

## Overcoming Environmental Obstacles To Property Deals

*Law360, New York (August 18, 2010)* -- Environmental concerns should never be the cause of a failed real estate transaction (including refinancing). In other words, developers need not walk away from opportunities and associated revenues purely for environmental reasons.

Gone are the days when it makes sense to rely solely on the All Appropriate Inquiry Standard and a well-performed Phase I Environmental Site Assessment (Phase I) to provide protection against environmental liability.

First, a well done Phase I only protects you in that it makes up one element of the “Innocent Purchaser” defense under the Comprehensive Environmental Response, Compensation and Liability Act; however, it does nothing to protect you against liability under other statutes or from third-party suits.



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Second, despite all the information that must be analyzed in Phase I, these are invariably performed under extremely tight monetary and time constraints. The cost of defense and environmental liability can be far too high to rely solely on this method of protection. This is not the place to cut corners.

Environmental Risk Management mechanisms, such as environmental liability insurance, can help to solve these issues and potentially bring greater value to the property and the transaction. This is accomplished by reducing the environmental “number” in the transaction’s equation to a hard cost that, when stacked against the value of the deal, is often reduced to a nominal number.

Environmental risk transfer mechanisms have traditionally benefitted buyers of real estate, but are often used in sell-side due diligence and positioning in order to gain a higher price for the property to avoid selling the property as a distressed asset.

Traditional environmental liability insurance policies can cover on- and off-site pollution conditions that are already present at the property and new conditions that may occur during the policy term. These typically cover cleanup and claims for bodily injury and property damage alleged to have been caused by pollution conditions at or migrating through the property.

These also cover defense costs. This way, whether ultimately liable or not, the cost to defend oneself is covered. Business Interruption and other coverages are also available. Best of all, these protections are transferrable to the real

estate buyer, helping facilitate a sale of the property at a price that does not include a discount for environmental concerns.

Sellers who are fearful of triggering regulatory issues by allowing due diligence are more willing now to allow environmental due diligence by a buyer under the cloak of confidentiality with an agreement not to disclose any unfavorable results to the seller, if it means they can (1) move the property they want to sell and (2) gain protection from environmental liability in the process. The potential buyer has no duty to disclose what it finds, as the seller might if it had actual knowledge of a reportable condition.

Commercial Lenders are also driving interest in risk transfer on one-off deals where they stand to inherit environmental liability in the event of a default and for their portfolios to maintain or recoup collateral value. One-off pricing is cheaper than ever due to the level of competition in the marketplace, and portfolio pricing is so low per site that it doesn't make sense not to cover the exposure.

Qualified Intermediaries (QI) in 1031 Exchanges are now recognizing the environmental liability risk they take when taking title to property without the protections of environmental liability coverage. The indemnification protecting the QI is not strong enough to overcome the environmental liability incurred on their watch.

For instance, Improvement Exchange — the QI holds title to property during capital improvement of the site; during excavation, the contractor uncovers buried drums. Who is liable? Arguably, the seller is liable, but as the owner of the site, the QI is first in line for liability. Chances are that the QI's only protection in the indemnification is in its agreement. The good news is insurance can be purchased to back that up and avoid litigation.

A combination of environmental liability coverage and other risk management tools is being used successfully to remove environmental liability from property under cleanup orders, so that the owner can sell the property free of environmental liability for a positive value. Cooperation from the regulators is required, and the solution must be tailored to fit the exact situation.

The seller can walk away "clean", and the ultimate buyer can come into ownership "clean" of the potential for environmental liability associated with a very dirty site. Admittedly, this complex combination of insurance and other solutions only fits certain scenarios, yet it is one example of problem solving at its best.

In short, no matter what the environmental issues at a property, the transaction shouldn't fail solely for that reason. You can take comfort in knowing that ways to work through these issues to the mutual satisfaction of all parties exist and that the transfer of the risk of environmental liability can happen so the full value of the property can be realized.

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