

ARNOLD & PORTER LLP

# ALLOCATING LIABILITY: ENVIRONMENTAL INDEMNITIES

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## Agenda

- Transactions with Environmental Indemnities
- General Principles for Contracts and Indemnities
- Key Considerations for Allocation of Liability
- The Architecture of an Environmental Indemnity
- Practical Tips



# Transactions Involving Environmental Indemnities

- Sale and lease of real property
- Sale of business (asset or stock)
- Settlement agreements
- Loans and other financing documents
- Land use restrictions
- Access agreements
- Service contracts with environmental contractors



## General Principles: Contracts And Environmental Law

- Principle 1: Beware of general principles!



## General Principles

- Principle 2: You cannot contract away your liability vis-à-vis the government

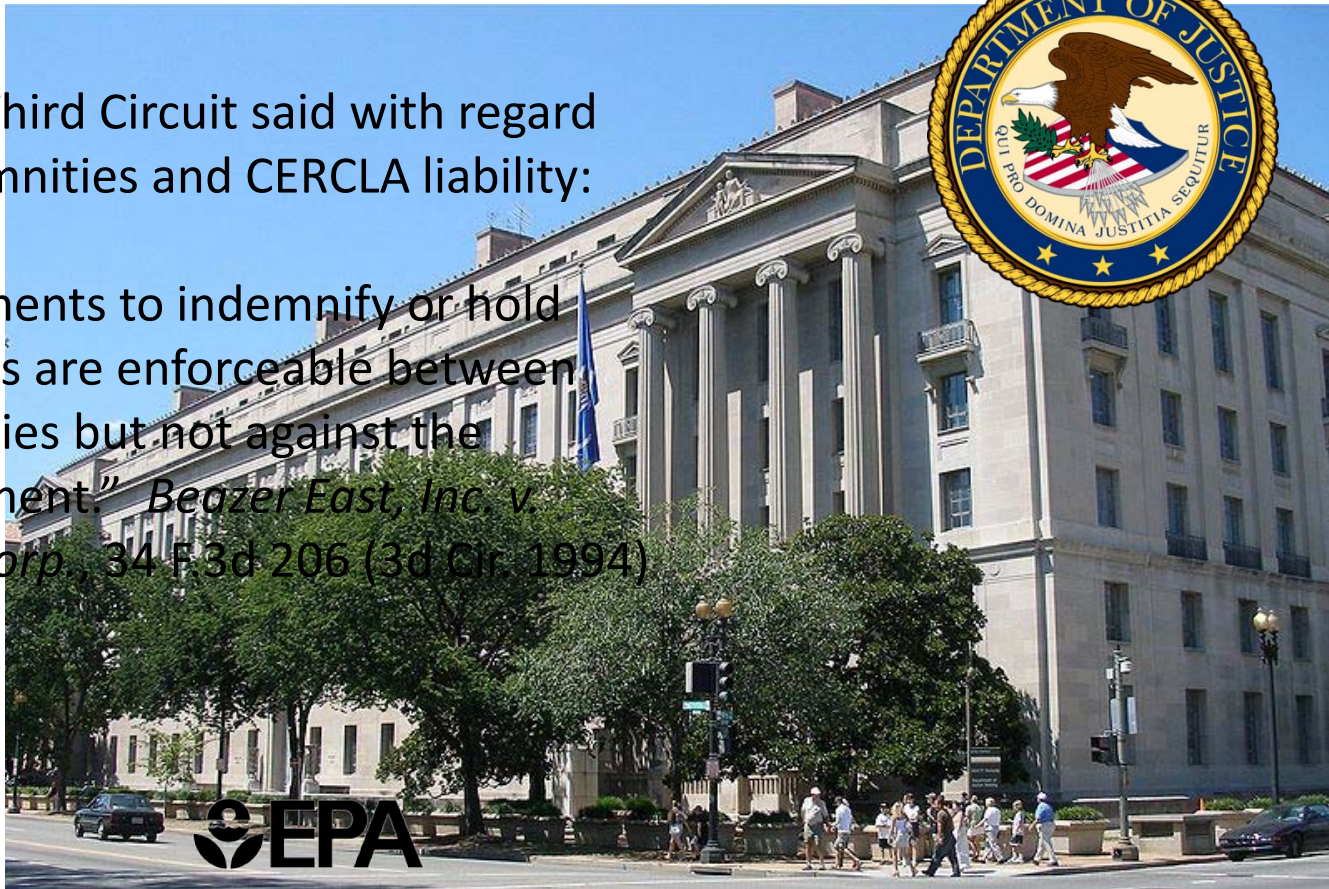




# General Principles

As the Third Circuit said with regard to indemnities and CERCLA liability:

“Agreements to indemnify or hold harmless are enforceable between the parties but not against the government.” *Beazer East, Inc. v. Mead Corp.*, 34 F.3d 206 (3d Cir. 1994)



## General Principles

- Principle 3: For the most part, contracts only bind the parties to the contract and do not bind third parties
  - **Exceptions** (sometimes):
    - Successors and assigns
    - Affiliates
    - Running with the land

I Accept

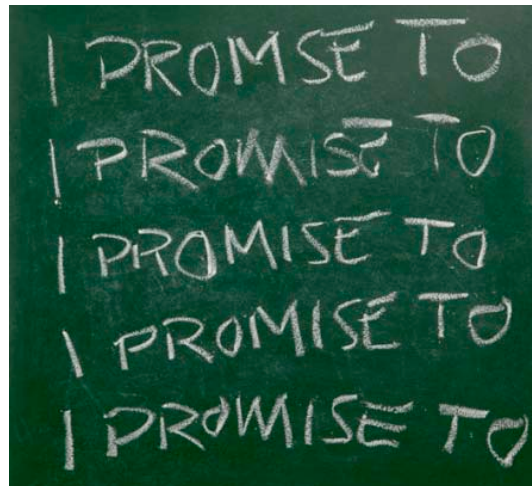
I Do Not Accept





## General Principles

- Principle 4: Contract promises are only as good as the assets that back them up
  - An environmental indemnity is only as good as the balance sheet of the party giving the indemnity
  - Consider parent company guarantee, letter of credit, reserves, escrows, other financial mechanisms





## Key Contract Terms to Allocate Environmental Liabilities

### – Environmental Indemnity

- *“We agree to indemnify, defend and hold harmless....”*

### – Covenants and Affirmative Commitments

- *“We agree to perform government ordered cleanup and reimburse your added site redevelopment costs...”*

### – Releases

- *Covenants not to sue*

### – Representations and warranties

- *“We are in compliance with all environmental laws as of the closing...”*



## Practice Tips

- A good contract has:
  - A separate environmental section
  - All of the above terms (indemnity, covenants, release of liability, reps and warranties)
  - Consider a deed restriction (no sensitive uses)
  - Consider an access agreement
  - Consider a technical risk management plan





## The Architecture of an Environmental Indemnity



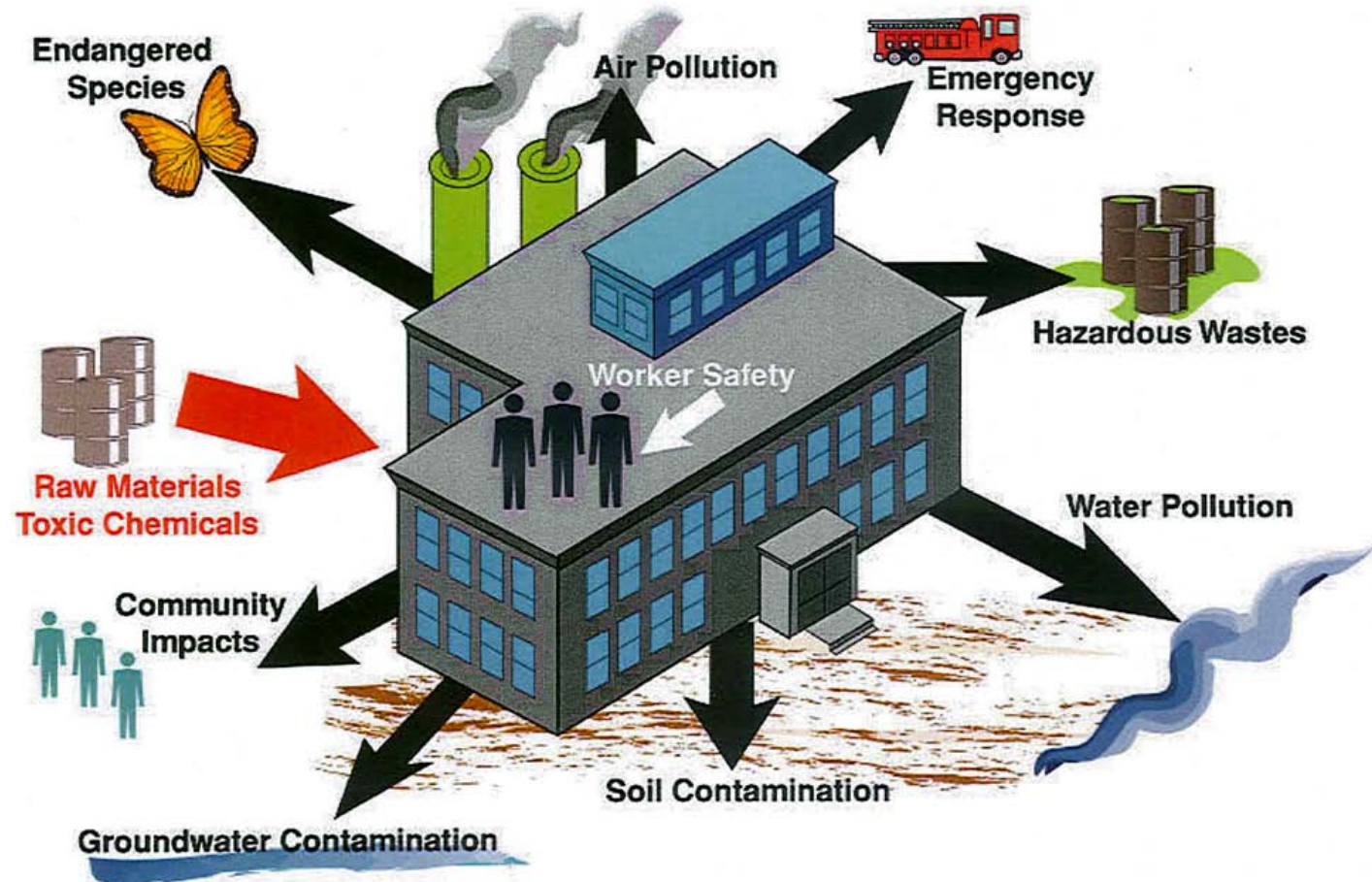
## Key Questions to Ask and Answer

- Who is giving protection?
- Who is receiving protection?
- “Indemnify, *defend*, and hold harmless”?
- What is covered?
- What is not covered?
- Proportional fault, or not?
  - “Arising from or related to” vs. “to the extent caused by”

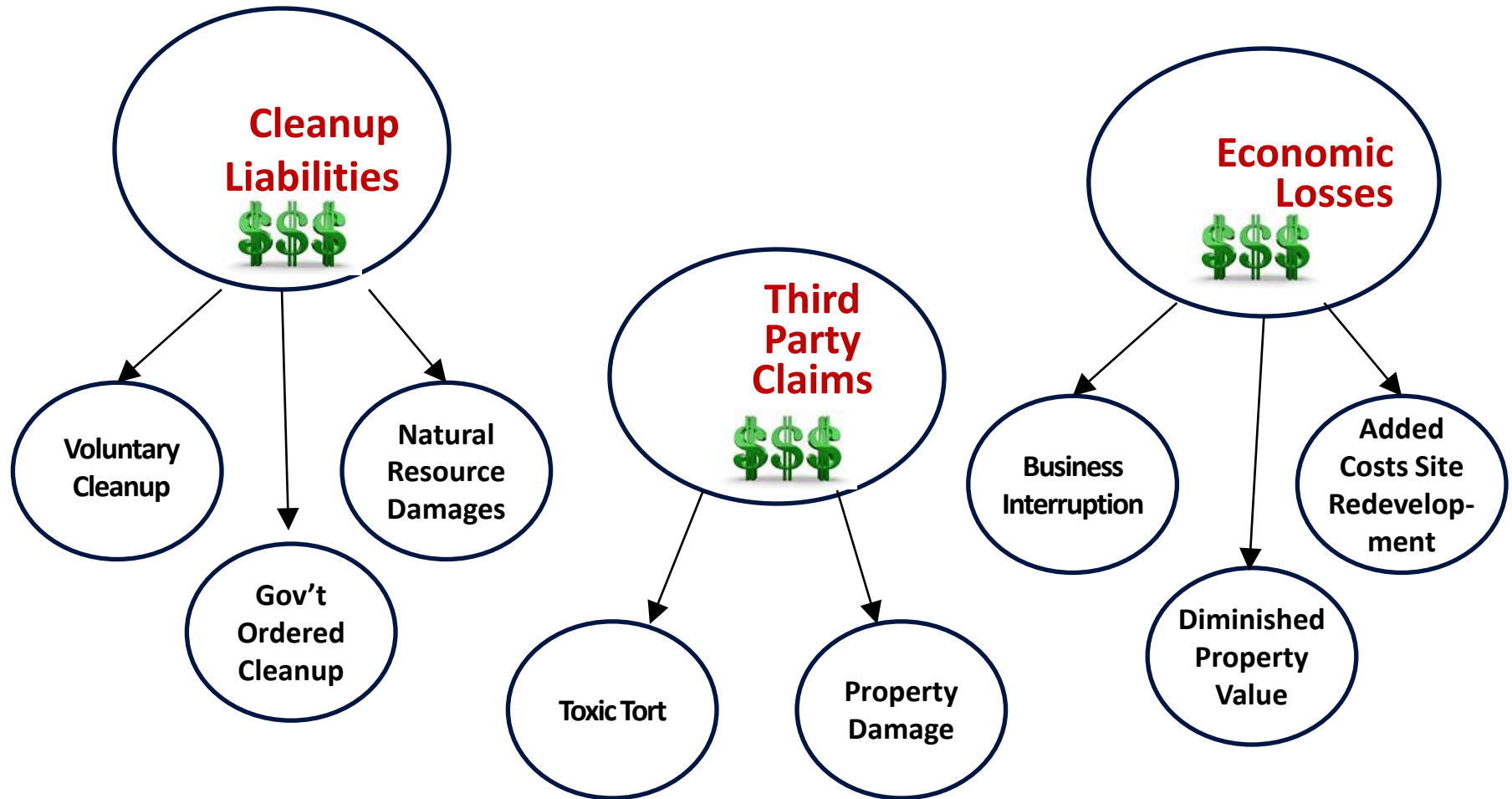




# What Kinds of Liabilities Might Occur?



# Types of Liability





## Drafting an Indemnity

- When you draft:
  - Consider all these types of liabilities
    - Allocate them
    - Use definitions for clarity and economy of style



## Site Cleanup Liabilities

- Who is responsible – Buyer or Seller?
- For what?
  - Pre-closing legacy contamination only?
    - Presumptions and baselines
  - Only government ordered cleanup?
    - Or anything required by laws?
  - Voluntary cleanup?
  - Cleanup of soil and groundwater only?
    - Asbestos, lead paint, mold, demolition?





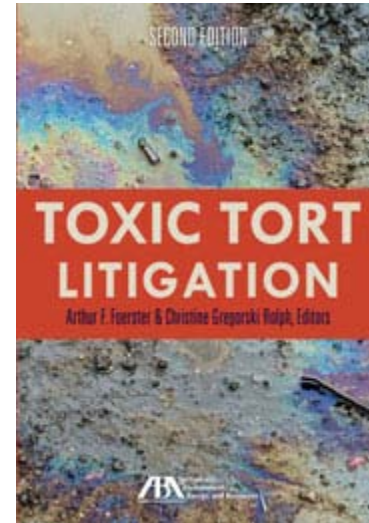
## Site Cleanup Liabilities

- What kind of cleanup?
  - Industrial/commercial versus residential?
  - Risked-based permitted?
    - Use of institutional controls permitted?
    - How implemented and complied with?
    - Deed restrictions?
- Who controls communications with government?



## Third Party Claims

- Toxic tort claims
  - Examples: site workers, future occupants
- Property damage claims
  - Example: offsite neighbors
- Natural resource damages





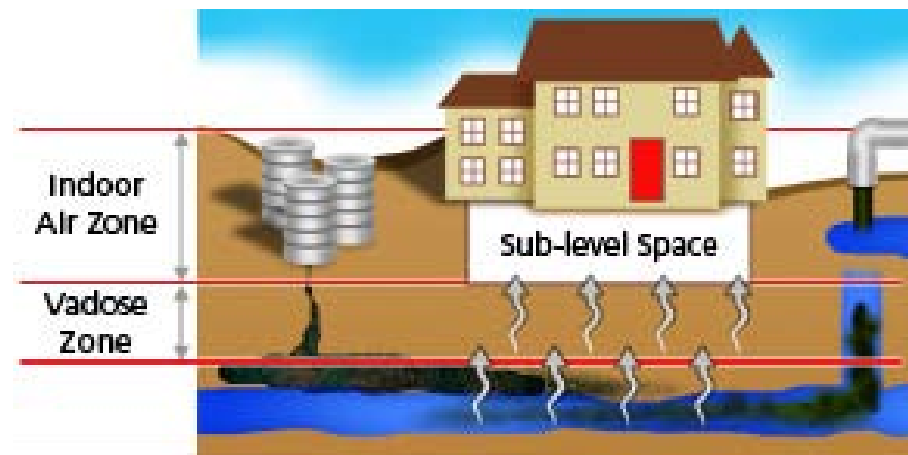
## Site Redevelopment Costs

- Future owners may incur added costs beyond gov't ordered cleanup
  - Excavation in connection with development
  - Disposal of contaminated media
    - Example of parking garage
  - Cost of studies and hazmat contractors



## Vapor Intrusion Liabilities

- Vapor intrusion into site buildings?
  - Investigation and testing
  - HVAC control
  - Engineered mitigation systems
    - Installation and long term O&M
- Who pays? Who controls?





# First Party Costs and Damages

- **First party costs and damages**
  - Site redevelopment costs
  - Voluntary cleanup
  - Diminution in value of property acquired
  - Other direct costs to buyer
  
- **IMPORTANT:** Many courts interpret standard indemnities to cover only third party claims, not first party damages, costs and losses



Draft accordingly

**You can't be a wizard.....**

**But be careful when drafting environmental indemnities**

