Prospective Purchaser Agreements and Comfort Letters: Tools to Consider in Real Estate Transactions Involving Contaminated Sites

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History

The major legal and environmental concern in any real estate transaction is liability for past on-site contamination. Nationwide, there are numerous properties that are subject to potential response actions by the Environmental Protection Agency (EPA), or the equivalent state environmental regulatory agency, under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. §§ 9601–9675 (1994 & Supp. 1998).

Defining and minimizing environmental risks associated with real property have become essential tasks of environmental and real estate lawyers who negotiate commercial real estate transactions. "Environmental due diligence" is required for almost every transaction in real property. After the nature and extent of any contamination have been identified, special contract language, including representations, warranties and indemnities are generally crafted and negotiated between the parties. Along with these traditional assurances, two additional tools that should be considered are Prospective Purchaser Agreements and Comfort Letters. These will be discussed later in this article.

Anyone who owns property to which contamination has migrated in an underlying aquifer faces potential uncertainty with respect to liability as an "owner" under CERCLA, 42 U.S.C. § 9607(a)(1). This liability extends even to an owner who has neither participated in the handling of hazardous substances, nor taken any action to exacerbate the release. Some owners who have property overlaying contaminated aquifers have experienced difficulty when selling the property, or when obtaining financing for development, because prospective purchasers and lenders view the potential CERCLA liability as a significant risk.

Standards of the American Society for Testing and Materials: Phase I and II

The American Society for Testing and Materials, a private standards writing organization, has developed general standards for environmental due diligence and commercial real estate transactions. According to the society, four components are required for an acceptable Phase I Environmental Site Assessment. They include: (1) a records review; (2) a site reconnaissance; (3) interviews with current owners and occupants of the property; and (4) interviews with local government officials. The scope and extent of acceptable environmental due diligence for each of these components is more fully set forth in standards relating to commercial real estate.[1]

Generally, the American Society for Testing and Materials Phase I Standards[2] require the environmental professional to identify potential environmental contamination. First, this is developed in an *Opinion*, which includes "the *environmental professional's* opinion of the impact of *recognized environmental conditions* in connection with the property." Also included are *Findings and Conclusions* that state that "this assessment has revealed no evidence of recognized environmental conditions in connection with the property," or the preceding statement followed by a list of exceptions. Section 3.3.28 of ASTM E-1527 defines the proper criteria for the environmental professional's determination of what is a recognized environmental condition.

The primary objectives for conducting a Phase II Environmental Site Assessment are: (1) to evaluate the "recognized environmental conditions" identified in the Phase I assessment or the Transaction Screen Process, for the purpose of providing sufficient information regarding the nature and extent of contamination, to assist in making informed business decisions about the property; and where applicable, (2) to provide the level of knowledge necessary to satisfy the "innocent purchaser defense" under CERCLA.

Environmental Databases: The Case of Arizona

In Arizona, the Environmental Protection Agency (EPA) and the Arizona Department of Environmental Quality have identified large areas of real property subject to potential environmental enforcement. This information is reported in various regulatory databases. These databases include the EPA's National Priority List, the EPA's Comprehensive Environmental Response, Compensation and Liability Information System, and the Arizona Department of Environmental Quality's Water Quality Assurance Revolving Fund Registry.

Generally, groundwater contamination is the environmental issue most frequently associated with property in Arizona. A typical Phase I Environmental Site Assessment describes groundwater contamination as a recognized environmental condition that has been identified on real property within a CERCLA or Water Quality Assurance Revolving Fund site. This recognized environmental condition provides a theoretical, but not actual, groundwater contamination issue and subsequent liability for the borrower, lender and potential purchaser.

New Tools

Along with these traditional representations, warranties and indemnities, there are two additional tools, on both the federal and state level, that environmental and real estate lawyers may wish to consider in real estate transactions. They are Prospective Purchaser Agreements and Comfort Letters.

The Prospective Purchaser Agreement is a legally enforceable document entered into by a prospective purchaser and the Agency (EPA or state agency) to formally establish and limit the issue of liability for existing contamination. Comfort Letters relate only zto the Agency's intent to exercise its response and enforcement authority at a property based upon the information known at the time of the request. The Comfort Letter is not binding upon the Agency, does not provide assurance of no action, and may be rescinded by the Agency with the submission of new information.

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Prospective Purchaser Agreements: In order to foster real property transfers, and to speed environmental cleanup, the EPA and the Department of Justice offer a Prospective Purchaser Agreement.[3] The EPA is aware of CERCLA's impact on private real estate transactions, notwithstanding the so-called "innocent purchaser defense." Despite the clear liability attached for landowners that choose to purchase contaminated property with knowledge of the contamination, private transactions concerning such property are still a reality.

Due to these concerns about cleanup liability, the EPA receives requests for covenants not to sue from prospective purchasers of CERCLA sites. It is the EPA's policy not to involve itself in purely private real estate transactions. However, in very limited circumstances, at sites where enforcement action is ongoing or anticipated, and performance of cleanup, or payment for cleanup, would not otherwise be available, a covenant not to sue a prospective purchaser might be considered.

The agreements are between the federal or state government and the potential developers of abandoned, contaminated sites. They clearly spell out the federal government's participation in the cleanup of the site, as well as protect purchasers who do not contribute to a contaminated site from federal liability.

The benefit of entering into a prospective purchaser agreement with the EPA is that, subject to specific reservations outlined in the guidance, a party receives a legally-binding **covenant-not-to-sue** from the United States for past contamination at the site. As a result, Department of Justice must concur on any agreement. Current owners are generally not considered appropriate for such an agreement, nor is anyone who caused or contributed to the contamination.

The EPA has published a Model Prospective Purchaser Agreement presented at 60 Fed. Reg. 34,790 (1995). The Arizona Department of Environmental Quality has also developed a draft Prospective Purchaser Agreement dated May 18, 1998.

Comfort Letters: In addition to prospective purchaser agreements, the EPA has also identified Comfort Letters as a potential solution between parties involved in a contaminated property.[4] As stated by the EPA,

> Upon receiving a request from an interested party for information about their circumstances, regional offices may issue comfort/status letters, at their discretion, when there is a realistic perception or probability of incurring Superfund liability and such comfort will facilitate the cleanup and redevelopment of a brownfield property, and there is no other mechanism available to adequately address the party's concerns. EPA believes that these comfort/status letters are not necessary or appropriate for typical real estate transactions. With the information provided by EPA, the party inquiring about the property can decide whether the risk of EPA action is enough to forego involvement, whether to proceed as planned, whether additional investigation into site conditions is necessary, or whether further information from EPA or other agencies is needed.

Draft EPA Comfort Letters are presented at 62 Fed. Reg. 4,625 (1997) for general use. The Arizona Department of Environmental Quality has also developed a draft Comfort Letter dated February 4, 1999.

Example Client

Under CERCLA, the EPA established a National Priority List of Superfund sites. Inclusion on the list generally suggests that contamination poses a significant risk to public health and the environment and indicates a Federal Priority to remediate the site. An example client or property purchaser who might request a Prospective Purchaser Agreement or Comfort Letter would be a purchaser of property included within the geographical description of the Motorola 52nd Street National Priority List Site in Phoenix, Arizona.

Investigations have determined that groundwater and soil at the site of the Motorola plant is contaminated with Volatile Organic Compounds (VOC's). Further investigation has determined that large areas of groundwater west of the Motorola plant have also been contaminated with these same compounds. Monitoring wells and Air Sparging/Soil Vapor Extraction units have been installed to treat the contaminated groundwater. Generally, the subject property or adjoining facilities have not been identified as Potentially Responsible Parties. Current data could indicate that the property to be purchased is probably not located within the boundaries of the contamination plume. However, groundwater flow measurements indicate that the plume is migrating in a westerly direction, which places the property cross-gradient of the known plume. Unfortunately, the National Priority List plume boundaries are approximate. The potential environmental impact from this site to the property to be purchased is currently unknown, but believed to be low to moderate.

Conclusion

In Arizona, uncertainty about potential contamination and CERCLA and/or Water Quality Assurance Revolving Fund liability may prevent otherwise interested parties from purchasing or lending on real property. To alleviate the parties' fear of federal or state agencies coming after them for cleanup of real property, the EPA and state environmental agencies can provide varying degrees of assurance by communicating the agency's intentions concerning a particular piece of property.

Under appropriate circumstances, legal documents from the EPA and the state agency should be considered. These documents include **Prospective Purchaser Agreements**, formal legal agreements containing a covenant not to sue which releases a party from liability for cleanup of existing contamination, and **Comfort Letters**, regarding the exercise of enforcement discretion as it relates to specific circumstances of a property, or activities of a party to the transaction.

Notes

1. *ASTM E-1527 Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process; ASTM E-1528 Standard Practice for Environmental Site Assessments: Transaction Screen Process; ASTM E-1903 Standard Guide for Environmental Site Assessments: Phase II Environmental Site Assessment Process.*

2. *ASTM E-1527 §§ 11.5, Opinions and 11.6, Findings and Conclusions.*

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3. *See* 54 Fed. Reg. 34,235 (1989) and 60 Fed. Reg. 34,790 (1995). *See also* Arizona Revised Statutes (A.R.S.) § 49-285.01.

4. *See* 62 Fed. Reg. 4,624 (1997).

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