to the SARA amendments of 1986, and the passage of Section 113, Superfund provided for liability in Sections 106 and 107. Under Section 107, a party without liability who had incurred response costs could pursue a potentially responsible party (PRP) for recovery of those costs. No statute existed, however, which addressed the situation where a liable PRP spent a disproportionate amount of money at a Superfund site and sought to recover from non-participating PRPs. Many courts prior to 1986 addressed this deficiency by allowing PRP cost recovery for contribution under Section 107 through its statutory language or through federal common law.[4]

After SARA, a PRP was able to pursue contribution costs under either Section 107 or 113, though many courts held that PRPs seeking contribution must use Section 113 instead of Section 107, as Section 107 was reserved for total cost recovery claims brought by non-liable parties, not PRPs.[5] Section 113(f)(1) provides that "any person" may seek contribution from any PRP "during or following any civil action" brought by the EPA under Section 106 to enforce an administrative cleanup order or by another person under Section 107(a) to seek cost recovery. The last sentence of this provision is referred to as the "savings" clause, which states: "[n]othing in this subsection shall diminish the right of any person to bring an action for contribution in the absence of a civil action" under Sections 106 or 107(a).

Prior to the United States Supreme Court's decision in *Cooper Industries v. Aviall Services*,[6] Section 113(f)(1)

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[1] 42 U.S.C. § 9601 et seq. (2007).

[2] *Id.* § 9607.

[3] 42 U.S.C. § 9613 (2007).

[4] *See, e.g.,* United States v. New Castle County, 643 F. Supp. 1258 (D. Del. 1986).

[5] *See, e.g.,* Centerior Serv. Co. v. Acme Scrap Iron & Metal Corp., 153 F.3d 344 (6th Cir. 1998).

[6] 543 U.S. 157 (2004).

had been interpreted by a majority of courts as allowing PRP contribution actions against other PRPs even if there was no prior Section 106 or 107 action by the EPA or state against the party seeking contribution.[7] Given this interpretation, federal and state environmental agencies had, in recent history, relied on private parties to cleanup thousands of contaminated sites "voluntarily" (i.e., without being sued by the government) and to utilize private contribution actions to work out allocation of cleanup costs with other PRPs.

b. *Cooper Industries, Inc. v. Aviall Services, Inc.*

Aviall Services, Inc. (Aviall) operated an aircraft engine maintenance site in Texas which had been previously operated by Cooper Industries, Inc. Aviall discovered contamination at the site and determined that it resulted from Aviall's own operations and those of Cooper. While the Texas Commission on Environmental Quality (the Commission) issued an order compelling Aviall to clean up the site, the agency threatened, but did not file, an enforcement action.

Aviall incurred costs as the result of complying with the cleanup order, and sued Cooper Industries seeking contribution for those costs and for costs it expected to incur in the future. In addition to state law claims, Aviall brought claims under CERCLA Sections 107 and 113.

Aviall's first claim was brought under Section 107(a), and its second claim was under Section 113(f)(1).To comply with Fifth Circuit precedent in effect at the time (*see* note 8, supra), Aviall subsequently amended its complaint to combine its claims under Sections 107(a) and 113(f)(1). The district court interpreted this decision to be a waiver of Aviall's independent claim under 107(a) and focused its analysis on Section 113(f)(1). Subsequently, the court granted summary judgment to Cooper because Aviall's contribution claim was not brought "during or following" a civil action under Sections 106 or 107(a), as stated in Section 113(f)(1). Aviall appealed to the United States Court of Appeals for the Fifth Circuit, which first affirmed the district court's decision, but then reversed after a rehearing en banc.[8] Its ultimate decision was grounded on the conclusion that both the first and last sentences of Section 113(f)(1) give rise to claims for contribution. In making this decision, the court reasoned that the word "may" within Section 113(f)(1) did not mean that private parties "may only" sue during or after a civil action. This decision was appealed to the United States Supreme Court which granted certiorari.

On December 13, 2004, in a 7-2 opinion authored by Justice Clarence Thomas, the Supreme Court reversed.[9] In reversing, the Court held that the "natural meaning" of the language of §113(f)(1) limited contribution actions to those filed during or after a civil action. Otherwise, the Court reasoned, contribution claims would be unrestricted, nullifying the conditions set forth in sections 113(f)(1) and section 113(f)(3)(B). The Court specifically rejected the argument that the savings clause provided a separate claim, concluding that its purpose was merely to rebut any presumption that the conditions established by Section 113(f)(1) would apply to contribution actions brought under other sections of CERCLA.

The result of this holding is clear that PRPs may no longer use Section 113(f)(1) to sue other PRPs for contribution unless they have first been subjected to a "civil action" by EPA to enforce an order issued under Section 106, and/or a cost recovery action brought under Section 107(a). This interpretation marks a complete departure from the way in which the section has long been applied by courts and litigants, and potentially has profound implications for the Brownfields Program. In addition, this decision left open a number of questions unanswered, which will need to be addressed before accurate counsel may be given to private parties considering whether or not to take action and remediate a contaminated site in their possession which is not subject to a civil action.

One of the more important questions remaining after *Aviall* was whether Section 107(a) allows for contribution claims. The Court expressly declined to take on the issue of whether Aviall had waived any claim it may have had under Section 107(a), and thus left open the question of whether a PRP could bring a Section 107(a) cost recovery claim against other PRPs under some form of liability other than joint and several. Nearly three years later, in *United States v.*

[7] *See*, *e.g.*, Kalamazoo River Study Group v. Rockwell Int'l Corp., 274 F.3d 1043 (6th Cir. 2001); Amoco Oil Co. v. Borden, Inc., 889 F.2d 664 (5th Cir. 1989); Aviall Servs., Inc. v. Cooper Indus., Inc., 312 F.3d 677 (5th Cir. 2002). The Second, Third, Fourth, Seventh, Eighth, Ninth and Tenth Circuits had agreed with this position.

[8] Aviall Servs., Inc. v. Cooper Indus., Inc., 263 F.3d 134 (5th Cir. 2001); Aviall Servs. Inc. v. Cooper Indus., Inc., 312 F.3d 677 (5th Cir. 2002).

[9] Cooper Indus., Inc. v. Aviall Servs, Inc., 543 U.S. 157 (2004).

Atlantic Research Corp.,[10] the Court answered the question and held that Section 107(a) does allow a PRP to recover costs from other PRPs.

c. *United States v. Atlantic Research Corp.*

Atlantic Research leased a site from the United States Government (Government) and contaminated the land while performing work for the Government.[11] Atlantic Research cleaned the site at its own expense and later sued the Government for cost recovery under both Sections 107(a) and 113(f). After the Court's decision in *Aviall*, Atlantic Research amended its complaint to seek relief under Section 107(a). The Government moved to dismiss the complaint on the ground that Section 107(a) did not allow PRPs to seek cost recovery.[12] The District Court for the Western District of Arkansas granted the motion to dismiss.[13] The Court of Appeals for the Eighth Circuit reversed, however, holding that Section 113(f) does not provide "the exclusive route by which PRPs may recover cleanup costs."[14] The Court granted certiorari.[15]

The Court's decision focused on which "other person[s]" may sue under Section 107(a)(4)(B).[16] The Government argued that "any other person" referred to any person not identified as a PRP in Sections 107(a)(1)-(4), while Atlantic Research argued that the phrase took its cue from Section 107(a)(4)(A).[17] In other words, the Government argued that the "other persons" referred to in Section 107(a)(4)(B) were non-PRPs, as only PRPs were covered under Section 107(a)(1)-(4).[18] Atlantic Research instead argued, and the Court agreed, that subparagraph (B) referred directly back to subparagraph (A) and limited the cause of action to persons who were not explicitly named in subparagraph (A)—i.e., the United States, a State, or an Indian tribe.[19]

The Court also disagreed with the Government's position based on policy concerns. The Court feared that the Government's stance would result in "preclud[ing] all PRPs, innocent or not, from recovering cleanup costs."[20]

In addition, the Court also rejected the Government's argument that this holding would lead to "friction" between Sections 107(a) and 113(f). The Government offered three arguments for its position: (i) this ruling would allow PRPs to circumvent Section 113(f) and its shorter statute of limitations; (ii) PRPs would eschew the equitable apportionment under Section 113(f) and would instead file actions under Section 107(a) for its joint and several liability provision; and (iii) the holding would eviscerate the settlement bar set forth in Section 113(f)(2).[21]

First, the Court noted that the two Sections provide two distinct remedies. Section 113(f) grants PRPs a right to contribution, while, Section 107(a) permits cost recovery, not a right to contribution.[22] An action under Section 113(f) is dependent upon whether there has been an inequitable distribution of common liability among the liable parties.[23] Section 107(a) action only allows a PRP to cover costs that it has "incurred" in cleaning up a site. If a PRP has to pay in order to satisfy a settlement agreement or court judgment, then the PRP has not actually "incurred" any costs. It has merely reimbursed other parties for the costs that they have wrongly incurred.[24] Therefore, PRPs would be unable to choose 107(a) over 113(f) merely for the longer statute of limitations. A PRP that has to pay money to satisfy a settlement agreement or court judgment can file a Section 113(f) claim to seek contribution from other liable parties, while a PRP that has itself incurred cleanup costs can seek cost recovery under Section 107(a).[25]

Second, the Court asserted that PRPs will be unable to avoid Section 113(f)'s equitable distribution of reimbursement costs among PRPs by instead choosing to impose joint and several liability on another liable party under Section 107(a).[26] If a PRP will be imposed to inequitable distribution of costs under a Section 107(a), then that PRP can file a Section 113(f) counterclaim to facilitate a more equitable distribution

[10] 551 U.S.__, No. 06-562, slip op. at 1 (June 2007).

[11] *Id.* at 3.

[12] *Id.*

[13] *Id.*

[14] *Id.* at 4 (quoting *Atl. Research Corp. v. United States*, 459 F.3d 827, 830 n.4 (8th Cir. 2006)).

[15] *Id.*

[16] *Id.*

[17] *Id.* at 4-5.

[18] *Id.* at 5.

[19] *Id.*

[20] *Id.* at 6.

[21] *Id.* at 7-8.

[22] *Id.* at 8-9.

[23] *Id.* at 9.

[24] *Id.*

[25] *Id.*

[26] *Id.* at 10.

of costs amongst all the liable parties, including the PRP that filed the Section 113(f) claim.[27]

Finally, the Court held that permitting PRPs to seek recovery under Section 107(a) will not eviscerate the settlement bar set forth in Section 113(f)(2).[28] Section 113(f)(2) provides that Section 113(f) claims are prohibited against "[a] person who has resolved its liability to the United States or a State in an administrative or judicially approved settlement . . . ."[29] The Court noted that "the settlement bar continues to provide significant protection from contribution suits by PRPs that have inequitably reimbursed the costs incurred by another party…[S]ettlement carries the inherent benefit of finally resolving liability as to the United States or a State."[30]

2. Resource Conservation and Recovery Act (RCRA) § 7002

RCRA[31] establishes a system for controlling hazardous waste from its point of generation to its final disposal. The statute governs the treatment, storage, and disposal of solid and hazardous waste. Section 7002 of RCRA provides a cause of action against any person who "contributed or who is contributing to the past or present handling, storage, treatment, transportation, or disposal of any solid or hazardous waste which may present an imminent and substantial endangerment to health or the environment."[32] This citizen suit provision, however, has strict limitations. In *KFC Western, Inc. v. Meghrig*,[33] the United States Supreme Court held that RCRA's citizen suit provision does not allow for private recovery for cleanup costs.[34] An action may only provide an injunction requiring abatement of "imminent and substantial endangerment." The Court reached this conclusion after determining that RCRA's purpose, unlike that of CERCLA, is to ensure the proper treatment, storage, and disposal of hazardous waste.[35] CERCLA's purpose, in contrast, is to effectuate the cleanup of hazardous waste sites.[36]

[27] *Id.*

[28] *Id.* at 11.

[29] *Id.* (quoting 42 U.S.C. § 9613(f)(2)).

[30] *Id.*

[31] 42 U.S.C. § 6901 et seq. (2007).

[32] *Id.* § 6972(a)(1)(B).

[33] 516 U.S. 479 (1996).

[34] *Id.* at 483.

[35] *Id.*

[36] *Id.*

The Court did, however, leave open the possibility of recovering future response costs:

> *Without considering whether a private party could seek to obtain an injunction requiring another party to pay cleanup costs which arise after a RCRA citizen suit has been properly commenced,…or otherwise recover cleanup costs paid out after the invocation of RCRA's statutory process*, we agree with the Meghrigs that a private party cannot recover the cost of a *past* cleanup effort under RCRA, and that KFC's complaint is defective for the reasons stated by the District Court [for the Central District of California]. Section 6972(a) does not contemplate the award of past cleanup costs, and [Section] 6972(a)(1)(B) permits a private party to bring suit only upon an allegation that the contaminated site presently poses an "imminent and substantial endangerment to health or the environment," and not upon an allegation that it posed such an endangerment at some time in the past.[37]

B. State Statutes

1. Texas Solid Waste Disposal Act (TSWDA)

TSDWA[38] specifically provides for cost recovery of proper remedial work. The statute provides a private right of action for cost recovery as long as the cleanup is "necessary" and "approved by the [C]ommission."[39] To recover costs, the person seeking cost recovery must: (1) have made "reasonable" attempts to notify the offending party of the existence of the release or threatened release and (2) intend to take steps to eliminate the release or threatened release.[40]

2. Texas Water Code § 26.039

Under the Texas Water Code, an accidental discharge is "an act or omission through which waste or other substances are inadvertently discharged into water in the state [of Texas]."[41] "Other substances" are those which ordinarily would not be considered waste, but which cause pollution when discharged into the

[37] *Id.* at 488 (citations omitted and emphasis added).

[38] Tex. Health & Safety Code § 361.001 et seq.

[39] *Id.* § 361.344(a), *preempted in part on other grounds by* Vine Street LLC v. Keeling, 460 F.Supp.2d 728, 768 (E.D.Tex. 2006).

[40] *Id.* § 361.344(b).

[41] *Id.* § 26.039(a)(1) (2007).

water.[42] The Commission establishes rules for safety and other preventive measures for inherently or potentially harmful activities that have the capacity to result in the "spillage or accidental discharge of waste or other substances and which pose serious or significant threats of pollution."[43]

C. Common Law

1. Nuisance

A nuisance action can be brought against a person who substantially interferes with the use and enjoyment of another's land by causing unreasonable discomfort or annoyance to a person of ordinary sensibilities attempting to use and enjoy the land.[44] To bring a successful claim, the plaintiff must show that the defendant either: (1) intentionally invaded another's interests; (2) negligently invaded another's interests; or (3) engaged in other conduct, "culpable because abnormal and out of place in its surroundings, that invade[d] another's interests."[45]

2. Trespass

A trespass is an intentional or unintentional interference with or injury to another's property that causes either actual damage to the property or deprives the owner of its use.[46] Unlike nuisance, a trespass claim requires the physical invasion of another's property. The physical invasion can be minute. For instance, in *Shell Petroleum Corp. v. Liberty Gravel & Sand Co.*,[47] the Texas Court of Civil Appeals held that Shell committed a trespass when it moved a sand pile from one part of Liberty Gravel's land to another part of its land.[48] In addition, one does not need to physically enter another's land to commit a trespass. Entry can be made by "causing or permitting a thing to cross the boundary of the premises."[49]

3. Negligence

To recover under a negligence claim, the plaintiff must establish that the defendant breached a duty that it owed to the plaintiff and that the breach was the proximate cause of harm suffered by the plaintiff.[50] When deciding whether the defendant in fact had a duty to the plaintiff, a court will consider the nature of the risk, the foreseeability of the injury, and the likelihood of the injury weighed against the social utility of the defendant's conduct and the burden of guarding against the injury.[51] Of these factors, foreseeability of risk is "the utmost and dominant consideration."[52]

II. Allocation of Risk Through Contract and Insurance

A. Anatomy of a Real Estate Transaction

Each of the three parties of a real estate transaction—the buyer, the seller, and the lender—have different objectives and motivations during the negotiation process.

1. Buyer

The buyer's motivation during the negotiation process is to gain all possible knowledge about the property for sale. One possible way to do this is to conduct environmental due diligence of the property. Due diligence is a prospective purchaser's investigation and analysis of a piece of property.[53] Because the time period in which due diligence is conducted may be limited, the buyer will seek to add broad provisions to the contract that will protect his interests and to provide a guarantee that he has indeed been made aware of all possible risks or that he will be indemnified against pre-closing contamination.

The buyer will also seek representations and warranties from the seller as to the environmental conditions of the property. If the property is obviously contaminated or if cleanup is underway, then the buyer will further seek assurances that the seller will remediate the property or continue the cleanup to its completion.

2. Seller

[42] *Id.* § 26.039(a)(3).

[43] *Id.* § 26.039(c).

[44] Hicks v. Humble Oil & Refining Co., 970 S.W.2d 90, 96 (Tex. App. Houston-14th 1998).

[45] *Id.* (citing Watson v. Brazos Elec. Power Coop., Inc. 918 S.W.2d 639, 644 (Tex. App.-Waco 1996).

[46] Armstrong v. Benavides, 180 S.W.3d 359, 363 (Tex. App.-Dallas 2005).

[47] 128 S.W.2d 471 (Tex. Civ. App. 1939).

[48] *Id.* at 474.

[49] Glade v. Dietart, 295 S.W.2d 642, 645 (Tex. 1956) (quoting 87 C.J.S. *Trespass* §13).

[50] El Chico Corp. v. Poole, 732 S.W.2d 306, 311 (Tex. 1987), *rev'd on other grounds by* F.F.P. Operating Partners, L.P. v. Duenez, 69 S.W.3d 800 (Tex. App.-Corpus Christi 2002).

[51] Otis Eng'g Corp. v. Clark, 668 S.W.2d 307, 309 (Tex. 1983).

[52] *El Chico*, 732 S.W.2d at 310.

[53] BLACK'S LAW DICTIONARY, 8th ed. (2004).

The seller will try to transfer all liability to the prospective purchaser and will try to construct an agreement that strongly limits its own remaining responsibilities to the property. The seller will try to sell the property "as is," meaning that the seller grants no representations or warranties to the buyer. If this cannot be accomplished, then the seller will try to limit the scope of his representations and warranties. For example, the seller might try to include language that states that his liability is limited to conditions of which he had "actual," not "constructive," knowledge. In the case of property that is obviously contaminated, then the seller would seek to become indemnified in the case that he receive a "no further action" letter from the local environmental regulatory agency.

3. Lender

The lender's concerns are similar to those of the buyer. The lender will try to become as knowledgeable as possible about the environmental conditions of the property because this information will have a direct impact on the value of the potential collateral. A lender will also require a broad indemnity provision from the buyer whereby the lender will be absolved of all liability if the buyer contaminates the property. During the life of the loan, a lender will also require that the buyer provide to the lender notice of events such as violation notices so that the lender can re-evaluate the value of its collateral.

B. Contracts for Sale

1. Definitions

Clear and concise definitions in a contract are essential and can have a sweeping effect on the shift of liability from one party to the other. Key definitional terms include: environmental liabilities, health & safety requirements, pre- and post-closing releases, closure and post-closure care. The scope of what is covered or not-covered by the environmental provisions of a contract are often dictated by how broad or narrow these terms are defined. For example, in order to protect against third-party claims associated with off-site releases, the definition of "environmental liabilities" should include an off-site and third-party component that includes, among others, property damage and business interruption claims.

Additionally, the definition of pre- and post closing releases is Purchasers want indemnification for pre-closing liabilities, while sellers want indemnification for post-closing liabilities. Sellers indemnify buyers from all costs and claims related to pre-closing contamination, but they will try to make the scope as narrow as possible and will include language limiting representations "to the best of its [actual] knowledge."[54] Meanwhile buyers want the indemnity provision to be as broad as possible and will try to include language such as "[k]knowledge based upon what seller knows or reasonably should know."[55]

2. Indemnity Provisions

An indemnity clause is one "in which one party agrees to answer for any specified or unspecified liability or harm that the other party might incur."[56] Buyers will typically want the purchaser to indemnify them for all environmental liabilities that emanate from a "pre-closing release," which means any cost liability that is attributable to the spill or release of a hazardous substance and/oil prior to the property closing (essentially, anything bad that happened on your watch). These indemnities would thus cover: (1) breach of warranty; (2) an act or omission by the seller prior to the completion of the transaction; or (3) an environmental condition that existed prior to the sale. The length of the indemnity periods vary, some having a discrete end date of 5 to 10 years and others having a descending cost responsibility over a shorter period of time (e.g., 100% coverage within 1st year from closing, 75% for the second year, 50% for the third and 0% thereafter). In addition, the indemnities may vary dependant on whether the liability for which the indeminity being sough pertains to an on-site liability (i.e., a release or condition on the property that is the subject of the sale) or off-site liability.

In Texas, an indemnity provision that a court finds to be "ambiguous" may be invalidated entirely. In *Ethyl Corp. v. Daniel Construction Co.,*[57] the Supreme Court of Texas adopted an express negligence test for determining whether the parties of an indemnity contract—such as a buyer and a seller—intended to absolve the seller from the consequences of his own negligence.[58] If a contract does not explicitly state that the seller is absolved from all consequences resulting from his own negligence, then the court will find the indemnification provision ambiguous and will void it. Therefore, in the case of CERCLA liability, a seller who has negotiated an indemnity provision with the buyer will still be liable for a contribution claim if the contamination resulted from the seller's own

[54] David Paget, *Closing a Property Transaction Involving Complex Environmental Issues*, 430 PLI/REAL 295, 311 (1998).

[55] *Id.* at 312.

[56] BLACK'S LAW DICTIONARY, 8th ed. (2004).

[57] 725 S.W.2d 705 (Tex. 1987).

[58] *Id.* at 706.

negligence, *unless* the contract specifically states that the seller will be indemnified from the consequences of acts resulting from his own negligence.

3. Representations & Warranties

The representations and warranties section of a contract provides the purchaser with the assurance that the property for sale is in compliance with environmental laws. This provision also forms the basis for claims for relief due to fraud and breach of contract. Sellers have an affirmative duty to disclose to the buyer all known defects in the property. This disclosure includes all known environmental hazards. If a seller fails to disclose any environmental issues with the property, then an indemnity provision provided by the purchaser will be void. The seller therefore will try to include language such as "to its knowledge," while a buyer will try to incorporate language such as "what the seller knows or reasonably should know."

4. Cost-Sharing

Cost-sharing provisions typically set forth the percentage or dollar amount each party will be expected to contribute toward environmental costs. The part of the arrangement that might cause tension is how the party with the remedial obligation ensures that the other party actually fulfills its obligation to pay. This can be done either by setting up an escrow account[59] or by having the other party provide some other type of financial assurance, such as a letter of credit or bond.

5. Access

Access provisions come in two forms: (1) the access that is granted to the buyer to perform its due diligence of the property which may included environmental investigations and (2) access to the seller to perform remediation activities on the property after closing, provided that the agreement obligates the seller to conduct these activities. The access provisions can either be embedded within the contract itself or attached as an appendix. The access provisions would also set out what rights each party has to undertake certain activities on the property. For instance, the provision would address whether a prospective purchaser has the right to drill exploratory boring and wells to obtain samples of soil or groundwater.[60] Moreover, the access provisions would identify any insurance or bonding requirements that might need to be in place before work is performed on the property.

6. Dispute Resolution/Arbitration

Arbitration is a method of dispute resolution involving one or more neutral third parties agreed to by the disputing parties and whose decision is binding.[61] The underlying purpose of arbitration is to keep disputing parties from having to resort to the court system to settle disputes. Sometimes, the disputing parties establish specific procedures to follow in the event of a dispute, such as perhaps establishing provisions that place the burden of proof on either the buyer or the seller.[62]

C. Environmental Insurance

1. What is "environmental insurance"?

After incidents like Love Canal, claims were being made by insureds under their general liability policies for the costs associated with environmental suits and cleanup efforts. In the mid-1980s, some insurance companies decided to market an insurance policy to fill in the gap in general liability coverage. Environmental insurance is used to cover specific environmental risks for limited time periods to fill in this gap.

2. Environmental Risk Insurance Policies

Various types of environmental risk insurance are available. The most common environmental risk policies are: (1) pollution legal liability insurance, (2) cleanup cost insurance, (3) contractors pollution liability insurance, and (4) secured creditor impaired property insurance.

a. Pollution Legal Liability (PLL)

PLL is third-party insurance coverage against liability resulting from contamination at or emanating from

[59] Escrow accounts typically are used in situations where it is feared that the party with the remedial obligation is not solvent enough to fully fulfill its obligations. The funds of the account are only released in response to the party with the remedial obligation reaching certain specified milestones.

[60] Robert E. Steinberg & Richard H. Mays, 5 ENV. L. FORMS GUIDE § 57:46, *Access agreement to conduct sampling or environmental due diligence* (2007).

[61] BLACK'S LAW DICTIONARY, 8th ed. (2004).

[62] Sherri L. Toub, *"Buyer's Regret" No Longer: Drafting Effective MAC Clauses in a Post-IBP Environment,* CARDOZO L. REV. 849, 858 (2003).

properties specifically listed in the policy that are policy owner-owned or operated. PLL insurance can also cover liability resulting from "transportation of the insured's product or waste, or [arising] from the disposal of the insured's waste at a non-owned location."[63] PLL insurance coverage can be also extended to include a duty to defend or to provide defense costs.

b. Cleanup Cost Cap Insurance/Remediation Stop Loss/Cost Contaminant Coverage

Cleanup cost cap insurance is first-party coverage designed to protect the policyholder against possible cost overruns in the course of performance of environmental remediation projects. The policyholder has to submit details of the remediation plan and cost estimates before obtaining the cleanup cost cap insurance. This form of insurance generally excludes coverage for third-party liability, bodily injury, property damage, fines, penalties, and noncompliance or criminal acts by the policyholder.

c. Contractors Pollution Liability (PL) Insurance

Contractors performing environmental remediation work may obtain insurance against off-site bodily injury and property damage for incidents that arise from covered operations. Unlike the other forms of environmental risk insurance coverage which are issued only on a claim-made basis,[64] contractors PL insurance is offered on an occurrence basis. Simply put, for a claim to be successful, the contractors PL insurance policy does not have to be presently current, but has to have been current when the contamination itself occurred. For the other types of environmental risk insurance, the policy has to have been current when the claim is made.

d. Secured Creditor Impaired Property Insurance

Secured creditor impaired property insurance is available only to financial institutions with security interests in real property. This insurance coverage falls within two categories: (1) protection against the financial risk of borrower default where environmental contamination has impaired the loan collateral and (2) protection against the lender incurring direct costs of cleanup, property damage or bodily injury.

D. Greater Detail of PLL

1. Scope of PLL

PLL insurance covers bodily injury and property damage on both on-site and off-site locations. In addition, it covers natural resource damage. This form of insurance has been used to protect policyholders against: (1) government-ordered CERCLA or RCRA cleanup costs; (2) non-owned disposal site risks (over which the waste generator lacks future control); (3) transportation risk (involving pollution spills or problems in-route); (4) and third-party contribution claims. These are not the only situations where PLL insurance may come in handy. PLL can also be used during: (1) the sale, purchase, merger, or ownership of business; (2) sale, purchase, ownership, development, leasing, or financing of real property; (3) settlement of claims under general liability policies; and (4) as part of the environmental due diligence process.

2. Types of PLLs:

PLL insurance comes in three forms: (1) property transfer insurance, (2) secured creditors environmental insurance, and (3) underground storage tank insurance.

a. Property transfer insurance

Property transfer insurance is used during the sale or purchase of property. It protects the lender if a borrower is unable to pay for the cleanup costs on land where environmental contamination is found subsequent to the loan transaction. Because this type of insurance only covers cleanup costs, third-party liability coverage is usually also purchased.

b. Secured creditors environmental insurance

Secured creditors environmental insurance protects the lender's interest in property being used as collateral by the borrower. A claim is paid in the event that a borrower defaults on the loan after discovering contamination on the insured property.

[63] William H. Howard, *New Issues in Environmental Risk Insurance*, 40 TORT TRIAL & INS. PRAC. L.J. 957, 959 (2005) (quoting Tod I. Zuckerman & Mark C. Raskoff, *Environmental Insurance Litigation, Practice Forms* § 7:7 (2004).

[64] Insurance issued on a claims-made basis requires a claim be made during the policy period.

c. Underground Storage Tank (UST) insurance

USTs are generally excluded from PLLs.[65] As a result, owners and operators of USTs have to purchase UST insurance to meet their RCRA requirements. Under RCRA, owners and operators of USTs are required to demonstrate their financial ability to pay claims resulting from the release of fuel or hazardous materials. Having UST insurance demonstrates that UST owners and operators can meet this financial responsibility. This form of insurance covers third-party liability claims for on-site and off-site bodily injury and property damage and defense costs.

3. Coverage Limits

In a PLL policy, types of coverage can be offered. Coverage A covers on-site cleanup of pre-existing conditions. Coverage B covers on-site cleanup of new conditions. Coverage C covers third-party claims for on-site bodily injury and property damage. Coverage D covers third-party claims for off-site cleanup resulting from pre-existing conditions. Coverage E covers third-party claims for off-site cleanup resulting from new conditions. Coverage F covers third-party claims for off-site bodily injury and property damage. Coverage G covers third-party claims for on-site bodily injury, property damage or cleanup costs — non-owned locations. Coverage H covers third-party claims for off-site bodily injury, property damage or cleanup costs — non-owned locations. Coverage I covers pollution conditions resulting from transported cargo. Coverage J covers business interruption coverage — actual loss or rental value

The policy term usually ranges from one to five years. Sometimes, policies can last up to 20 years. The policy limits range from $1,000,000 up to $150,000,000.

4. Duties of the insurer

PLL insurance policies may include a duty to defend or to provide payment of defense costs. In Texas, an insurer's duty to defend and its duty to indemnify are separate duties. The duty to defend remains even if there is no duty to indemnify. If the factual allegations in an underlying complaint fall outside of the policy coverage, however, neither duty is triggered.[66] For further discussion of duties of the insurer, see Part E(2).

[65] *See* Part D(2)(5).

[66] *See* Farmers Tex. County Mut. Ins. Co. v. Griffin, 955 S.W.2d 81, 82-84 (Tex. 1997).

5. Exclusions

PLLs contain a large number of exclusions, including, but not limited to: cleanup costs, claims loss, actual loss, extra expense, or loss of rental value; criminal fines, penalties, and assessments; contractual liability; intentional noncompliance; property owned or leased by the insured; transportation; asbestos and lead; prior knowledge/nondisclosure; and known losses. Known losses are those arising from pollution conditions existing prior to the inception date and known by a responsible insured and not disclosed in the application for the policy. In addition, USTs and bodily injury arising out of and in the course of employment are also excluded from PLLs.

6. Effectiveness of PLLs

Texas courts generally enforce PLLs. For instance, in *Ingalls Shipbuilding v. Federal Insurance Co.*,[67] the Court of Appeals for the Fifth Circuit enforced the duty to defend provision of Transocean's PLL. Texas courts have held that this duty "to defend an insured [exists] as long as the complaint alleges at least one cause of action within the policy's coverage."[68]

Other courts have also enforced PLL insurance policies. The Court of Appeals for the First and Ninth Circuits have upheld the validity of claims-made PL policies and have held that insurers are only liable for claims that arise during the policy period.[69] In *Camalloy Wire, Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa.*,[70] for instance, the Supreme Court of New York held that an insurer had to pay the insured for costs incurred during an oil spill.[71]

E. How Borrowers Minimize the Risk of Environmental Insurance

1. Negotiating policy terms

Insurance policies can be tailored to the needs of the policyholder, so one way for a policyholder to minimize its liability is to negotiate some specific policy terms. The following terms can be negotiated:

[67] 410 F.3d 214 (5th Cir. 2005).

[68] *See, e.g.,* Cont'l Carbon Co. v. Am. Int'l Specialty Lines Ins. Co., 2006 WL 1442237, *11 (S.D.Tex. May 23, 2006).

[69] *See* Paul Oil Co. v. Federated Mut. Ins. Co., 154 F.3d 1049, 1052 (9th Cir. 1998); Alan Corp. v. Int'l Surplus Lines Ins. Co., 22 F.3d 339, 342 (1st Cir. 1994).

[70] 273 A.D.2d 123 (N.Y. App. Div. 2000).

[71]

known conditions, insured, bodily injury, property damage, USTs, divested property, intentional acts, contractual liability, insured's property, cancellation, choice of law/choice of forum, "other insurance" provision, notice, subrogation, severability or separation of insureds, no assignment, natural resources damages, mold, fungus and microbial matters, war and terrorism, and cleanup cost cap policy.

2. Depending on the insurers' duties to defend and indemnify

While provisions concerning the insurer's duties to defend and indemnify are present in environmental risk insurance policies, the language of the policy itself may be ambiguous which causes some insurers to try to limit their coverage exposure. For instance, some insurers will try to argue that the ambiguous language of the duty to indemnify provision does not apply to the recovery of defense costs. They may try to limit the amount of defense costs coverage either by applying the defense costs against the policy limits or by placing a cap on the amount of recovery. When negotiating the policy, the policyholder should make sure that the insurer's duties are explicitly laid out. An insurer may also try to limit its exposure by including a choice of law or forum that is most favorable to the insurer's position, so a prospective policyholder should also negotiate for a forum that is most favorable to his own position.

F. Using Environmental Insurance to Reduce Risk

Environmental risk insurance was traditionally used by companies that were involved with the transportation, storage, and disposal of hazardous materials. The scope of usage has expanded to cover businesses such as car dealerships, hospitals, universities, and dry cleaners. In addition, companies are now using environmental risk insurance in business transactions such as mergers and acquisitions, real estate development, and brownfields redevelopment.

1. Mergers and Acquisitions

Environmental risk insurance can minimize the acquisition candidate's risk of on-site and off-site contamination of contaminants, "off-site disposal of hazardous waste, regulatory actions, administrative fines or penalties, criminal misconduct, worker safety actions and toxic tort [s]uits."[72] Due diligence can be performed to discover existing contamination, the liability for which can be shared between the buyer and seller.

With respect to the purchase of a privately held corporation, environmental risk can be allocated between the buyer and seller using indemnity provisions and cleanup covenants.[73] Escrow accounts can also be used to fund remediation work that occurs after the transaction.[74]

2. Real Estate Lender Liability

Environmental risk insurance allows the lenders to minimize their risk in real estate lending. If buyers do not purchase environmental risk insurance, lenders can charge a higher interest rate or not approve the loan if the land is believed to have liability issues, because lenders may fear that such buyers would be unable to repay their loans if they are assessed large cleanup penalties. To determine whether property might have future environmental liability, lenders may require an environmental assessment be conducted as a part of environmental due diligence.

While environmental risk insurance can eliminate the risk of environmental liability, a buyer must still conduct due diligence to be protected by the "innocent purchaser" defense. Lenders still should require buyers to conduct due diligence. If lenders do not warn borrowers about the risks posed to them by not performing due diligence, borrowers may be able to bring suit against the lenders for violating a fiduciary duty owed to them.[75]

3. Brownfields Redevelopment

Environmental risk insurance can also aid in the redevelopment of brownfields. Brownfields are "real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant."[76] Brownfield development usually involves a developer purchasing former industrial or commercial property to redevelop the site. Both the

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[72] Stuart Hammer, *Environmental Risk: Protecting the Buyer*, THE M&A LAWYER 24 (Dec. 1999/Jan. 2000).

[73] Janice E. Falini, *Using Environmental Insurance to Manage Risk Encountered in Non-Traditional Transactions*, 14 VILL. ENVTL. L.J. 95, 106 (2003).

[74] *Id.*

[75] *Id.* at 107-08.

[76] Public Law 107-118 (H.R. 2869) - "Small Business Liability Relief and Brownfields Revitalization Act".

seller and the purchaser will want to minimize their liability. As a result, the seller will want to minimize its indemnification obligation to the purchaser, while the purchaser will want to conduct an environmental assessment to discover the possible presence of environmental contamination.

While environmental risk insurance can minimize the risk associated with brownfields development, typically environmental insurance does not cover land that is known to be contaminated, unless the contamination has been cleaned up or the local environmental regulatory agency has issued a "no-further action" letter. Coverage can be obtained where there is known contamination that has not yet been resolved, however, if the underwriter's engineering staff determines that the level of contamination is below the threshold level for regulatory action.

To further minimize the developer's risk and maximize the insurance coverage for the Brownfields site, the developer should locate "all old insurance policies purchased by owners, prior owners, tenants of the property, and possibly even vendors who were involved in handling chemicals, disposing of waste, etc."[77] General liability policies from 1970 to 1085 may provide coverage either because they have incorporated the qualified pollution exclusion[78] or they were written on an "occurrence" basis. Policies written before 1970 will also provide coverage because they generally did not have pollution exclusions.[79]

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[77] Falini, *supra* note 66, at 109 (quoting Lorelie S. Masters, *Back to the Future: Coverage For Environmental Loss In the New Millennium*, THE METROPOLITAN CORPORATE COUNSEL, INC. 8 (2000)).

[78] Qualified pollution exclusions cover only contamination that occurs as the result of pollution that follows a "sudden and accidental" release.

[79] Falini, *supra* note 66, at 110.