Pre-Acquisition Due Diligence

Reducing Environmental Cleanup Costs *by Randy Airst*

Entities that purchase rights of way should conduct a thorough investigation of the environmental condition of the subject property. Environmental problems can reduce the value of a property and, in many instances, subject the owner or operator to liability for the cleanup of any contamination found on site. The owner of a contaminated property can also be subjected to a number of other damaging actions, including criminal liability or costly toxic tort lawsuits.

This article focuses on the diminution in value that frequently accompanies environmental problems. The parties who purchase rights of way can avoid paying more than the market value of environmentally challenged property by conducting a thorough environmental audit before the acquisition of the property. The purchaser must then ensure that the appraisal of the property accounts for the environmental challenges confronting the property.

During the past 15 years, federal, state and local governments have responded to a rising tide of public pressure to protect the environment. This response has frequently taken the form of laws that are designed to protect water, air and soil. These new laws have also spawned growth within the administrative agencies charged with implementing them in a manner consistent with the intent of the legislature. The result has been a prolific growth of the U.S. Environmental Protection Agency (EPA).

State environmental agencies have also undergone a prolonged period of high growth. To a large extent, this growth has been driven by the responsibility delegated by the federal government for the management of various statutes. Typically, the federal government has created a blueprint, and then, left the day-to-day management and oversight of the enforcement and regulation to the states.

These environmental laws and regulations present prospective purchasers and owners with a formidable gauntlet of restrictions and liabilities. These restrictions and liabilities are now forcing buyers, sellers and lenders to evaluate the economic impact of various environmental statutes and the judicial decisions interpreting these laws. (Patchin, Peter J. "Valuation of Contaminated Properties," *The Appraisal Journal* (Jan. 1988), at pages 7 and 8.) Environmental statutes and regulations are not the only environmentally related reason for properties to substantially decrease in value.

A number of court decisions hold that the presence of contamination substantially reduced, and, in some cases, even eliminated, the market value of a property. (See, for example, *Monroe County Board of Assessment Appeals v.*

MUSTANG ENGINEERING, INC.
The Industry Excellence
FOR ALL OF YOUR R/W NEEDS:

- Appraisal Studies
- Permitting
- Title Abstracting
- R/W Acquisition
- Survey Permission
- Uniform Act Projects
- Due Diligence Studies
- Condemnations
- Expert Testimony
- Computerized Tracking

ADDITIONAL SERVICES

- Route Studies
- Survey & Mapping
- Engineering P/L Systems
- Total Turn Key Projects
- Inspection - Onshore and Offshore
- Project Management

On Schedule - On Target - On Budget

Monroe, LA Office
Mustang Engineering, Inc.
P. O. Box 4848
Monroe, Louisiana 71211
(318) 322-3000
Fax 318-322-3440

Main Office
Mustang Engineering, Inc.
16001 Park Ten Place, Ste. 500
Houston, Texas 77084
(713) 578-0070

Miller, 570 A. 29 1386 (Pa. 1990); Westlake v. Transmission Agency of Northern California, No. 98803, Cal.Sup.Ct., Shasta County 1993.)

Literally thousands of contaminants exist whose mere presence can cause the market value of an afflicted property to plummet. Consequently, many situations exist where the presence of a contaminant will cause the host property to decrease in value. This diminution in value occurs despite the lack of conclusive evidence establishing the contaminant's adverse impact on either human health or the environment. Frequently, the stigma associated with an environmental condition is sufficient to precipitate a decline in the market value of the afflicted property.

Statutes and Regulations

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) was enacted in 1980. 42 U.S.C. Subsection 9601 *et seq.* The author has chosen to examine CERCLA for a very good reason: members of the regulatory community almost unanimously recognize this statute as posing the greatest regulatory threat to their financial health. The federal government can order any one of five types of parties to remediate a hazardous waste problem. The average CERCLA site costs in excess of $25 million to clean up.

The original CERCLA statute identifies four of the five types of parties who can be ordered to remediate a CERCLA site. CERCLA refers to these parties as Potentially Responsible Parties (PRPs). If a party refuses or is not identified before the government cleanup, the government can sue for reimbursement. The four CERCLA classifications of PRPs include:

- Current owners or operators of a contaminated site
- Anyone who owned or operated the contaminated property at the time the hazardous waste substance was disposed of
- Any person who generated waste and arranged for disposal or treatment of the waste at the site
- Any person who transported hazardous substances to a site of their choosing when there is a subsequent release or threatened release at the site. 42 U.S.C. Section 9607 (a)(1)-(4).

CERCLA was amended by the Superfund Amendments and Reauthorization Act (SARA). SARA added a fifth category of PRP. This category consists of intervening owners who secured actual knowledge about the presence of hazardous waste and did not reveal this information at the time the property was sold. 42 U.S.C. Subsection 9601 (35)(c).

If a party refuses or is not identified before the government cleanup, the government can sue for reimbursement.

CERCLA imposes strict, joint and several liability on PRPs. Many of the parties who purchase rights of way have relatively deep pockets. Consequently, they are particularly susceptible to the imposition of joint and several liability for the entire cost of cleanup. In many instances, the EPA will attempt to limit its litigation expenditures by only imposing liability on a limited number of well-heeled PRPs.

These parties must then attempt to recoup part of their losses through the imposition of contribution-liability on less affluent PRPs. This is a risky strategy because, in many instances, these parties cannot be found or are unable to share in the remediation expenses in a meaningful way, because of the dearth of financial resources.

Once a property becomes subject to a

RIGHT OF WAY SERVICES

JAMES DANIELS & ASSOCIATES, INC.
210 WEST SIXTH STREET, SUITE 506
FORT WORTH, TEXAS 76102
(817) 338-0221 -- OFFICE
(817) 877-0921 -- FAX

- ENVIRONMENTAL STUDIES
- ABSTRACTING OWNERSHIP RECORDS
- RIGHT OF ENTRY
- SURVEYING
- APPRAISAL SERVICES
- APPRAISAL REVIEW
- NEGOTIATIONS
- RELOCATION ASSISTANCE
- EXPERT WITNESS TESTIMONY
- PROJECT MANAGEMENT
- PROJECT IMPACT STUDIES

COMPLETE TURN KEY RIGHT-OF- WAY ACQUISITION SERVICES
BILLY R. STEWART, P.E., DIRECTOR

CERCLA cleanup, it can easily lose all of its market value. It is not uncommon for the remediation expenses to exceed the uncontaminated value of the property by a substantial amount.

Other Environmental Statutes

It is important for purchasers to remember that CERCLA is only one of many environmental statutes that can, and frequently do, have an adverse impact on property values. Another important statute is the Resource Conservation and Recovery Act (RCRA). RCRA is a comprehensive program designed to control the domestic treatment, storage and disposal of hazardous waste. 42 U.S.C. Subsection 6901 *et seq*. The statute includes provisions that create a "cradle to grave" system governing generators and transporters of hazardous waste, as well as the operators of treatment, storage and disposal facilities.

If these regulations are not being adhered to, the purchaser may not be able to use the permit it was counting on at the time the property was purchased. Any violation of the statute or its regulations may prove to be financially burdensome for the purchaser to rectify. Finally, closure of a RCRA facility can be financially draining because of the numerous expenditures, such as payment for any remedial action that may be required.

These are only two of the many environmental statutes that frequently cause the value of regulated properties to diminish appreciably.

Environmental Audits

Environmental audits have become more and more sophisticated as a growing number of parties seek to avoid inheriting the liability for environmental problems created by their predecessors. Parties who purchase rights of way may not be as concerned about the presence of contamination as other purchasers. The reason is that, often, these tracts of land will not be used for any residential, industrial or commercial purpose. The properties are typically used for the construction of transportation corridors, utilities, pipelines, etc. Therefore, this article focuses on ensuring that this group of property owners only pay the fair market value for properties.

Environmental audits should be used to identify the environmental problems confronting a property. The applicability of environmental statutes and regulations are only one example of an environmental factor that can substantially reduce the value of a property. Environmental audits will uncover the applicable environmental statutes and regulations, as well as the other relevant environmental factors. Fortunately, some important standards have developed to help property owners ensure that their investigation is effective.

Many of these standards must be used for specific purposes. For example, the widely cited ASTM Standard for Commercial Real Estate is most useful for avoiding CERCLA liability. The prudent purchaser will ensure that the contractor it hires possesses a substantial amount of experience with respect to the type of property being examined. This will help the auditor focus his examination on the relevant areas.

Another important standard is the National Ground Water Association Guidance to Environmental Site Assessments. This standard, combined with the ASTM standards, is being used by purchasers to avoid CERCLA and other types of environmental liability.

These standards provide interested parties with guidance about what steps to take in order to ascertain whether or not potentially adverse environmental factors exist that could affect the market value of the property. The importance of environmental auditing can be seen by the fact that banking regulators now demand that lenders examine the environmental condition of a property before the initiation of a loan. (See, for example, The FDIC Guidelines for Environmental Risk Programs.)

Banks now regularly demand to review the results of an environmental

RESPONSIVE

To The Needs Of Our Clients

- Feasibility Studies
- Project Management
- Engineering Design
- Route Selection
- G.P.S./Conventional Surveys
- Permits
- Material Management
- R.O.W. Acquisition
- Title Research
- Damage & Claim Settlement
- Mapping
- CAD Drafting
- Construction Management
- Inspection

Contact Del Delcoure, **Willbros Butler Engineers, Inc.**
(918) 496-0400, 2087 E. 71st Street, Tulsa, OK 74136

audit before they agree to loan money on real property. One of the main reasons for this development is the realization that the presence of any one environmental factor has the potential to significantly decrease the value of the property/collateral. This could easily create a situation whereby the amount of the loan would be greater than the market value of the property.

Parties who purchase rights of way may not be as sensitive to the impact of environmental factors on value. This type of investor rarely sells the property. This contrasts sharply with a bank that may not be able to collect its interest or principal once environmental factors materially diminish the value of a property. Parties who purchase rights of way must take concrete steps to ensure that they do not overpay for environmentally challenged properties.

Appraisal

Environmental factors can have a material impact on the value of real estate. The auditing standards will allow purchasers to identify the sources of environmental concern. The purchaser must then hand this information over to an appraiser who is trained to quantify the economic consequences imposed by the existence of various environmental problems. This type of appraiser will be able to evaluate the economic impact that the environmental factors will have on the fair market value of a property. Without this type of evaluation it might be possible for a purchaser to pay substantially more than fair market value.

Summary

Today, literally millions of pieces of real estate are subject to some environmental problems. Many of these problems arise because the building, the land or the groundwater is subject to one of hundreds of federal and state statutes and regulations. Corporations that purchase rights of way must be careful not to overpay for these properties.

Overpayment can easily occur. This situation most frequently transpires when the purchaser reaches its determination of value without incorporating the impact of any environmental problems confronting the property and its owner. Consequently, a prospective purchaser must first thoroughly examine the environmental factors that afflict the subject property. It must then ensure that these factors are included in the valuation of the property.

This process will ensure that both the purchaser and its stakeholders receive an equitable deal that includes the information gathered during a thorough investigation into the property's environmental condition. This investigation is destined to become an increasingly important part of the pre-acquisition due diligence conducted by purchasers of rights of way. ❑

Randy L. Airst is an attorney with the Marga Environmental Corporation in Wayne, Penn. The company provides environmental education and training programs. Mr. Airst is writing a book on environmental auditing and due diligence, which is targeted toward the needs of the financial, accounting, real estate and appraisal industries.

H.C. PECK & ASSOCIATES INC.

A FULL-SERVICE NATIONAL RIGHT-OF-WAY COMPANY

HELEN C. PECK, President

475 Seventeenth Street Suite 544 Denver, CO 80202
(303) 293-8718 Fax (303) 293-8720