

## **Taking Another Look at the Environmental Indemnity**

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For at least the past 30 years, parties involved in the purchase or sale of properties that contain environmental exposure have had to negotiate environmental indemnity agreements, either to protect assets, transfer liability, or to simply get a deal across the finish line.

The essential characteristics of the environmental indemnity have not changed in that time, and it still contains four essential promises: (1) that the property either has no environmental issues or that any such issues have been disclosed; (2) that the indemnitee will ensure that no such issues commence in the future; (3) if they do, that the indemnitor will defend and indemnify the indemnitee for any costs related to those issues; and (4) that the indemnitee will be allowed some right to investigate environmental issues on the property. However, as more properties have become insured through comprehensive environmental insurance programs, thus fundamentally changing the nature of, and obligations associated with, the environmental risks associated with that property, indemnity agreements often have not kept pace.

Below are three examples of sometimes overlooked provisions that can have a significant impact on the parties' environmental exposure, and for which environmental insurance can help shape the parties' respective rights and obligations, with the understanding that an analysis of an environmental indemnity depends heavily on who is providing the indemnification (e.g., a borrower for the benefit of the lender, a seller for the benefit of the buyer, or vice versa) and for what purpose (e.g., to demolish any existing structures and develop a residential complex, or as part of an asset purchase of an ongoing and continuing manufacturing operation).

#### **COOPERATION AND ACCESS**

An often under-negotiated provision addresses the right of an indemnitee—most often a lender seeking to protect its collateral—to investigate any potential environmental issue on the property. Below is an example of indemnitee-favored language addressing such a right:

"If indemnitee has reason to believe that an environmental hazard exists on the 'property' [which should be tied to the legal descriptions in the transactional documents or provided in an exhibit to the indemnity agreement] that, in the sole and absolute discretion of indemnitee, endangers or may endanger any tenants or other occupants of the property, their guests, or the general public, or materially and adversely affects or may materially and adversely affect the value of the property, then indemnitor covenants and agrees that it shall, at indemnitor's expense, promptly cause an engineer or consultant selected by the indemnitee to conduct an environmental assessment or audit (the scope of which shall be determined in the sole and absolute discretion of indemnitee) and take any samples of soil, groundwater or other water, air, or building materials or any other invasive testing requested by indemnitee and shall cooperate with and provide indemnitee and any such person designated by indemnitee with access to the property upon reasonable prior notice (subject to rights of tenants under any existing leases)."

From an indemnitor's perspective, a number of problems emerge. First, the discretion upon which the indemnitee bases its request for an investigation should be subject to some form of

“reasonableness” standard, or it could gain access to the property even if there was no potential of a release and the indemnitee simply wanted to poke around the property.

Second, the scope of the investigation should be limited to noninvasive testing (i.e., a Phase I Environmental Site Assessment). Allowing the indemnitee, at its discretion, to install groundwater monitoring wells and soil borings would create significant environmental liability for the indemnitor, possibly trigger reporting requirements to the relevant regulators, and likely impair its ability to use the property during such investigation. Sometimes a middle-ground position is to allow for a noninvasive investigation, and if such an investigation recommends further invasive testing to move forward, preferably such follow-up testing should be conducted by the indemnitee.

Third, if the indemnitee desires to conduct an investigation as a belts-and-suspenders measure, it arguably should pay for it. Parties often disagree on this point and sometimes agree to share the costs.

Fourth, both parties should be involved in the selection of the consultant—often one party selects the consultant, and the other retains the right to reasonably approve or disapprove of the selection.

Fifth, any investigation conducted by the indemnitee should be subject to notice requirements sufficient to allow the indemnitor the ability to prepare the site and limit the disruption of any activities being conducted on the property.

Lastly, if a pollution legal liability insurance program is in effect for the property during the period of the indemnification, there needs to be an allowance for the fact that, should a coverable claim be made pursuant to a release of contamination, the insurance carrier would conduct (and pay for) all investigations and remedial activities, including the selection of an environmental consultant and the scope of investigation. Because the indemnitee is often (and should be) an additional insured on such a policy, it would get the benefit of such coverage and should allow its investigatory rights to be secondary to that of the carrier.

## **SURVIVAL**

Many indemnitees, most notably lenders, will often require that the obligations and liabilities of the indemnitor fully survive indefinitely, notwithstanding any termination, satisfaction, assignment, entry of a judgment of foreclosure, exercise of any power of sale, or delivery of a deed in lieu of foreclosure—basically an indemnification in perpetuity. There are a number of ways to respond. It is not uncommon to negotiate a hard date—usually some small number of years after satisfaction of the loan—at which point the indemnity obligations terminate. Failing that solution, it is sometimes possible to tie the indemnity survival to the period of the pollution legal liability coverage. Indemnitors will sometimes agree to use commercially reasonable efforts to procure an additional long-term policy, with similar coverage, at the expiration of the existing policy, naming the indemnitee as an insured on that additional policy. This could provide the indemnitee with as many as 15 to 20 years of protection, but the indemnification obligations would cease upon the expiration of the existing policy.

Alternatively, the indemnitor can negotiate language that allows it to, upon satisfaction of the loan, deliver to the indemnitee an updated Phase I Environmental Site Assessment (often paid for by the indemnitor and prepared by an environmental consultant reasonably satisfactory to the indemnitee), which Phase I discloses no environmental condition of the property and contains no recommendations for further action relating to any environmental issues.

## **REPRESENTATIONS AND WARRANTIES**

A first-cut environmental “representations and warranties” section drafted by an indemnitee might look something like this:

Indemnitor warrants that: there are no hazardous substances (always a defined term), or underground storage tanks in, on, or under the property, except those that are in material compliance with all applicable environmental laws (also a defined term) and with permits issued pursuant thereto; there are no past, present, or threatened releases (sometimes defined) of hazardous substances in, on, under, or from the property which have not been remediated in accordance with environmental law; indemnitor has not received any written notice from any person relating to any release of hazardous substances migrating to the property; there is no present or past noncompliance in any material with respect of environmental laws or with permits issued pursuant thereto, in each case, in connection with the property which has not been remediated in accordance with environmental laws; indemnitor does not know of, and has not received, any written notice or other communication from any person (including, but not limited to, a governmental entity) relating to the presence or release of hazardous substances or remediation thereof of possible liability of indemnitor pursuant to any environmental laws, or as a result of other environmental conditions in connection with the property, or any actual or potential administrative or judicial proceedings in connection with any of the foregoing; and the indemnitor has truthfully and fully provided to the indemnitee, in writing, any and all material information relating to conditions in, on, under, or from the property that is known to the indemnitor and that is contained in files and records of the indemnitor, (including, but not limited to, any reports) relating to hazardous substances in, on, under, or from the property and/or to the environmental condition of the property.

Again, from the indemnitor’s perspective, there are three main issues with this language. First, the representations and warranties are not tied to the indemnitor’s knowledge. The indemnitor, even if it is the current owner (e.g., seller) of the property, rather than a prospective purchaser, might have limited knowledge as to the historical environmental condition of the property, and should not be charged with such knowledge. As such, any representations as to the historical condition of the property should be limited to “the indemnitor’s knowledge,” often with the required caveat “upon due inquiry and investigation.”

Second, what (or who) constitutes the knowledge of the indemnitor should be expressly stated. Such knowledge can range from one specifically named person to any employee, supervisor, manager, director, or officer of the indemnitor.

Third, the language above does not except any potential environmental issues already disclosed to the indemnitor or those that are a matter of the public record. When negotiating indemnity agreements on behalf of an indemnitor, it is common to exclude from the representations and

warranties those issues about which the indemnitee has been made aware and, less commonly, those about which the indemnitor should be aware of as a result of publicly available documents.

It is advisable to attach as an exhibit a list of all information shared between the indemnitor and indemnitee. Often, a reference to the documents disclosed to the insurance carrier in procuring a pollution legal liability policy is an effective end-around, as carriers tend to be more generous with the information they are charged with receiving.

As environmental risk management has become more sophisticated and more central to transactions involving environmentally contaminated real estate, so should negotiations apportioning environmental risks among various stakeholders. This includes a more-nuanced approach that recognizes that parties other than the signatories to an indemnification agreement can incur such risks.

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