

Managing the Risks of Environmental Contamination in Redevelopment Projects

Over the past year, Law Corner has focused on a number of emerging development issues of interest to the development community. In this final Law Corner article of 2013 we discuss methods of managing risks of environmental contamination in redevelopment projects.

Urban infill and brownfields redevelopment projects are often the most desirable options for accommodating urban growth. Whether these projects involve redevelopment of municipal property or private property within municipal boundaries, they typically involve significant municipal and private involvement in the development process and often a public-private partnership. Tools are available to assist both the private and the public sector in managing the risks associated with environmental remediation and make brownfield and urban-infill sites highly attractive development opportunities.

Most environmental issues are substantially similar in public and private redevelopment of contaminated properties. Of the issues to be considered, however, management of legal and financial risk once a project is underway can be particularly important. These risks include remediation cost overruns, potential liabilities due to changes in enforcement policies, changes in applicable regulatory or risk-based cleanup standards, remedy failures, undiscovered or migrating contamination, and related third-party claims.

Municipalities and other local governmental entities often are subject to financial constraints and considerations not applicable to private entities, including budgeting and appropriation procedures, conditions on issuing debt, governmental immunity, and charter or state law restrictions on their ability to incur contingent liabilities. As a consequence, both public and private entities involved in municipal projects are likely to have a heightened need to manage legal and financial risks involved in these projects and should be aware of the basic tools available for this purpose.

Contractual Risk Allocation

The most basic tools for managing legal and financial risk associated with environmental contamination are contractual arrangements among participants in an urban redevelopment project. Contracts should define, at a minimum, the circumstances in which the parties are obligated to perform and pay for any environmental cleanup and the procedures and standards for

completing that cleanup. Indemnification clauses are another important means to transfer environmental liabilities among sellers and buyers, owners and operators, and their lenders, environmental consultants, and contractors. Indemnification clauses need not necessarily reflect causation or fault, but can be treated as simply a means to allocate different legal liabilities as elements of the "deal." Releases and "as is" clauses also can be used to limit liabilities by eliminating legal recourse between one or more parties to the contract for particular types of claims.

The strength of an indemnity or other contractual commitment is only as good, of course, as the financial strength of the party providing it. Thus, requiring insurance, bonding, or escrowed funds is a useful financial assurance that cleanup and indemnification obligations will be met.

Environmental Insurance

Among the financial assurances noted above, environmental insurance is one of the most comprehensive environmental risk management tools available. Policies can be tailored to the types of contractual and regulatory liabilities facing property owners, operators, and contractors in an urban redevelopment project. These policies are available both for sites that are subject to regulatory enforcement action, as well as sites where remediation will be conducted on a voluntary basis.

Pollution legal liability (or "PLL") policies are designed for property owners and operators. These policies cover cleanup costs, and claims for bodily injury and property damage arising from unknown or new pollution conditions at a specified location or caused by pollution migrating off-site from the covered location. PLL policies also cover cleanup costs and claims for bodily injury and property damage arising from changes in regulatory or risk-based standards applicable to known conditions after coverage commences. Pre-existing conditions known to require remediation are typically excluded from such coverage. PLL coverage, thus, is appropriate for sites where site cleanup has been completed or where contamination exists, but is below current regulatory or risk-based standards and does not require remediation. While insurers



KAPLAN KIRSCH ROCKWELL

303-825-7000 | www.kaplankirsch.com

NAIOP

COMMERCIAL REAL ESTATE
DEVELOPMENT ASSOCIATION
COLORADO CHAPTER

1720 South Bellaire Street, Suite 110, Denver, CO 80222 Tel: (303) 782-0155 Fax: (303) 820-3844 www.naiop-colorado.org

typically use a form policy, these policies are negotiable and can be tailored to address the issues associated with a particular project.

In the past, cost cap or “stop loss” policies were available as a means to control costs of remediation resulting from contamination in excess of known amounts, newly discovered types of contaminants, or regulatory changes that affect the type or extent of required cleanup. Cost cap policies were useful for remediation contractors to insure fixed price contracts or for property owners or developers to cap remediation costs. These policies could also be purchased to cover the costs of long-term monitoring and maintenance of a property where contamination will remain on the site (e.g., landfill cleanups). While these policies are difficult to obtain at reasonable prices in the current market, as the market shifts over time this option may again be a viable risk management tool. An escrow fund for cleanup is a form of financial assurance often used in lieu of cost cap insurance.

Finally, professional and contractor liability policies are also available. These policies cover bodily injury, property damage, and cleanup cost claims arising out of covered professional services and contracting operations provided by environmental consultants. These policies provide another level of protection to public and private entities against cost overruns that may be attributable to errors or omissions or negligence of an environmental contractor or professional and can be required under professional services contracts.

Regulatory Programs

Where environmental regulators have not initiated enforcement action to require cleanup of contaminated sites, most property owners and prospective purchasers instinctively avoid regulatory involvement for fear of facing cost-prohibitive requirements that include expensive reporting and review processes. However, taking advantage of programs providing regulatory supervision and/or approval of cleanup efforts may be another method of managing legal and financial risk associated with regulatory enforcement actions.

Most states have adopted voluntary cleanup programs that offer incentives for remediating and redeveloping contaminated sites in the form of liability protection or streamlined approval of remediation plans and completed cleanup. These programs typically offer “no further action” letters, which document a finding by the state regulatory agency that no further remedial action is required to meet regulatory or risk-based environmental standards for the end use of the property. These letters usually do not preclude enforcement action to address new conditions or conditions that differ from those disclosed by the

property owner or operator. Such letters do, however, offer assurance that enforcement action is unlikely and also may make third-party negligence claims more difficult to establish.

Some state voluntary cleanup programs also may allow regulators to offer covenants not-to-sue or third-party liability protections to the property owner once cleanup has been completed and approved by the state regulatory agency or in the form of prospective purchaser agreements that require reciprocal benefits to the state. In addition, some states have negotiated memoranda of understanding with the U.S. Environmental Protection Agency (“EPA”) under which EPA defers enforcement action at sites that are remediated under the state’s voluntary program. Even where states do not have a formal voluntary program, most regulatory agencies have authority under state law to enter into voluntary or consent agreements under which similar benefits would be available.

In limited circumstances, EPA will issue comfort letters to property owners or operators and prospective purchasers that indicate EPA’s intention not to take enforcement action at the site. While these letters are not binding on EPA and do not preclude EPA from taking enforcement action in the future, they offer some assurance regarding the likelihood of EPA enforcement action. EPA also offers covenants not to sue to prospective purchasers of contaminated sites under very limited circumstances pursuant to prospective purchaser agreements or PPAs. For example, a PPA may be available for redevelopment of property already under an active EPA order.



KAPLAN KIRSCH ROCKWELL

303-825-7000 | www.kaplankirsch.com

For more information, please contact:

Stephen H. Kaplan, Partner
skaplan@kaplankirsch.com

Sarah Rockwell, Partner
srockwell@kaplankirsch.com

William M. Silberstein, Partner
bsilberstein@kaplankirsch.com

Polly B. Jessen, Partner
pjessen@kaplankirsch.com

Third-Party Liability Assumption

Third-party liability assumption or “guaranteed fixed price remediation” is another option for managing the legal and financial risk associated with environmental contamination that has come into use since the late 1990s. A number of environmental firms offer liability assumption and fixed-price remediation services. For a fixed price, these firms will assume all contractual and regulatory liability related to a site through contractual indemnity and will conduct site cleanup necessary to obtain regulatory approval. These obligations are typically backed by an environmental insurance policy or other guarantees. Some firms may also agree to take and hold title to the contaminated parcel during the cleanup.

Taking this approach is a method of transferring not only legal and financial risk from redevelopment participants, but also the responsibility for cleanup contracting, interaction with regulatory agencies, and insurance administration involved in a comprehensive environmental remediation program. However, like other risk management tools described above, its efficacy depends on the financial strength of the firm assuming liability and its insurer and, perhaps more importantly, the demonstrated experience and expertise of the firm selected.

Financial Incentives

The federal government and the state of Colorado currently offer a number of grants, loans, and other incentives for contaminated property investigation, cleanup, and redevelopment. (A good summary can be found at <http://www.colorado.gov/cs/Satellite/CDPHE-HM/CBON/1251615547629>.) In addition, a new Colorado program for funding cleanup of petroleum contaminated sites is expected to begin taking applications in the summer of 2014. The program offers up to \$500,000 per cleanup. Legislation to reauthorize a Colorado tax credit for redevelopment of contaminated property also is under development. This legislation would allow a tax credit of 40% on the first \$750,000 of cleanup costs and 30% on the next \$750,000 of cleanup costs, for a total of up to \$525,000 in tax credits on an individual project. The current draft legislation would allow these credits to be carried forward up to five years and to be transferred to other taxpayers. On the margin, these programs can make a project viable that might not otherwise be.

Not all of these tools may be appropriate for every redevelopment project. Depending on the characteristics of the site, the participants in the project, and their respective risk sensitivity, these tools may be applied singly or in combination to cost-effectively manage legal and financial risks associated with redevelopment of contaminated property.

For further information about the legal issues associated with contaminated property redevelopment, contact Polly Jessen at pjessen@kaplankirsch.com.



KAPLAN KIRSCH ROCKWELL

303-825-7000 | www.kaplankirsch.com

For more information, please contact:

Stephen H. Kaplan, Partner
skaplan@kaplankirsch.com

Sarah Rockwell, Partner
srockwell@kaplankirsch.com

William M. Silberstein, Partner
bsilberstein@kaplankirsch.com

Polly B. Jessen, Partner
pjessen@kaplankirsch.com

NAIOP

COMMERCIAL REAL ESTATE
DEVELOPMENT ASSOCIATION
COLORADO CHAPTER