Legal Brief

IGNORING ENVIRONMENTAL DUE DILIGENCE COULD BE COSTLY

By Danielle G. Sakai, Best Best & Krieger LLP

We have all heard the saying "ignorance is bliss," but in the area of real property acquisition, the more important idiom is "what you don't know can kill you." That may be a bit dramatic, but what you don't know about a property's condition could certainly cost the acquiring special district a lot of taxpayer money – money that would be better spent fulfilling the agency's statutory purpose, rather than cleaning up someone else's toxic mess.

On any property, there is always the potential that contamination undetected by the human eye is hidden in the soil, lurking in the groundwater or tainting the buildings. Take, for instance, the true story of a public agency in California, whose name has been changed to protect its identity. "Public Agency X" identified a certain parcel of property that it could use for a future development project. It later discovered that the property owner defaulted on its taxes and the property was up for a tax sale by the county, meaning it could be nabbed at a great bargain.

Public Agency X contacted the county and purchased the property for the cost of the unpaid taxes at a fraction of what the property would presumably sell for on the open market. Sounds like a great deal, right? The next thing the agency knows, the U.S. Environmental Protection Agency (EPA) is knocking at its door. The federal agency identified the property as a source of major contamination and designated the local agency as a "responsible party," ordering it to clean up the property or face penalties of up to $32,500 per day, in addition to potential damages.

Under federal and state law, a property owner is strictly liable for contamination discovered on its property unless it qualifies for one of a very few limited exceptions or defenses to liability. In the case of Public Agency X, there was no legal defense and it wound up spending nearly $500,000 to clean up the pollution created by the prior owners. Had Public Agency X undertaken environmental due diligence prior to purchasing the property, it could have discovered the pollution and avoided that nearly half-million dollar liability.

So, what is environmental due diligence? A key part of the property acquisition process, its purpose is to evaluate potential liabilities associated with land quality and other environmental and health and safety issues. Generally speaking, environmental due diligence consists of a Phase I environmental site assessment that could lead to an investigation depending on what is discovered during the assessment. The first step is essentially a paper search intended to evaluate past and present uses of the property, and their potential for having impacted soil, soil vapor and groundwater. An environmental professional reviews historic and current agency records of the property, interviews current and past owners, visits the site to look for obvious signs (to a professional) of concern and prepares a report. If, during the assessment, the environmental professional identifies any potential problems then additional field work will likely be recommended as part of a follow-up investigation. Known as a Phase II investigation, it usually consists of taking soil, soil vapor or water samples and comparing the results to local, state and federal standards. The test results will tell the potential buyer whether there is contamination and help identify the extent and required remedy, if any.

If the results of the assessment and/or investigation indicate there are no concerns, the agency can proceed with the purchase without any concerns. In addition to providing peace of mind, by conducting the environmental due diligence, the agency has engaged in what is called an "all appropriate inquiry," which is the legal foundation to providing the agency with the limited defenses

So, what is environmental due diligence?
A key part of the property acquisition process, its purpose is to evaluate potential liabilities associated with land quality and other environmental and health and safety issues.

available to liability, in the event that contamination that was not known or discovered as part of the due diligence process is later discovered.

In contrast, if the due diligence finds contamination on the property, the agency can still acquire the property. Under these circumstances, the agency has the following options: Require the owner to remediate the property at its cost prior to the sale; have a portion of the purchase price held in escrow to cover the cleanup costs; negotiate a reduction in the purchase price to reflect the contamination and cost of remediation, or require that the seller purchase environmental insurance.

If the agency decides to acquire the property and undertake the remediation itself, prior to closing the deal, it should work with either local environmental regulators or the federal EPA to negotiate a bona fide prospective purchaser agreement, which will give the agency credit for the remedial costs and help avoid future liability. Additionally, to the extent that the agency must acquire the property, if it has the power of eminent domain, it may want to consider condemning the property as condemnation is considered an involuntary acquisition under federal environmental law, which could exempt the agency from being a responsible party.

This is, of course, a simplification of the process. As with all things, work with your attorney and hire reputable and experienced environmental professionals to make sure the process has been strictly complied with and that the reports include all necessary elements. By doing so, you will save your agency from being on the receiving end of an EPA order and having to explain to ratepayers or board members why money is being spent to clean up someone else's mess. ■

Danielle G Sakai is a partner in the environmental law & natural resources practice group at Best Best & Krieger LLP. Based in Riverside, her practice focuses on environmental contamination, land use and real property disputes. She has significant experience with the environmental due diligence process and litigating contamination issues, including one of the state's most contentious superfund sites involving perchlorate groundwater contamination. She can be reached at Danielle.Sakai@BBKlaw.com.