MUNICIPAL SETTING DESIGNATIONS: ALLOCATION AND RESOLUTION OF ENVIRONMENTAL RISK IN REAL PROPERTY TRANSACTIONS

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MUNICIPAL SETTING DESIGNATIONS: ALLOCATION AND RESOLUTION OF ENVIRONMENTAL RISK IN REAL PROPERTY TRANSACTIONS*

I. INTRODUCTION – GETTING THE DEAL CLOSED

The last decade or so of environmental law in Texas has seen the development and proliferation of a variety of statutory and regulatory legal tools among whose net effect has been to resolve environmental risks associated with real property. The Municipal Setting Designation ("*MSD*"), enacted in 2003 as H.B. 3152[1] and amended in 2007,[2] has the greatest potential for resolving such risks.

The purpose of this presentation is to provide real estate practitioners of all levels of experience with the background to spot these environmental risks early in a transaction and, notwithstanding the existence of environmental impairments, to close their client's deals in a manner that meets business needs using sound commercial and legal practices.

The current economic decline and corresponding relative unavailability of credit have adversely impacted the Texas real estate market, including what had been an increasing demand for environmentally impaired real estate. Prior to that time, real estate with a variety of environmental impairments had become more attractive for redevelopment due to its location. The author believes that when the Texas real estate market begins to improve, the demand for the locations where environmentally impaired real estate is present, particularly in urban in-fill areas, may lead the way. And, the tool that will lead that resurgence will be the MSD.

Demand for real property where environmentally impaired real estate tends to be located has evolved over the last decade and a half. Developers and municipalities found common ground in these so-called Brownfield sites: both sought economic redevelopment to return blighted or underutilized real property to its highest and best use.

Standing in the way was the uncertain timing and cost of environmental impairments. The key to this evolution was bringing economic certainty, or at least less uncertainty, and more predictable timing, to the resolution of environmental impairments. At the same time, Texas could not lose sight of political and public expectations of continued protection of public health and the environment.

The fact that this evolution began and continues is not a reflection of less regard for the environmental risk. In fact, the evolution was initiated by the recognition and application of principles of scientific and statistical risk assessment by the Texas Commission on Environmental Quality ("TCEQ"). Environmental investigation and remediation requirements did not become less stringent over time, and especially with the recent change in Administrations in Washington, D.C., the opposite is becoming increasingly apparent.

The private market had done its part to bring about this evolution by (1) broadened, improved environmental due diligence, (2) increasing comfort with those of Texas' statutorily-driven environmental programs containing an economic development component, and (3) real estate transactions of greater size and financial magnitude that could more readily absorb environmental risk.

As a practical matter, the market forces of supply and demand played a role as well. The fact has been that demand in urban areas for in-fill property has outweighed the supply of land in those areas that lack environmental impairment. The fact has also been that some non-urban outlying areas that have traditionally competed with their urban neighbors and fellow towns for new business development have seen the need in some cases to revisit their balance between economic development and environmental protection to gain a competitive edge or to keep pace with one another. The result has been an evolution in the real estate development and lending communities. As the real estate market begins to improve in pockets and eventually throughout Texas, demand for these environmentally impaired properties is likely to return.

This presentation is divided into three parts: a discussion of Texas' Municipal Setting Designation program, a review of real estate drafting issues related to environmental problems, and recommendations concerning selected transaction structural and due diligence issues influenced by environmental law.

It is not the intention of this presentation to create environmental experts out of career real estate attorneys. It is written admittedly from the perspective of a career environmental lawyer. The author routinely assists transactional counsel and has focused here on the environmental issues of greatest concern to them. The author acknowledges that those who only occasionally encounter environmental issues, including experienced real estate counsel, may tend to view these

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* Portions of this paper have appeared in other forms previously. The MSD section in particular draws on work done by my colleagues John Slavich, Greg Rogers, David Whitten, and Erika Erikson, who have been instrumental in developing the MSD process in Texas and with its implementation for our firm's clients. Also, Ms. Erikson assisted with research for the paper and the preparation of the Endnotes.

issues with greater concern and skepticism than does the author who deals with such matters on a daily basis.

II. MUNICIPAL SETTING DESIGNATIONS

A. Background

The Texas Commission on Environmental Quality (*"TCEQ")* Certificate of Completion continues to be the regulatory resolution of preference in the Texas real estate market. The process for obtaining a Certificate of Completion (*"COC"*) has become a reasonably well understood process in the environmental community, and in many ways the program, though extraordinarily detailed and complicated, has become standardized in many respects.

A COC is issued by the TCEQ's Voluntary Cleanup Program (*"VCP*"). The issues with the VCP process, from a real estate perspective, are in the author's view, mainly two. First, the VCP process can take an unpredictable amount of time to conclude: more time than most real estate transactions can bear. Second, the part of the VCP process that is not approaching standardization is the part where the greatest costs are incurred. The magnitude and uncertainty of cost to address an environmental impairment has been an irreconcilable problem for many real estate deals.

The critical VCP process standard has been that all environmentally impaired groundwater must be investigated and remediated as if it were a drinking water source, whether or not that is or has ever been or will be the case. This standard is particularly illogical where the contaminated groundwater was of such long lastingly poor quality due to natural conditions (brackish water, for example) that even in the absence of man-made contamination, it was not and would never become potable or consumed from a scientific standpoint.

The net effect of this standard was that only a few real properties with groundwater impairments had been voluntarily remediated. They laid fallow, discouraging economic redevelopment and adding nothing except heartache and trouble to the local community and its tax base. Investment in these properties did not occur. There was little prospect of future investment because addressing the property's environmental conditions was uncertain and potentially cost prohibitive.

In 2003, the Texas legislature determined to change this approach with the MSD enabling statute. The legislative conclusion was that groundwater protection should, at least in part, become a local issue. It would no longer be a state requirement to protect groundwater of such long lastingly poor quality in the same manner as groundwater of better quality with actual or presumably better potential human consumptive value. More specifically, the legislature concluded that if a local government authority was legally prepared to conclude that the groundwater at a property within its jurisdiction could not be remediated to the point where human consumption could be reasonably anticipated, the public policy of the state should not be to force those state standards on the investigation and remediation of the property.

The Texas MSD program addresses this standard and the issues of timing and cost head on. A Municipal Setting Designation obtained from a local municipality and certified by the TCEQ is a component part of the VCP regulatory closure process. The MSD process in combination with VCP can pave the way for achieving resolution of an environmental impairment more quickly, more completely and in a less costly manner with less long term risk than other environmental tools. And, the resolution, by statute, is deemed to be to residential standards. The Legislature determined that MSD-tailored environmental standards applied to a specific groundwater problem are protective of human health and the environment.

This MSD/VCP combination does not achieve the Ideal Environmental Outcome, if that outcome is defined to be a final resolution of the environmental impairment for all purposes. However, it comes closer to that ideal than the other regulatory and contractual tools presently available. An MSD is not a stand-alone regulatory fix for a contaminated property, but in the right context, it can be of enormous legal, financial and practical benefit in getting a deal closed.

The environmental tools most familiar to real estate counsel are the following TCEQ programs:

(1) Voluntary Cleanup Program, standing alone, that is, without the MSD process,
(2) Innocent Owner/Operator Program,
(3) Dry Cleaner Remediation Program,
(4) Petroleum Storage Tank Program,
(5) Corrective Action Program, and
(6) Combination of one or more of these programs.

Added to this list are federal and State statutory provisions offering protection to certain parties, for example, innocent owners of certain property, from liabilities to the government.

The VCP process standard remains in place today in all areas of the state where an MSD program has not been locally implemented, and even in jurisdictions with MSD programs, this standard applies unless and until it is made applicable to a specific property through formal MSD procedures generally set by that locality.

The MSD process has encouraged voluntary remediation of groundwater at sites that in the absence

of this program would have continued to lay fallow. In so doing, the range of redevelopment outcomes has broadened as costs have become more certain and probably lower. Timing, while still an issue, has become less so.

The MSD accelerates the realization of the VCP liability function, which eliminates liability of future landowners and lenders at a remediated property.[3] When the necessary investigation and appropriate response actions with respect to a site have been completed and a COC is issued by TCEQ, future owners, operators, and lenders are released (subject to limited exceptions) from liability to the State of Texas with respect to cleanup of contamination present at the site covered by the COC at the time the COC was issued.[4] Prospective purchasers of contaminated sites that become applicants under the VCP *prior to taking ownership of the property* are in addition released from liability for that property upon TCEQ's subsequent issuance of a COC.[5] With an MSD in place, this release more quickly becomes reality.

B. The Regulatory Implications of the MSD and VCP Combination

The Texas Risk Reduction Program ("*TRRP*") is the TCEQ's environmental risk management methodology for Texas environmental investigation and remediation projects. The detailed TRRP regulations,[6] and extensive accompanying guidance issued by TCEQ, provide a comprehensive risk-based approach for assessing and responding to environmental contamination. TRRP requires persons addressing environmental contamination to perform a series of activities with respect to a site. Those activities include:

a. Conducting an affected property assessment for all chemicals of concern, classifying groundwater, determining land use, and notifying affected offsite property owners;
b. Determining critical protective concentration levels ("*PCLs*") for the affected environmental media (e.g., soil, groundwater, surface water) and potential exposure pathways (e.g. dermal exposure to soil, human ingestion of groundwater, ecological receptors, etc.) for each chemical of concern;
c. Preparing and filing an Affected Property Assessment Report ("*APAR*") which details findings of the above work, and provides a significant amount of other site-related information required by the TRRP process;
d. Developing a Response Action Plan that describes how the proposed response objectives will be met for each chemical of concern;
e. Preparing and submitting to TCEQ a Response Action Completion Report following completion of response actions; and
f. Receipt of a Certificate of Completion issued by the TCEQ.[7]

For most environmentally impaired properties, the first step in this process is the most expensive and time-consuming. The investigation and remediation of contaminated groundwater to meet potential human consumption standards is typically the greatest cost and takes more time than any other TCEQ consideration under the VCP. The MSD program's focus is on this step. It provides particular relief from the technical focus on potential human consumption of contaminated groundwater. Its downstream VCP process impacts follow.

If the local jurisdiction has determined that groundwater at the subject site is not a drinking water source, as evidenced by the issuance of an MSD certificate, the TCEQ is thereby legally precluded from considering the human consumption of groundwater in its VCP determinations. This narrows the second step of this process. In VCP parlance, this standard is described as the groundwater PCL for direct human ingestion of groundwater ($^{GW}GW_{Ing}$).

It seems common sense as well that one should not be required to investigate or remediate groundwater with no reasonable human consumptive value to the same level as groundwater that can be reasonably anticipated to be potentially available for human consumption

There is an additional benefit. The elimination of the above groundwater pathway from regulatory consideration leads to altered, more favorable soil assessment and soil remediation requirements. This standard is described as the soil PCL for protection against leaching of contaminants from soils into groundwater at levels that would be unsafe for human ingestion ($^{GW}Soil_{Ing}$).

A numeric example illustrates the potential benefit of MSD certification. At dry cleaner sites, the contaminant tetrachlorethylene, commonly known as perc, is at issue. The groundwater PCL, without an MSD, will be 5 ppb.[8] With an MSD, the critical PCL is increased to 500 ppm, a 100,000 fold increase. At that same site, the critical PCL for soil would increase from 0.05 mg/kg to 100 mg/kg[9] for a residential site and 410 mg/kg [10] for a commercial/industrial site.

C. The Municipal Setting Designation Process

MSD statutory requirements are few, fairly simple, and are found in Chapter 361, Subchapter W of the Texas Solid Waste Disposal Act ("TSWDA").[11]

As adopted, the statute imposed two MSD disability criteria:

1. A public drinking water supply system exists which is capable of supplying drinking water to the MSD property and property within a ½ mile of the MSD property; and
2. The property is within the corporate city limits or extraterritorial jurisdiction of a municipality with a population of at least 20,000.[12]

The second eligibility criterion was modified by the 80th Legislature in 2007 to delete the population requirement.[13] Today, about 100 MSDs have been certified by the TCEQ.

The TCEQ's MSD/VCP process requirements consist of five general steps. (1) One typically must apply to the TCEQ VCP program and pay an application fee. (2) One must follow local procedures and the TCEQ procedural overlay on those procedures to obtain the MSD certificate from the municipality. The procedural overlay includes notice of the application to affected, adjoining municipalities, municipal and retail public water utilities, and registered private water well owners. While the MSD process is ongoing, the TCEQ will suspend its administration of the VCP application. (3) Once the MSD is certified by the municipality, it is delivered by the applicant to the TCEQ as part of a TCEQ MSD application. Staff technical review of that application will take 90 days. Before TCEQ may certify an MSD, the applicant must provide documentation evidencing that:

a. The MSD application to TCEQ is accompanied by resolutions in support adopted by (i) the city council of the municipality in which the MSD is located and any other municipalities lying within the boundaries of the MSD and ½ mile buffer zone; and (ii) the governing body of each municipal and retail public water utility having a groundwater supply well within 5 miles of the MSD[14]; and
b. The property for which an MSD is sought is subject to either:

   (1) a municipal ordinance that prohibits the use of affected groundwater from beneath the property as potable water and that appropriately restricts other uses of and contact with that groundwater; or
   (2) a restrictive covenant enforceable by the municipality in which the property is located that prohibits the use of designated groundwater from beneath the property as potable water and appropriately restricts other uses or contact with that groundwater. Restrictive covenants must be approved by municipal resolution.[15]

(4) The result of that review, presumably certification of the MSD, is then delivered to the VCP program staff. (5) The VCP staff then resumes administration of the VCP application.

The remaining requirements of the MSD regulatory process are determined at the local level. A City ordinance or deed restriction prohibiting potable use of affected groundwater within an MSD is required.[16] Cities have chosen either to enact a procedural ordinance, setting out the steps an applicant must follow for the city to grant an MSD certificate, or to create a process by which applicants directly address their applications and needs to the city counsel.

An MSD may be sought by any natural or unnatural person, including the municipality that enacted the local MSD ordinance, and by owners of multiple parcels of real property who in many jurisdictions may apply together in a single MSD application.

An MSD application must contain a specific legal description, described by metes and bounds, and a survey. The MSD property can be as small or as large as the applicant(s) specifies so long as the land sought to be included is within the municipality's jurisdiction.

It would seem that an MSD application should not be able to extend to lands not owned by the applicant(s). To include such lands in an application would seem to create a cause of action against the applicant, possibly for trespass to title or other common law actions.[17] Nevertheless, the City of Fort Worth obtained an MSD for 1,964 acres in the Trinity Uptown section of the city without the prior written approval of all of the property owners within the MSD's legal boundaries.

Additionally, the City of Beaumont has put in place an ordinance that has designated all groundwater in the city as non-potable, thereby paving the way for relatively simple MSD approval at the local level.

The MSD process is not without its limitations. Several are highlighted below. First, the municipality in which the real property of interest is located must have an MSD program before an MSD may be considered or a certification issued. Though the list of cities having MSD programs is growing, MSD programs are far from ubiquitous. The fact that a municipality does not have an MSD ordinance or program does not mean it will or will not enact one,

but its absence in the time-sensitive context in which real estate transactions often arise can be problematic.

Second, the presence of an MSD ordinance or program does not assure that an MSD certificate will be issued for any given real property. The fact that the program is in place is a good indication that an application for an MSD certificate will be actively considered, but again there are exigencies of various types that may create hurdles, at least in the time frame of many real estate transactions. One must recognize that at its heart the enactment of an MSD ordinance or program is a public policy/political decision with all that entails.

Third, the issuance of an MSD may not eliminate all environmental assessment and cleanup requirements. While two of the groundwater-related exposure pathways are eliminated, three others remain.[18] Remaining also are soils requirements. For these and other reasons discussed above, it is important that persons considering whether to employ an MSD strategy conduct an initial MSD screening to evaluate the costs and benefits of doing so.

Fourth, an MSD does not affect the legal duty in the VCP program to protect "ecological receptors." Navigable water, lakes, streams, creeks, wetlands, and their inhabitants receive the same level of environmental protection with or without the issuance of an MSD.

Fifth, TCEQ VCP staff, with reported encouragement from federal authorities, has raised questions at times over whether an MSD is available for properties that are in the midst of, or which have gone through certain TCEQ legal processes. There is no statutory authority known to this author that would sanction denial of an MSD certification by the TCEQ on this basis, but one can not overlook its potential application by regulatory decision makers.

Finally, one must recognize that, when an MSD is involved, issuance of a VCP COC does not address or provide legal protection from claims associated with the off-site migration, if any, of pollution to other properties. This is an MSD trade off, in a sense, for the cost and time savings associated with freeing the subject property for redevelopment sooner and at less cost than without an MSD. One might consider a manuscripted environmental insurance product to address off-site potential risks.

D. Actions Required of Municipalities

The Texas legislature purposefully left the existence and fate of the MSD process to the discretion of local officials. Legislative intent was to allow each municipality to make the decision whether to balance economic development with groundwater considerations in a manner tailored to local needs.

Thus, the initial step by a municipality is to consider whether an MSD process is something it is willing to entertain. TCEQ has published guidance for municipalities interested in enacting an MSD program.[19] Municipalities have reaped available benefits of MSD programs, but they are not necessarily for all municipalities.[20]

MSD programs generally are not self-initiated by municipalities. In the author's and his firm's experience, the proposition of creating a local MSD process requires an advocate and a desirable project that, but for enactment of an MSD process, would not occur. The advocacy team ought to include professionals that can assist with the political and related legal issues. The same is true for the teams presenting an MSD application to a municipality.

In urban areas, these projects have been plentiful, and for that reason, most MSD processes in Texas are found in urban areas. The first two MSDs were certified by the City of Dallas on a "pilot project" basis. The City of Dallas subsequently adopted a procedural ordinance[21] to standardize the processing of MSD applications. Since that time, twenty-six other municipalities have adopted MSD processes.[22]

Texas municipalities have essentially two options for creating an MSD process. First, a city may enact a codified MSD procedural ordinance. Larger cities that have an environmental professional on staff have tended to favor this approach. Other cities have chosen to create processes that consider each MSD application at the city council or other similar elected body.

The municipal MSD programs vary in their approach to application fees, notice requirements, public participation and paperwork required during and after related TCEQ determinations. A critical step is the development of local substantive requirements. The city of Houston's 2007 MSD ordinance is full of economic redevelopment promise but contains certain substantive requirements that have restricted its practical value considerably. A common initial misconception is that a municipality must have environmental expertise to administer an MSD process. This is not the case at all. As described above, the TCEQ's VCP staff stands at the ready to apply its sophisticated technical expertise to all VCP applications, whether or not the application is accompanied by a local MSD certificate.

A TCEQ MSD certificate may be obtained only if the requisite resolutions in support of the MSD are received from the certain adjoining municipalities and regulated public water utilities within specified distances from the property at hand. That is, these other entities have effectively absolute veto power over the local MSD process. Therefore, the MSD advocacy team should identify such entities, if present, and

determine whether each is willing to support the municipality in its MSD efforts.

E. The Importance of MSDs to Real Estate Deals

The MSD process in combination with VCP may result in resolution of an environmental impairment to real estate more quickly, more completely (to residential standards) and in a less costly manner with less long term risk than most other environmental tools. The question is why wouldn't an MSD be the right approach to resolving an environmental impairment? The answer is the MSD is the right approach in many cases.

In our firm's experience in dealing with those challenges on clients' projects, the MSD has provided a significant improvement in offering more certainty and finality to projects involving contaminated properties at less cost and in a shorter period of time.

As noted earlier, an MSD reduces the timing necessary to achieve closure and receive a COC from the TCEQ. Previous discussion has focused on MSD-tailored environmental standards as a critical time savings. In addition, a VCP applicant with an MSD certificate is allowed to proceed with remediation if required without prior TCEQ review and approval of a Response Action Plan. This saves time as well. The filing of a Self Implementation Notice under TRRP rules accomplishes this goal.

Closure utilizing an MSD qualifies as TRRP Residential Remedy Standard A, meaning the property may be used in the future for residential, commercial, mixed use or industrial purposes. Without an MSD, remediation standards would be substantially more stringent and costs correspondingly higher to qualify for future residential use.

An MSD strategy can eliminate the need to "chase the plume" of contamination off the subject property, which would otherwise be required under TRRP.

MSDs can also address concerns regarding liability exposure for environmental conditions that may have impacted surrounding properties. MSDs can reduce the potential for tort exposure by demonstrating that levels that exceed TRRP published standards can be left in place and still be deemed protective of human health and the environment. MSDs also offer a vehicle for the owners of impacted adjacent property to join with the MSD applicant and extend the boundaries of the MSD to cover that adjacent property. This is a means to resolve potential claims or threatened litigation by neighboring property owners.

The MSD process can provide comfort to lenders and environmental insurance underwriters for a Brownfield site. Prior to the current economic conditions, it had been our firm's experience that lenders were willing to consider financing for a contaminated property, even though regulatory closure has not yet been obtained from TCEQ, where an MSD has been (or, in certain instances, was expected to be) obtained for a property. Also issuance of an MSD should be considered to lower the underwriting risks for an environmental liability policy.

A combined VCP/MSD approach is preferable to an Innocent Owner/Operator program ("*IOP*") strategy for most sites. The certificate issued by TCEQ under the IOP program provides a release of liability from the State without addressing regulatory closure of the contamination. In contrast, an MSD/VCP approach can provide regulatory closure and also overcome the primary drawback of Innocent Owner Certificates ("*IOCs*") to real estate developers: the IOC does not run with the land.

By our informal calculation, the projected value of redevelopment projects made possible by the certified MSDs that Guida, Slavich & Flores has handled are valued in the hundreds of millions of dollars. This figure, while admittedly an estimate, shows the significant impact that the MSDs have had in the short time of their existence.[23] MSDs provide an important tool for property owners needing an exit strategy for environmentally-impacted properties, and for purchasers and developers dealing with the challenges of redeveloping contaminated property.

F. MSD Drafting Considerations

There have been approximately 100 MSDs certified by the TCEQ at this writing, therefore, there have been relatively few transactions where MSD's have played a central role. However, as time progresses, and as demand increases for locations at which environmentally impaired real estate is commonly found, drafting for the use of MSDs will become increasingly important.

Of course, the opportunity presented by issuance of an MSD is presented in only those municipalities in Texas that have an MSD process or are amenable to creating one. If this does not describe the jurisdiction of the deal property, an MSD-related contractual provision is moot.

Typically, an MSD provision should be drafted as would an affirmative covenant. The author would caution careful consideration of a contractual covenant mandating use of an MSD. As described above, issuance of an MSD is dependent in part on exigencies beyond the parties' direct control, for example, a local politician's view of an MSD for the property or the refusal by a retail water utility operator to pass a supporting resolution, the view of economic development in the community, and the interests of third parties in the property or in the community.

A common situation today is one where a buyer and seller contractually commit that one or the other is required post-closing to obtain a VCP Certificate of

Completion. Depending on cost and a variety of other factors, the parties may wish to specify whether obtaining an MSD in furtherance of that goal is an acceptable approach, and if it is, how the parties will work together and who will bear the costs. If an escrow or "basket" is part of the transaction, one ought to specify how an MSD and that contractual mechanism interrelate, if at all.

Few lenders are familiar with the MSD process, though in our firm's experience, those that are familiar with it, readily accept it. An educational process is critical in this regard. The terms of standard loan documents typically do not explicitly address MSDs, and so must be modified accordingly, especially when one is required by TCEQ to file the VCP COC of record.

III. BUYER/SELLER CONTRACTUAL ENVIRONMENTAL PROVISIONS

A real estate owner/seller can not completely be relieved of legal and financial exposure for environmental problems on its property. In the same way, the real estate buyer can not completely avoid legal and financial environmental exposure for the property it acquires. Generally then, both parties have the same incentive: to identify and allocate the property's environmental risks.

It is fairly clear that a seller in Texas of environmentally-impacted real estate is unlikely to successfully shift legal responsibility by contract or otherwise for known environmental conditions, unless it substantially discloses them. The principles of conspicuousness associated with the express negligence doctrine apply to an attempt to shift responsibility for strict environmental liability, *Fina, Inc. v. ARCO*.[24] In *Fina*, the indemnification failed for the lack of an explicit description of adverse environmental conditions. This case followed *Houston Lighting & Power v. Atchison, Topeka & Santa Fe Ry.*[25] Conspicuousness in this context is best initiated, in the author's view, by preparing a schedule to the operative contract that identifies by name the documents shared by the parties.

This explicitness is not required uniformly across the country, nor is this explicitness required in the initial marketing of the real property.

A. Representations

Representations concerning the environmental condition of a real property are a significant component of most real estate contracts.

A seller should represent that it has provided all environmental documents, or the documents identified by name on an attached exhibit to the Purchase and Sale Contract, so the parties are clear on the disclosures that have and have not been made. This is critical for the seller intending to shift some legal exposure for the environmental conditions at or migrating from its real property.

It is not uncommon that with this disclosure the seller makes a negative representation concerning the accuracy of any environmental documents provided to the purchaser, and for the buyer to represent that it will not and does not rely on such information. Instead, the seller will ask that the purchaser represent that it is relying solely on its own advisors and due diligence. A provision taken from a recent contract negotiated by the author included the following language:

> PURCHASER ACKNOWLEDGES THAT ALL INFORMATION OBTAINED BY PURCHASER WAS OBTAINED FROM A VARIETY OF SOURCES, AND, EXCEPT FOR SELLER'S WRITTEN REPRESENTATIONS AND WARRANTIES AS MAY BE EXPRESSLY SET FORTH IN THIS AGREEMENT AND IN SELLER'S CLOSING DOCUMENTS, SELLER HAS NOT MADE, AND SHALL NOT BE DEEMED TO HAVE REPRESENTED OR WARRANTED THE COMPLETENESS, TRUTH OR ACCURACY OF ANY OF THE SUBMISSION DOCUMENTS OR OTHER SUCH INFORMATION HERETOFORE OR HEREAFTER FURNISHED TO PURCHASER.
>
> EXCEPT FOR SELLER'S WRITTEN REPRESENTATIONS, WARRANTIES AND COVENANTS AS MAY BE EXPRESSLY SET FORTH IN THIS AGREEMENT AND IN SELLER'S CLOSING DOCUMENTS, PURCHASER HAS NOT RELIED UPON AND WILL NOT RELY UPON, EITHER DIRECTLY OR INDIRECTLY, ANY REPRESENTATION, WARRANTY OR COVENANT OF SELLER OR ANY OF SELLER'S AGENTS OR REPRESENTATIVES. PURCHASER HEREBY ACKNOWLEDGES THAT NO SUCH REPRESENTATIONS, WARRANTIES OR COVENANTS HAVE BEEN MADE. PURCHASER REPRESENTS THAT IT IS A KNOWLEDGEABLE, EXPERIENCED AND SOPHISTICATED PURCHASER OF REAL ESTATE, AND THAT EXCEPT FOR SELLER'S WRITTEN REPRESENTATIONS, WARRANTIES AND COVENANTS AS MAY BE EXPRESSLY SET FORTH IN THIS AGREEMENT AND SELLER'S CLOSING

> DOCUMENTS, PURCHASER IS RELYING SOLELY ON ITS OWN EXPERTISE AND THAT OF PURCHASER'S CONSULTANTS IN PURCHASING THE PROPERTY. AS OF CLOSING, PURCHASER WILL HAVE BEEN GIVEN A SUFFICIENT OPPORTUNITY HEREIN TO CONDUCT AND WILL HAVE CONDUCTED SUCH INSPECTIONS, INVESTIGATIONS AND OTHER INDEPENDENT EXAMINATIONS OF THE PROPERTY AND RELATED MATTERS AS PURCHASER DEEMS NECESSARY, INCLUDING BUT NOT LIMITED TO THE PHYSICAL AND ENVIRONMENTAL CONDITIONS THEREOF, AND WILL RELY UPON SAME AND NOT UPON ANY STATEMENTS OF SELLER (EXCLUDING THE LIMITED MATTERS AS MAY BE REPRESENTED BY SELLER IN THIS AGREEMENT) NOR OF ANY OFFICER, DIRECTOR, EMPLOYEE, AGENT OR ATTORNEY OF SELLER.

Whether such provisions are acceptable to the buyer or not, it is common for the buyer to seek a covenant from the seller to provide a "legal reliance letter" from each third party consultant whose reports are disclosed by the seller, so that buyer has the ability to rely and use the information in those reports to its benefit after closing.

B. Compliance with Environmental Laws

A representation of "compliance with environmental laws," while useful in some contexts, is typically not adequate to provide disclosure to a sophisticated purchaser. A provision presented to the author illustrated this problem and in the author's judgment probably does not give its drafter the intended protections:

> Seller has received no written notice from any governmental authority that the Property, or any portion thereof, is in violation of any ordinance, regulation, law, or statute pertaining to the ownership or operation of the Property, and, to Seller's knowledge, the Property is not in violation of any ordinance, regulation, law or statute of any governmental authority.

There are three clear problems with this provision. Environmental liabilities are not necessarily "violations of law." Second, qualifying this provision to the seller's knowledge is a significant carve out because often environmental liabilities and financial exposures are latent: they may arise from conditions that were not observable or known, or both, at closing or which were known and may be compliant with laws and still impose financial exposures, such as personal injury or property damage. Finally, the provision may have limitations even within its self-narrowed scope because it does not meet the conspicuousness requirements of the express negligence/strict liability rules in Texas discussed above.

While a "compliance with laws" representation is helpful to the purchaser, protections of real consequence are derived from far more environmentally-informed representations.

C. "As Is, Where Is" and its Limitations

The author has observed many real property sellers relying on "as is, where is" clauses to purportedly shift all environmental responsibilities to the purchaser. A good example, taken from a recent transaction, stated the following:

> EXCEPT FOR SELLER'S WRITTEN REPRESENTATIONS, WARRANTIES AND COVENANTS AS MAY BE EPXRESSLY SET FORTH IN THIS AGEREMENT AND IN SELLER'S CLOSING DOCUMENTS, SELLER SPECIFICALLY DISCLAIMS, AND NEITHER SELLER NOR ANY OF SELLER'S AFFILIATES NOR ANY OTHER PERSON IS MAKING ANY REPRESENTATION, WARRANTY, COVENANT OR ASSURANCE WHATSOEVER TO PURCHAER, AND NO WARRANTIES, REPRESENTATIONS OR COVENANTS OF ANY KIND OR CHARACTER, EITHER EXPRESS OR IMPLIED, ARE MADE BY SELLER OR RELIED UPON BY PURCHASER WITH RESPECT TO THE CONDITION OF THE PROPERTY, OR ANY PORTION THEREOF, INCLUDING BUT NOT LIMITED TO (a) ANY CLAIM BY PURCHASER FOR DAMAGES BECAUSE OF DEFECTS, WHETHER KNOWN OR UNKNOWN, WITH RESPECT TO THE PROPERTY, AND (b) THE COMPLIANCE OR LACK THEREOF OF THE PROPERTY WITH GOVERNMENTAL REGULATIONS, INCLUDING WITHOUT LIMITATION, ENVIRONMENTAL LAWS, NOW EXISTING OR HEREAFTER ENACTED OR PROMULGATED, IT BEING THE EXPRESS INTENTION OF SELLER AND PURCHAER THAT,

> EXCEPT FOR SELLER'S WRITTEN REPRESENTATIONS, WARRANTIES AND COVENANTS AS MAY BE EXPRESSLY SET FORTH IN THIS AGREEMENT AND IN SELLER'S CLOSING DOCUMENTS, THE PROPERTY WILL BE CONVEYED AND TRANSFERRED TO PURCHASER IN ITS PRESENT CONDITION AND STATE OF REPAIR, "AS IS" AND "WHERE IS," WITH ALL FAULTS.
> PURCHASER ACKNOWLEDGES THAT THE PURCHASE PRICE REFLECTS THE "AS IS, WHERE IS" NATURE OF THIS SALE AND ANY FAULTS, LIABILITIES, DEFECTS OR OTHER ADVERSE MATTERS THAT MAY BE ASSOCIATED WITH THE PROPERTY.

This is a sophisticated, if not intimidating, and definitely conspicuous provision. Some sellers would balk at the inclusion of such a provision because of its implication that such a thorough provision is necessary because there are serious environmental problems with the real estate. Practical and business inferences aside, the question for counsel is whether this provision is as effective as its author intends in shifting all risks associated with the items enumerated therein from the seller to the purchaser.

In some transactions, the seller believes that a conspicuous "as is, where is" provision (possibly even meeting Texas' express negligence definition of conspicuousness), is sufficient to transfer all its environmental legal and financial exposure to the buyer. Similarly, some buyers fight "to the death" to avoid accepting such provisions, for fear that they are accepting all of the seller's environmental legal and financial liability. Or, a buyer may negotiate hard for the absence of such a provision, concluding that in its absence, it takes on no environmental responsibility. All of these parties misunderstand the law in Texas to some degree.

"As is, where is" is simply not all encompassing. "As is, where is" is a general common law disclaimer of representations and warranties not expressly made in a Purchase and Sale Agreement in Texas. The author of the above quoted provision seems to appreciate this limitation. In the environmental context, one may think of the clause as applying to the condition of the real property in question. One case in which an "as is, where is" clause was found to be quite helpful to a seller was *Prudential Ins. Co. of Am. v. Jefferson Assoc.*[26]

In this case, the contract in question had multiple provisions attempting to shift environmental risk from the seller to the buyer, one of which was an "as is, where is" clause. The seller was unaware of the presence of asbestos in its building. The purchaser discovered the asbestos following closing and sued to have seller pay for abatement of the asbestos. The seller successfully defended the claim on the basis of the multiple provisions attempting to shift environmental risk from the seller to the buyer, with special emphasis on the "as is, where is" clause. The court held for the former property owner, and acknowledged the "as is, where is" clause as critical.

The author recommends caution in placing undue reliance on this case and the "as is, where is" clause because more often, claims for environmental remediation expenses and injunctive relief, including affirmative relief requiring a party to conduct an environmental clean up are brought not under common law, but pursuant to federal statutes and the Texas Solid Waste Disposal Act ("*TSWDA*") in Texas. The "as is, where is" clause seems to be of little use in Texas standing alone, in relation to the seller's existing environmental liabilities under statute, or in certain instances, its common law liability.

In distinguishing *Prudential*, the Court of Appeals of Dallas, found in *Bonnie Blue*[27] that a purported "as is, where is" clause was not a bar to the imposition of statutory responsibility under the TSWDA. Under CERCLA[28], "as is, where is" clauses do not bar claims, *Int'l Clinical Lab v. Stevens.*[29] As one author has stated, "neither an 'as is' clause, standing alone, nor the seller's ignorance of contamination, will bar a CERCLA-based lawsuit for contribution costs."[30]

As a general proposition, contractual protections, including without limitation an "as is, where is" clause in a contract between two parties does not impact the rights of persons not a party to the contract. This privity issue is especially important when dealing with the environmental arena. Statutory claims and common law causes of action may be available to adjacent property owners, governmental authorities, tenants and other persons not in the chain of title and not parties to a contract involving that title against the seller of real property, even if its purchaser has accepted that property on an "as is, where is" basis.

D. Indemnification/Release/Covenant Not to Sue

Contractual indemnifications are often based on the negligence or fault of the indemnitor. It is critical in crafting these types of contractual risk allocation provisions to recall that liability under environmental laws is often strict, and joint and several, not negligence or fault-based. Therefore, an indemnification that stops at negligence or fault of the indemnitor, is often ineffective in the environmental field. A failure to expressly identify strict environmental liability has been found to be sufficient

to reject an indemnification claim based on an environmental liability, *Fina, Inc. v. ARCO.*[31]

In addition, an indemnification between private parties does nothing to change the parties' obligations to the federal government under CERCLA. Once an entity is a responsible party under CERCLA, it remains jointly and severally liable to the government for cleanup and/or exposure costs, notwithstanding the existence of an indemnification agreement. *United States v. Lang.*[32] Federal law contains an explicit provision that states that no indemnification, hold harmless or similar agreement shall be effective to transfer the CERCLA liability of a current owner to the federal government or to a new owner.[33] The law however, does not bar the agreement to insure, hold harmless or indemnify between private parties,[34] but by inference this indemnification is valid only as to the claims between the private parties. The author would anticipate this outcome under the TSWDA, based on the similarity of strict liability schemes.

A contractual release is intended to counter an indemnification. One could fairly anticipate that the same rules for enforceability of an indemnification concerning environmental liabilities would apply to a contractual release. In other words, a release between private parties might govern their rights against one another, but would not affect their rights and obligations to the federal, and probably state authorities.

A covenant not to sue is often included in real estate contracts involving environmentally impaired property in tandem with an indemnification. A good example of a release/covenant not to sue used in a recent contract stated:

> PURCHASER COVENANTS AND AGREES NOT TO SUE SELLER AND SELLER'S AFFILIATES AND RELEASES SELLER AND SELLER'S AFFILIATES OF AND FROM AND WAIVES ANY CLAIM OR CAUSE OF ACTION, INCLUDING, WITHOUT LIMITATION, ANY STRICT LIABILITY CLAIM OR CAUSE OF ACTION, THAT PURCHASER MAY HAVE AGAINST SELLER OR SELLER'S AFFILIATES UNDER ANY ENVIRONMENTAL LAW, NOW EXISTING OR HEREAFTER ENACTED OR PROMULGATED, RELATING TO ENVIRONMENTAL MATTERS OR ENVIRONMENTAL CONDITIONS IN, ON, UNDER, ABOUT OR MIGRATING FROM OR ONTO THE PROPERTY, INCLUDING, WITHOUT LIMITATION, [LAWS CITED], OR BY VIRTUE OF ANY COMMON LAW RIGHT, NOW EXISTING OR HEREAFTER CREATED, RELATED TO ENVIRONMENTAL CONDITIONS OR ENVIRONMENTAL MATTERS IN, ON, UNDER, ABOUT OR MIGRATING FROM OR ONTO THE PROPERTY.

E. Affirmative Environmental Covenants

In the event the parties intend that affirmative steps to address known (or possibly later-discovered) environmental conditions will be taken by one or the other party, detailed contractual language will be necessary. This difficult, detailed drafting is often left to experienced environmental counsel.

The standard approach of early environmental programs in Texas and elsewhere was to address an environmental problem by requiring its clean up to the point that one could not detect that the problem had existed. The chemicals were removed to the level that they occurred in nature: to their natural background level. Essentially the approach was to remove all risk associated with the environmental problem that had been created. This made drafting relatively easy.

While this approach was simple to explain and to appreciate, experience showed that it was very difficult and in some cases impossible to implement. A variety of factors were at work. In the real estate context, the issue of time was often a serious impediment to remediation to natural background conditions. An environmentally-impaired parcel of real estate might be able to be cleaned up, but not within a time frame consistent with transactional goals.

Moreover, the cost to return environmentally-impaired real property to actual background conditions often was untenable based on the value of the real estate involved, or by one or more other financial measures.

Texas was among the first states to take action. Today's VCP program and the myriad options offered by the agency's programs identified earlier in this presentation, especially the MSD program, now rely on risk-based regulations: the Texas Risk Reduction Program.[35] This program applies to all types of chemical releases to real property, surface and subsurface water in Texas, regardless of the source of the environmental problem.

Affirmative environmental covenants ought to specify the Texas regulatory program(s) whose approach is controlling, and an agreement concerning the remediation standards to be met. The source of many post-closing disagreements is contractual language that the environmental remediation will satisfy "government standards." Given today's reliance on risk-based standards, there are often many possible, government-approvable remediation standards, and a failure to specify can be a ready source of contention.

If an MSD is to be an available alternative, it should be spelled out explicitly.

If, as is often the case, the contractual approach may or will include recording a notice in the county deed records, this should be negotiated as well.

Reaching a contractual agreement on the financial impact of a plan to address known environmental conditions can be as, or more, challenging than reaching agreement on the environmental standards that are to be met. If the extent of the contamination is not fully defined, agreement on this subject can be difficult. This is especially the case when both parties to the transaction are single asset entities. Escrow accounts, third party financial guarantees or other forms of support, including letters of credit and insurance, and other creative mechanisms are all ripe for discussion.

It is critical that any and all post-closing covenants expressly survive closing. The author has used language to the following effect:

> THE TERMS AND CONDITIONS OF THIS SECTION EXPRESSLY SURVIVE THE CLOSING AND DO NOT MERGE WITH THE PROVISIONS OF ANY CLOSING DOCUMENTS AND ARE HEREBY DEEMED INCORPORATED INTO THE DEED AS FULLY AS IF SET FORTH AT LENGTH THEREIN.

F. Environmental Insurance

There is an increasing focus on environmental insurance as a contractual means of allocating certain real estate-related environmental risks. Each of the following issues should be considered in drafting such contractual provisions.

Prior to the recent economic conditions, the market for environmental insurance was dominated by AIG. The national market has become fragmented recently with the difficulties experienced by AIG. There are several carriers in the market.

In the author's experience, there are few insurance brokers with expertise in this specialized niche. Coupled with a variety of "standard" policy forms available from the insurers and the need to manuscript each one to some significant degree to meet client needs, the exploration and evaluation of this option is best delegated to experienced environmental counsel. Texas insurance law requires the involvement of a broker at the time of sale but it is often most efficient to initially deal directly with the insurance underwriters.

Many real estate attorneys are aware that environmental insurance is available for unknown environmental conditions. What is less familiar to most is the availability of environmental insurance for known environmental conditions, under a "cost cap" approach. This approach requires sufficiently clear definition of the environmental problems so that an agreed estimate for the anticipated affirmative environmental actions can be developed. The insurer will then set this amount or a higher amount at the insured's discretion as the self-retained limit or cost cap. To the extent costs exceed the cost cap, the insurer will respond up to the policy limits. The insured should consider the role, if any, of an MSD in its evaluation of an environmental insurance approach.

Environmental insurance is also available for personal injury, medical monitoring costs, property damage, damages to natural resources, and various forms of economic loss. They are often excluded from more common forms of business insurance.

Maybe the most important point for non-environmental attorneys is to be aware that environmental insurance is typically manuscripted: the off-the-shelf products rarely address the specific needs of each environmentally-impaired piece of real estate. Often, the final scope of coverage is heavily negotiated. Experienced environmental counsel guide their client through this insurance maze, especially as it relates to the Texas risk-based clean up standards discussed above.

IV. STRUCTURAL ENVIRONMENTAL CONSIDERATIONS

A. Single Asset Entities: Isolation of Environmental Liability

It is not possible to shift all of a real estate seller's environmental risks to a buyer because the federal (CERCLA) and state (TSWDA) statutory schemes that impose that liability do not terminate at closing. They present a continuing contingent obligation.

Most real estate counsel plan, or ought to have planned, when their client acquired their property to isolate the known and unknown environmental risks by taking title in a single asset entity.

Congress and state legislators have failed to resolve competing public policies that created confusion in this area. On the one hand, the Courts and legislatures were keen on protecting the corporate form and the isolation of its liabilities to the corporate entity. The competing public policy in environmental law favored the imposition of environmental remediation costs on those that stood to realize economic gain from real property ownership, even if that meant imposing liability on those that traditional corporate law would isolate.

It is now reasonably well settled that the corporate form has won this policy battle in most cases. Parent corporations are not liable for the environmental liabilities of their subsidiaries, absent pervasive control

of the subsidiary's waste management responsibilities. *United States v. Best Foods, Inc.*[36]

The Court stated that Congress did not create, or intend to create, a separate federal common law for piercing the corporate veil in federal environmental law. Rather, it intended to rely on the policy of individual states when and if the "corporate veil" is to be pierced. If a parent corporation would not be held liable for the liabilities of its subsidiary under a state's piercing the corporate veil theory for a non-environmental law claim, it should not be held liable for environmental claims. In effect, this decision can and is often read to mean that if corporate formalities are respected, an environmental liability can and should remain isolated in the entity that incurs that liability.

Subsequent case law,[37] and statutory changes pertinent to lenders' liability issues[38] have served to confirm the widespread application of this decision. In addition to validating the single asset corporate entity approach, these cases allow lenders to focus on the credit worthiness of their prospective borrower, and focus less on the environmental liabilities arising from other entities within a common corporate structure.

Since these statutory liability schemes also impose liability on those who operate the business or manage the polluting activity, one ought not to read these cases to limit the liability of persons in these roles. The individual owner of a business that controls the polluting activities may be deemed an "operator" with individual legal exposure. The corporate owner of the land at the time it was contaminated probably has joint and several legal responsibilities as well.

There is a dearth of Texas case law to inform Texas practitioners on the implications of the *Best Foods* case and its progeny on state law. There remains at least an academic question whether there is something peculiar to Texas law that could lead to a different outcome under the same or a similar set of facts because *Best Foods* was not decided under Texas law.

Although the environmental bar is not of one mind, the author's view is that a substantial majority would consider the *Best Foods* reasoning to apply to TSWDA claims because of the similarities in their liability schemes. Texas common law-based environmental claims, though also not governed by this decision, would seem to follow the same limitations on the piercing the corporate veil theory.

The status of popular single asset Texas limited partnerships that hold real property has not been judicially addressed. The question whether a Texas court would interpret federal or state environmental law to provide the same level of legal protection to general and limited partners in single asset limited partnerships in Texas as it would probably provide for a parent corporation is undecided.

While an in-depth review of the Texas partnership law is beyond the scope of this article, it is probably fair to state that the legal protection of limited partners in a limited partnership is not as clear cut or as long standing as the protections historically and generally afforded a parent corporation vis-à-vis the liabilities of its subsidiary. It would seem, however, that since the general partner in the limited partnership structure is empowered to discharge the legal obligations of the limited partnership, including the environmental obligations of the limited partnership, it could be held to be an operator and held responsible for a failure to satisfy the same. At a minimum, this situation strongly suggests the use of a corporate general partner.

The more difficult question concerns the limited partners in a limited partnership where, under the relevant Limited Partnership Agreement, the limited partners are given rights of management in addition to the right to receive distributions. This suggests limited partners' rights should be limited carefully by the Partnership Agreement.

Especially in the case of closely held single asset entities, where the individual owner of a business that controls the polluting activities may be deemed an "operator" with individual legal exposure, government regulators are supported by the federal and Texas courts when they carefully examine these situations. They are loath to allow individuals who personally pollute, or allow the pollution of the environment, to remain shielded behind corporate or legal forms of organization. Government authorities remain skeptical of single asset entities for the very reason investors prefer them: the insulation of individuals from legal exposures by structural mechanisms and lawful legal technicality.

The fact that there are few cases addressing the foregoing situations creates the context for the environmental due diligence process.

B. Environmental Due Diligence

Most in the real estate legal community today in Texas acknowledge that some form of environmental due diligence is advisable as a practical if not a legal matter. Fewer begin with the end in mind: what goals do we hope to accomplish with this work? Satisfaction of lender requirements, satisfaction of "innocent purchaser" requirements, developing leverage for further negotiations, obtaining insurance, and obtaining Sarbanes-Oxley related information are all common, non-exclusive goals.

It is critical for a variety of reasons that a real estate contract provides the prospective buyer with the opportunity to conduct its own due diligence. It is also advisable that when representing the buyer, counsel

include provisions obligating the seller to disclose all documentation concerning the environmental condition and regulatory status of the property. A key negotiating point is the degree to which the buyer may rely on the truth, accuracy and completeness of the information in such documents. In most cases, such disclosure is advantageous for the seller.

The environmental due diligence process actually may begin before the property is marketed. Should counsel advise its seller client to conduct pre-marketing environmental due diligence on its own property? While there is no simple answer, this is an important question. In today's era of corporate transparency and, for public companies, Sarbanes-Oxley, seller's counsel should explore with its client whether and to what extent an internal environmental evaluation of the real estate in question, whether through the company's traditional environmental function or in some other context, has occurred.

Environmental counsel often recommend that a seller conduct its own pre-marketing due diligence. This can aid the seller in its marketing decisions: whether and when to market its property and its purchase price are obvious benefits. Obtaining a preliminary understanding of environmental risk allocation and the corresponding contractual terms are somewhat less obvious but can be very valuable. A seller's pre-marketing environmental due diligence, if strategically shared with a prospective buyer, may settle or mitigate some or all of the buyer's concerns.

This work can be handled using internal resources or by engaging outside assistance: environmental counsel, environmental engineers, or both. In engaging an environmental consultant for this work, the terms of the engagement contract bear special attention.

A downside to seller pre-marketing due diligence may be that it will also broaden the disclosures that it will likely need to make if the seller hopes to shift some legal and financial liability to the buyer.

The seller should consider what information it may have about the property and whether it will be disclosed at the outset. Most sellers have an initial reluctance to make disclosures at the outset out of concern that prospective purchasers will choose to look elsewhere. This reluctance is often shortsighted.

Some form of environmental due diligence by real estate purchasers in Texas is almost universal, particularly for transactions of any significant size or for transactions involving reasonably sophisticated lenders. The reasons are several. In the author's judgment, the following are the most important: (a) creating leverage for further negotiation of price, allocation of environmental risks, or other contractual terms, or for terminating the contract, (b) satisfaction of the lender's requirements, (c) preparing for post-closing Sarbanes-Oxley and other corporate transparency obligations, and (d) attempting to establish the innocent owner or operator, or bona fide prospective purchaser, defenses under CERCLA.[39]

There are few industry standards for performing environmental due diligence. Many purchasers begin, and often end, with the standards of the subjective innocent owner or operator and bona fide purchaser defense under CERCLA. This requires the buyer to undertake, "at the time of acquisition," "all appropriate inquiry" into the "previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability," *Fina, Inc. v. ARCO*.[40] Over time, this has practically translated, at a minimum, to performance of a "Phase I Environmental Site Assessment." This terminology, and the scope of this work, were taken from non-binding guidance no. E 1527-07 of the American Society for Testing and Materials, a standards-setting organization.

A "Phase I ESA" provides only the most basic information, includes no physical testing, and unfortunately is performed at some environmental consulting companies by their most junior professional staff. Therefore, these reports often do not provide sufficient clarity with which to meet client goals. When further detail is needed, whether it be for asbestos testing, or outdoor testing of soil, water, or subsurface conditions, more work is necessary. Experienced environmental attorneys may offer counsel to assure that the required level of detail and risk evaluation is obtained. Lenders may engage counsel or consultants at times to assure the requisite analysis is provided to decision makers.

The standard for what constitutes "all appropriate inquiry" under federal law is evolving. Congress passed what is commonly referred to as The Federal Brownfields Law,[41] with the specific goal of creating clarity with respect to the level of due diligence required to qualify for CERCLA's innocent purchaser defense. Many predicted that this action would create minimum standards across the real estate industry for environmental due diligence. It hasn't happened yet.

The law directed the U.S. Environmental Protection Agency to promulgate regulations which address many aspects of environmental due diligence. EPA's work to date suggests that environmental due diligence will become broader and more expensive, and will be performed by persons with more than a modicum of background experience in the subject matter.

V. CONCLUSION

1. Consider how an MSD would materially advance the client's goals.

Begin with the end in mind; develop an environmental strategy to coordinate with the client's

business plan. A critical component of the project planning process is an information baseline derived from an environmental investigation. The scope of the investigation should be prepared with the assistance of experienced professionals and with the development plans in mind. That baseline and the development plans should be used to select the appropriate remediation tools and to develop a strategic approach. The strategic approach selected to address environmental issues should take into account the proposed use for the property and regulatory standards, especially the cleanup targets, the project will need to meet. Above all, the approach needs to factor the client's post-purchase exit strategy into the analysis.

2. Enlist the assistance of professionals with expertise and experience.

The developer is well advised to supplement the real estate/development/construction team with additional expertise when dealing with development of a Brownfield property. Usually that will include an environmental attorney, an environmental consultant, and remediation contractors. There may also be a need to include an environmental insurance broker, and community relations and governmental affairs liaisons. The coordination between and among the different disciplines is crucial for a successful project. Those additional professionals should be brought in at the earliest stages of the project and the team will need to closely coordinate their efforts throughout the project.

Where contaminated property is involved and remediation is recommended, if not mandatory, practitioners need to take advantage of remediation tools that are appropriate for the situation presented. MSDs may solve problems that heretofore would not have been resolvable in the past. When used strategically, an MSD in combination with the TCEQ VCP program can provide sufficient comfort for sellers, buyers, and lenders so that deals will close, environmental conditions are resolved and the land returned to productive use.

ENDNOTES

[1] Tex. H.B. 3152, 78th Leg., R.S. (2003).

[2] Tex. H.B. 2018, 80th Leg., R.S. (2007).

[3] TEX. HEALTH & SAFETY CODE § 361.602 (visited June 8, 2009) http://tlo2.tlc.state.tx.us/statutes/docs/HS/content/pdf/hs.005.00.000361.00.pdf.

[4] *Id.* § 361.610.

[5] *Id.*

[6] 30 TEX. ADMIN. CODE § 350.001 *et seq*. (visited June 8, 2009) http://www.tceq.state.tx.us/rules/indxpdf.html#350.

[7] *Id.* § 350.3.

[8] Table 3, Tier 1 Groundwater PCLs – Residential and Commercial/Industrial, updated Mar. 25, 2009 (visited June 11, 2009) http://www.tceq.state.tx.us/remediation/trrp/trrppcls.html.

[9] *Id.* Table 1, Tier 1 Residential Soil PCLs.

[10] *Id.* Table 2, Tier 1 Commercial/Industrial Soil PCLs.

[11] TEX. HEALTH & SAFETY CODE § 361.801 *et seq*. (2007).

[12] *Id.* § 361.803 (2003).

[13] Tex. H.B. 2018, 80th Leg., R.S. (2007).

[14] TEX. HEALTH & SAFETY CODE § 361.8065.

[15] *Id*.

[16] *Id*. § 361.8065(a)(2).

[17] *See* Susan Rainey, *Municipal Setting Designations and Tort Liability: Adjacent Property Owners at Risk,* 35 ST. B. TEX. ENVTL. L. J. 41 (Fall 2004).

[18] TEX. HEALTH & SAFETY CODE § 361.808.

[19] *Municipal Setting Designation: A Guide for Cities*, Texas Commission on Environmental Quality, August 2007, available at www.tceq.state.tx.us/files/gl-326.pdf-4445205.pdf.

[20] *See*, Kathryn A. Hansen, *Municipal Setting Designations "The Ever Lovin' Blue-Eyed Thing" (A Municipality's Perspective)*, presented to the 17th annual Texas Environmental Superconference, State Bar of Texas (Aug. 4, 2005).

[21] Dallas, Tex., Ordinance 262001, May 25, 2005 (visited June 8, 2009) http://www.dallascityhall.com/pdf/DevSvcs/MSDOrdinance.pdf.

[22] As of this writing, the following Texas municipalities have an MSD process in place: Abilene, Arlington, Beaumont, Bedford, Brownsville, Burleson, Carrollton, Denton, Duncanville, Euless, Fort Worth, Garland, Grand Prairie, Grapevine, Greenville, Houston, Irving, Longview, Lubbock, McKinney, Mesquite, Marshall, Missouri City, Plano, Port Arthur, Terrell and Wichita Falls.

[23] *Municipal Setting Designation: A New Tool for Reducing Environmental Risk and Cost Effects on Property Values. See* Jackson, Thomas O. and Pitts, Jennifer M. The Approval Journal 105 (Spring 2007).

[24] *Fina, Inc. v.* Arco, 200 F.3d 266 (5th Cir. 2000).

[25] *Houston Lighting & Power v. Atchison, Topeka & Santa Fe Ry Co.*, 890 S.W.2d 455, 458 (Tex. 1994).

[26] *Prudential Ins. Co. of Am. v. Jefferson Assoc.*, 896 S.W.2d 156 (Tex. 1995).

[27] *Bonnie Blue, Inc. v. Reichenstein*, 127 S.W.3d 366, 369 (Tex.App. – Dallas, 2004).

[28] 40 U.S.C. §9601 *et seq*.

[29] *Int'l. Clinical Lab., Inc. v.* Stevens, 710 F.Supp. 466 (E.D.N.Y. 1989).

[30] Timothy Boyce, "'As is, Where Is'—Where Are We?"-Jam. Probate and Property 26, 28 (May/Jun 1997).

[31] *Fina, Inc. v.* Arco, 200 F.3d 266 (5th Cir. 2000).

[32] *U.S. v.* Lang, 864 F.Supp. 610, 613 (E.D. Tex. 1994).

[33] 42 U.S.C. 9607(e)(1).

[34] *Id.*

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[35] 30 T.A.C. 350 (2004).

[36] *U.S. v. Best Foods*, 524 U.S. 51 (1998).

[37] *See, Mickowski v. Visi-Trak Worldwide, LLC*, 415 F.3d 501 (6th Cir. 2005), *New York v. Nat'l Servs. Indus., Inc.*, 352 F.3d 682 (2d.Cir. 2003), *U.S. v. Viking Resources, Inc.*, 607 F.Supp.2d 808 (S.D. Tex. 2009)(applying the *Best Foods* analysis to claims arising under the Oil Pollution Act).

[38] *Asset Conservation, Lender Liability, and Deposit Insurance Protection Act. of 1996*, H.R. 3610, 104th Cong. §§ 2501-2505 (1996) (enacted).

[39] 42 U.S.C. 9607(b)(3) and 42 U.S.C. 9601(35)(A)(i) (2002).

[40] *Fina, Inc. v.* Arco, 200 F.3d 266 (5th Cir. 2000).

[41] *Small Business Liability and Revitalization Act, of 2002* Pub. L. 107-118 (Jan. 11, 2002).