

# Six Common (but Problematic!) “Business Environmental Risks” To Look for in Commercial Real Estate Transactions

By Jose Almanzar

## Introduction

As corporate counsel work to navigate real estate-related issues, they should continue performing environmental due diligence prior to the purchase (or lease) of any piece of commercial (or investment) property. To that end, the Phase I Environmental Site Assessment—colloquially known as the “Phase One” or “Phase I”—is a great tool for assessing and mitigating environmental risk in connection with real estate transactions. Not only does a Phase I help purchasers satisfy one of the requirements to qualify for the statutory “landowner liability protections” afforded under the federal Superfund law,<sup>1</sup> but it also sniffs out “recognized environmental conditions” or “RECs.” Generally speaking, an REC is the presence or likely presence of hazardous substances or petroleum products at or beneath the property.<sup>2</sup>

The finding of an REC typically suggests that a more intrusive investigation, such as soil or groundwater sampling, might be required to determine if subsurface contamination is present. For this reason, when a Phase I report comes back “clean”—that is, with no RECs—prospective purchasers and their real estate counsel might be inclined to ignore the rest of the report. This is ill advised.

Phase I’s can tell a different story about potential environmental issues that can impact the dynamics of the deal, cause massive delays in construction, drive up post-closing costs, and generally, wreck an otherwise sound investment if not properly handled. I’m referring to the elusive and misunderstood “business environmental risk”—the BER. Corporate counsel who work with clients in acquiring or selling commercial real estate should be aware of BERs and the consequences of mishandling BERs.

## BERs . . . Ugh! What Is It Good For? Actually, Something!

The term BER refers to “a risk which can have a material environmental or environmentally driven impact on the business associated with the current or planned use of a parcel of commercial real estate, not necessarily limited to those environmental issues required to be investigated in [the standard Phase I ESA] practice. Consideration of business environmental risk issues may involve addressing one or more non-scope considerations...”<sup>3</sup> Because Phase Is need not account for every potential environmental issue, BERs get lumped into a “catch-all”



category. A few examples of BERs include historic fill material, open regulatory violations and indoor air issues, to name a few.

The occurrence of a BER in a Phase I will not trigger the need for a Phase II investigation, primarily because BERs rarely—if ever—concern potential soil or groundwater contamination. For that reason, BERs tend to get overlooked. However, BERs should be handled head-on and aggressively to establish clear and convincing evidence of compliance in case something goes awry in the future (and because your client wants peace of mind when purchasing a new piece of real estate).

The following is a non-exclusive list of some common—but problematic—BERs that environmental attorneys and consultants encounter. Corporate counsel should be aware that these are environmental issues that should not be ignored—they can be addressed with proper management and a team of experienced professionals.

## Common BERs

### 1. Asbestos Containing Material (ACM) and Lead-Based Paint (LBP)

Asbestos is ubiquitous and ACM is commonly found in older buildings, particularly those built before 1990.<sup>4</sup> The material was used in plumbing, piping, insulation, walls, roofing materials, floor tiles and adhesives, among others. The use of lead-based paint (LBP) has been banned in the United States since 1978.<sup>5</sup> However, older buildings

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and commercial structures (e.g., water tanks, antenna towers, etc.) may contain LBP.

Issues concerning ACM and LBP arise during demolition and redevelopment projects. Under both circumstances, a licensed inspector may need to be retained to sample suspect ACM and LBP in areas where disturbance is anticipated. If ACM or LBP is confirmed and needs to be removed (abated), ensure to follow local rules with respect to licensing and disposal. Asbestos abatement projects can get very costly, depending on the scope of abatement.

**Advice:** It might be wise to incorporate ACM and LBP sampling as part of your Phase I if you know at the outset that your client will be demolishing or undertaking significant renovations to the building. Knowing whether significant ACM or LBP is going to be disturbed before closing could present an opportunity to receive an offset on the purchase price.

## 2. Historic Fill

This is material that was deposited or brought to an area and used as “fill material.” Historic fill material was commonly used to fill waterbodies, wetlands or land depressions, before October 1962.<sup>6</sup> Due to its mixed composition, many times consisting of solid waste, including wood and coal ash, incinerator ash, construction debris and land clearing, it can be highly contaminated. Environmental consultants will flag down historic fill concerns when they notice new land patterns while reviewing historical aerial maps or if property records indicate the application of historic fill.

**Advice:** Historic fill is typically a non-issue if excavation is not taking place. It can remain underground and does not need to be cleaned up. However, if significant excavation is anticipated post-acquisition, disposing of historic fill can significantly drive up construction costs—sometimes enhancing soil disposal costs by 1.5-2 times—and impact construction schedules. It may be wise to retain an engineer or geotechnical consultant to advise as to the anticipated amount of excavation that will be required, and to estimate disposal costs of the historic fill. Additionally, be weary because disturbing too much historic fill could result in reporting obligations to the New York State Department of Environmental Conservation (NYSDEC).

## 3. Soil Vapor Intrusion

Soil vapor intrusion (SVI) can occur with “naturally occurring” subsurface volatile gases (e.g., radon, methane and hydrogen sulfide), as well as man-made gases that have been released to the soil or groundwater. Regardless of the type of contaminant, an SVI issue can pose a serious health risk to current and future occupants of a building. For this reason, the New York State Department of Health (NYSDOH) and NYSDEC take a rather conservative approach to SVI concerns.

When SVI issues are present, the agencies may require extensive on-site (and potentially expensive off-site) investigations to delineate the extent of vapor issues if the property is the likely source of contamination. If it appears that the property is not the source, but there is confirmed SVI, the state may require that a venting system (e.g., subslab depressurization system—SSDS) and/or a vapor barrier be installed at the building. The installation of an SSDS or other vapor mitigation system is not inexpensive—the least expensive ones cost at least \$50,000 to design and install. They also require on-going maintenance and 24/7, 365 electricity use.

**Advice:** Potential SVI issues should be flagged down early by a consultant and corporate counsel should take them very seriously. If there appears to be an SVI concern—likely due to confirmed releases of solvents or petroleum from underground storage tanks, or nearby highly contaminated properties—indoor air sampling should be conducted to determine whether indoor air at the building is being potentially impacted by the potential SVI. If indoor sampling confirms air impacts from solvents or other contaminants, the purchase price should be modified to account for mitigating and potentially remediating the SVI issue. Also, if the deal permits, the contract should be amended to include an indemnity and hold harmless provision in favor of the buyer to account for potential future liability and remediation and mitigation efforts.

## 4. “Emerging Contaminants”

Issues concerning “emerging contaminants” have gained a lot of traction in the last few years due to national media coverage<sup>7</sup> and the prevalence of class actions concerning groundwater contamination across the country, including one here in New York where plaintiffs were able to obtain class certification approval from Third Department last Fall.<sup>8</sup> The contaminants at issue are PFAS (per- and polyfluoroalkyl substances, which is a family of hundreds of man-made chemicals used in firefighting foams and non-stick materials, to name a few), and 1,4-dioxane (a chemical used to make detergents and cosmetics). These chemicals had been used in industry for decades, but only recently has laboratory equipment advanced enough to start detecting them in groundwater in the range of parts per billion. The USEPA and State agencies are still grappling with proposing groundwater contaminant limits, with New York State leading the way with proposed rules that would regulate these contaminants at extremely low levels.<sup>9</sup>

**Advice:** If you have a site with potential issues from “emerging contaminants,” I would consider purchasing additional insurance—or a separate pollution premise liability policy—to account for the possibility of intrusive and expansive government involvement. Also, if the deal allows, try to obtain a strong indemnification and hold harmless in favor of the purchaser. As of the date of

this article, only a handful of states have promulgated groundwater contamination limits for these emerging contaminants, and New York seems poised to promulgate final rules in the next 12 to 18 months. Laboratory analysis of these contaminants, alone, can be extremely costly, while remediation will be expensive and lengthy.

## 5. Regulatory (Non)Compliance

Open “spill” incident tickets, failure to register USTs, not renewing certain permits, failure to file annual reports/certifications and other regulatory mishaps can be sources of headaches in the future and can amount to expensive violations—particularly for “knowingly violating” the rules. For example, the new owner of a building that has a UST system with capacity of more than 1,100 gallons has to register all USTs with the NYSDEC within 30 days of closing—even if the UST system is already registered.<sup>10</sup>

**Advice:** If the deal allows it, pass on all open regulatory issues to the seller and do not close until they have been addressed. Alternatively, if the closing date cannot be delayed, propose to establish an escrow account funded with money drawn from proceeds of the sale to account of all open regulatory issues. Otherwise, the buyer will be left holding the bag (and headaches) with no recourse.

## 6. Climate Change

The ultimate impacts of climate change on our environment are still evolving. What we do know is that—at the current trajectory—sea levels will rise several inches around the globe, storms will be more intense, dry seasons will be longer, and summer months will be hotter. All of this is a recipe for disaster for the unprepared, particularly if your client is purchasing waterfront property or property in a vulnerable area, such as low-lying flood zones near rivers and streams.

Additionally, increased energy demands during summer months will put the energy grid at risk, and we can anticipate increases in blackouts or brownouts in certain areas. This might be problematic for industries that rely on energy to be readily available and abundant 24/7, 365, such as data centers, warehouses or pharmaceutical storage centers.

**Advice:** Ensure that your team is aware of issues relating to climate change prior to exploring deals and make climate resilience a priority, particularly for waterfront properties or those within susceptible flood areas. Consult with experienced environmental insurance brokers to explore policies that account for losses—including business interruption—from climate change-related impacts.

*(Notable Mentions: wetlands, mold, indoor air, and historically/archeologically significant zoning designations)*

## Conclusion

Corporate counsel should be aware of BERs. In many instances, the Phase I consultant only touches upon these risks because they do not rise to the level of a REC. However, their impacts can significantly impact the nature of the deal, drive up construction costs and otherwise cause delays and headaches. Do not ignore BERs!

## Endnotes

1. The Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. § 9601 *et seq.* (CERCLA or “Superfund”), provides three landowner protections that limit CERCLA liability. These “landowner liability protections” are known as the “innocent landowner,” “contiguous property owner,” and “bona fide prospective purchaser” limitations on CERCLA liability. CERCLA is an unforgiving law if you are not properly protected. With its “polluter pays” policy, the CERCLA liability scheme is expansive. It imposes strict, joint & several, and retroactive liability on owners or operators who fail to qualify for one of the three “landowner liability protections.”  
While these statutory shields to CERCLA liability all have distinct regulatory requirements, they all have one thing in common: the prospective purchaser (or lessee) must perform “all appropriate inquiries into the previous ownership and uses of the property consistent with good commercial and customary practice as defined at 42 U.S.C. § 9601(35)(B).” This is known as the “AAI Rule.” The prospective purchaser complies with the AAI Rule if they have a Phase I ESA performed by a qualified environmental professional prior to closing (or executing the lease).
2. The term “recognized environmental condition” means “the presence or likely presence of any hazardous substances or petroleum products in, on, or at a property: (1) due to any release to the environment; (2) under conditions indicative of a release to the environment; or (3) under conditions that pose a material threat of a future release to the environment. De minimis conditions are not recognized environmental conditions.” ASTM E1527-13 at § 1.1.1.
3. ASTM E1527-13 at § 3.2.11.
4. <https://www1.nyc.gov/site/buildings/business/project-requirements-asbestos.page>.
5. 16 C.F.R. 1303.4.
6. 6 N.Y.C.R.R. 375-1.2 (x).
7. <https://www.usatoday.com/story/news/health/2020/01/23/pfas-toxic-forever-chemicals-found-drinking-water-throughout-us/4540909002/>.
8. *Burdick v. Tonoga, Inc.*, 179 A.D.3d 53 (3d Dep’t 2019).
9. [https://regs.health.ny.gov/sites/default/files/proposed-regulations/Maximum%20Contaminant%20Levels%20%28MCLs%29\\_0.pdf](https://regs.health.ny.gov/sites/default/files/proposed-regulations/Maximum%20Contaminant%20Levels%20%28MCLs%29_0.pdf).
10. 6 N.Y.C.R.R. 613-1.9(d)(1).

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