Environmental due diligence in industrial property agreements

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Abstract

Environmental due diligence as a protection mechanism has become very important for many reasons when it comes to real estate transactions. For instance, the parties to a transaction have to establish whether or not the property being considered for purchase is contaminated or not. If the property is indeed contaminated the parties have to decide as to who will bear the remediation costs. Therefore environmental liabilities associated with the property being considered for purchase cannot be underrated. Environmental laws in many countries around the world such as South Africa state that contamination occurred before the new owner took ownership does not absolve either the new or old owner or occupier from being liable for contamination. The main of this research is to look at role environmental due diligence play in South Africa and other countries when concluding real estate agreements concerning property that may be contaminated. The research highlights the importance of environmental due diligence in real estate agreements. **Keywords:** real estate, contamination, liabilities, due diligence, insurance, indemnity

Uittreksel

Omgewings-omsigtigheidsondersoeke het vir verskeie redes in populariteit toegeneem as 'n beskermingsmaatreël vir partye tot eiendomsooreenkomste. Een van hierdie redes is dat omsigtigheidsondersoeke van partye tot 'n eiendomsooreenkoms vereis om vas te stel of die eiendom aan besoedeling blootgestel is, al dan nie. Indien hierdie vraag positief beantwoord kan word, moet die partye verder besluit watter een van hulle die opruimingskoste sal dra. Dit is duidelik dat omgewingsaanspreeklikheid ten opsigte van die betrokke eiendom nie 'n netelige saak is nie. In die Suid-Afrikaanse omgewingsreg (soos baie ander lande) word die vorige eienaar sowel as die nuwe eienaar nie vrygestel van aanspreeklikheid ten opsigte van die eiendom wat voor hulle eiendomsooreenkoms plaasgevind het nie. Die hoofdoel van hierdie navorsing is om die rol van omgewings-omsigtigheidsondersoeke in eiendomstransaksies te ondersoek - beide in Suid-Afrika en vreemde jurisdiksies - ten einde die belang van hierdie ondersoeke te bevestig. **Sleutewoorde:** real estate, besoedeling, laste, omsigtigheidsondersoeke ,versekering, vrywaring

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LIST OF ABBREVIATIONS

ASTM	American Society for Testing and Materials
ACSR	Australian Corporations and Securities Reports
AMCRE	American Creosoting Company
CERCLA	Federal Comprehensive Environmental Response Compensation Act
EDD	Environmental Due Diligence
EIA	Environmental Impact Assessment
ESA	Environmental Site Assessment
MEC	Member of the Executive Council
NEMA	National Environmental Management Act
NEMWA	National Environmental Management: Waste Act
NJDEP	New Jersey Department of Environmental Protection
NWA	National Water Act
SEMA	Specific Environmental Management Act
RSA	Republic of South Africa
US	United States of America

1. Introduction

South Africa is one of few countries on the African continent that are privileged to have a very progressive environmental regulatory framework. Section 24(1)(a) of the Constitution of the Republic of South Africa, 1996 (hereafter the Constitution) guarantees everyone the right to an environment that is not harmful to their health or well-being. Section 24 of the Constitution provides that the Government must adopt reasonable legislative and other measures to:

(i) prevent pollution and ecological degradation;

(ii) promote conservation; and

(iii) secure ecologically sustainable development and use of natural resources while promoting justifiable economic and social development.

Amongst others, the objectives of section 24 are achievable through environmental due diligence (EDD), which is a developing area of environmental liability risk management that comprises legal compliance audits, contractual risk allocation, pollution prevention and environmental damage insurance.[1]

EDD is important to both the seller and the buyer in identifying and addressing the environmental liabilities for contaminated properties. The reader is no doubt familiar with the concept of due diligence, which needs no special introduction, hence will presumably relate to its application in the environmental sphere.[2] The concept is commonly understood to involve either an investigation of a business or person prior to signing a contract, or to act with a certain standard of care.[3] It can be a legal obligation, but in many instances entails a voluntary investigation. Due diligence connotes a level of diligence or care to be exercised, when buying or selling a business,

1 Forte 2011 *Fordham Environmental Law Review*.
2 Anon 2013 http://www.internationalduediligenceassociation.org.
3 Carino 2000 *European Law Review*.

by the management of the prospective buyer on the one hand, and by external advisers, lawyers and auditors on the other.[4] Due diligence is commonly addressed in contracts of sale of commercial property such as real estate transactions.

The United States of America (US) is a prime example of a foreign jurisdiction where the principle of due diligence is commonly applied in various contractual agreements. It came into use in virtue of the *United States' Security Act* of 1993[5]. Section 11 of the Act includes a "due diligence defence" that can be adduced by broker-dealers when accused of inadequate disclosure to investors of material information with respect to the purchase of securities. The principle is commonly employed for the purposes of evaluating a target company or its assets for acquisition, but it is also employed in matters relating to human resources, as well as legal, technical, business, financial and accounting matters, and lately, EDD.[6]

EDD is practiced as a legal and technical exercise aimed at substantiating certain legal liability protections, such as *bona fide* prospective purchaser defence in the US.[7] Unfortunately EDD is not covered in most academic environmental programmes in South Africa.[8] As the property market recovers from the economic downturn many South Africans plan to either buy or lease properties as business premises that in many instances (eg. industrial properties) have been contaminated by previous occupants, thus indicating the need for EDD investigations to assist those in need of remedial intervention in this regard, with particular reference to providing for future environmental rehabilitation liability (eg. indemnity measures or environmental insurance).[9]

Thorough consideration of the concept of EDD will follow shortly, but at this juncture it is important to note that EDD is deal-specific and will be dependent on a variety of factors, including the buyer's knowledge of the site and operations, level of site

4 Forte 2011 *Fordham Environmental Law Review*.
5 United States Security Act of 1993.
6 Berkman 2013 *Due Diligence and Business Transactions: Getting a Deal Done 9*.
7 Schnapf 2014 http://www.environmental-law.net.
8 Strydom and King (eds) *Environmental Management in South Africa* 212-213.
9 Strydom and King (eds) *Environmental Management in South Africa* 212-213.

development, nature of operations, time and cost considerations, risk tolerance, deal structure and seller's viability.[10] It would probably be in the interest of a prospective buyer or lessee to have an EDD investigation done before assuming ownership or the lease of a property with an industrial history that could include pollution**.** Such investigation could be vital in identifying potential liability attributable to pollution, price, warranties and indemnities, and so on,[11] and to discounting liabilities when determining the relevant property's true value.[12] Furthermore, it affords a grasp of the property's contamination issues, and most critically, assesses and establishes liability for the clean-up operations.[13] Bing notes that EDD assessment should occur on two levels, the first being an investigation to hazardous waste, if any, on a property, while the second entails a compliance audit to determine if the seller has violated environmental statutes or otherwise may be subject to toxic delictual liability to third parties for an off-premises matter.[14] As a rule individuals who are involved with commercial real estate are required to perform due-diligence assessments.

For example, the question whether a lessee can be held liable for environmental contamination was raised in the US, and was in fact addressed by the *Federal Comprehensive Environmental Response Compensation Act* of 1980 ("CERCLA" / "Superfund")[15]. Section 107 of that Act is very broad and includes the following parties in its list of possibly liable persons:

a. The owner and operator of a vessel or a facility;

b. Any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of;

c. Any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances; and

10 Barker *et al* 2013 http://www.wyche.com.
11 Schnapt 2000 *Natural Resources & Environment*.
12 Smith *et al.* 1990 *International Bar Association Series*.
13 Falk *et al* http://www.media.mofo.com.
14 Bing *Due Diligence Techniques and Analysis: Critical Questions for Business Decisions* 57.
15 Federal Comprehensive Environmental Response Compensation Act 1980.

d. Any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which causes the incurrence of response costs, of hazardous substance.[16]

In *United States v. South Carolina Recycling & Disposal, Inc*.[17] the court ruled that hazardous substance generators and the owner of the Bluff Road waste disposal site were jointly and severally liable for removal costs under section 107 of CERCLA. The owners of the site in South Carolina leased a portion of it to a chemical company for storage of chemicals. The site was also sublet to a waste brokering and recycling operation. Both lessees were held liable. The court further stated that the provisions of section 107 of CERCLA did not require a direct causal connection between a generator's substances and costs.

Applying the two-phased conceptualisation of Bing to the US, EDD in commercial real estate transactions involves two phases of environmental site assessments, which are Phase I (Environmental Site Assessment) and Phase II (Investigation). Environmental site assessment is a report that is prepared for a real estate holding which identifies potential or existing environmental contamination liabilities. The assessments are undertaken to avoid liability under the comprehensive environmental response, compensation, and liability act (CERCLA). The Phase I process requires the environmental professional to conduct sufficient research to conclude whether or not recognised environmental conditions have been discovered and provide an opinion on their impact.[18]Phase II is envisaged to investigate in detail the critical issues arising in Phase I.[19]

It is evident that EDD is all about identifying and managing risks and exposures related to property acquisitions or divestitures, which is important in maintaining and preserving the investor's material interest. The fact that contamination of the soil or

16 Section 107 (a) CERCLA.
17 ELR 20272.
18 Martin *Site Assessment and Remediation Handbook* 32.
19 Hejzlar *et al Technical Aspects of PhaseI/II Environmental Site Assessment* 161.

groundwater at the site occurred before its ownership or lease changed does not exempt the new owner or lessee from an obligation to take remedial steps to repair the environmental damage. This relates to a large extent to the liability provisions contained in the *National Environmental Management Act* 107 of 1998 (NEMA),[20] *National Water Act* 36 of 1998 (NWA) and the *National Environmental Management Waste Act* 59 of 2008 (NEMWA)[21]. These pieces of legislation provide that land owners may be liable for pollution that occurred before change of ownership. Remediation costs are partly recoverable from a prior polluter (ie. the person "responsible for undertaking remediation" - cf. NEMWA[22]) in cases where the land in question has been declared an official remediation site. Since NEMWA does not specify exactly who the responsible party is beyond the cited wording, however, the onus may fall on the current occupier, particularly if high-risk activities that may contribute to the pollution are undertaken there at the behest and under the authority of said occupier. While statutory environmental liability evidently does exist, the EDD aspect of such provision does not deal adequately with the issue of mitigating potential environmental damage. This legal *lacuna* takes precedence in the research at issue.

In short, the main aim of this study is to examine the role of EDD in industrial property agreements or real estate agreements in the current South African legal landscape. In pursuing this aim the writer will investigate a series of interrelated topics. In chapter 2, for instance, the evolution of EDD will be elaborated with reference to foreign judicial precedents and pieces of foreign and local legislation. Chapter 3 will cover interpretation and application of EDD in litigation and legislation relating to property purchase agreements in the US. Chapter 4 addresses the extent to which EDD provision in South African law serves the purpose of mitigating environmental damage. Chapter 5 contains the writer's concluding assessment, indicating whether the aim of the study has been achieved, as well as the writer's recommendations in light of the findings brought out in the study.

20 National Environmental Management Act 107 of 1998.
21 National Environmental Management: Waste Act 59 2008.
22 National Water Act 36 of 1998.

2. Evolution of EDD

2.1 Introduction

As noted initially, EDD entails a legal exercise to secure liability protection (eg. *bona fide* prospective purchaser defence in the US), as well as an exercise to collect and assess data relating to existing environmental conditions or impacts in order to assess environment-related financial, legal and reputational risks[23] that may be incurred in concluding a property transaction. The investigation normally takes place in three consecutive stages:

- demarcating the regulatory framework;
- environmental appraisal; and
- monitoring the project after approval.[24]

EDD is an aspect of the developing area of environmental liability risk management which includes contractual risk allocation and environmental damage insurance, amongst others. This part of the research looks closely at how EDD has evolved internationally and particularly how it has been utilised as a tool by international financial institutions and money lenders, how foreign courts have dealt with EDD-related matters in their own jurisdictions, and modulations in the EDD process as it passes through the above-mentioned stages.

2.2 EDD in the international context

23 Reuvid 2005 *The Corporate Finance Handbook*.
24 Anon 2013 http://www.iic.org.

Studies conducted in the 1990s showed that 50% to 80% of money lenders sampled at the time had made use of EDD investigations.[25] Commentators interpreted this incidence as an indication that in some markets environmental risks were becoming "an integral part of the credit appraisal process".[26]

Many international banks around the world today have developed numerous ways of identifying and dealing with potential risks attending specific transactions. Environmental impact assessments (EIAs) and EDD investigations are among a range of tools employed by international banks and money lenders for the purposes of environmental risk management.[27]

EIAs became known internationally after the 1972 Stockholm Conference and are now recognised internationally in the Rio Principles and have become an accepted norm of international law for many countries and institutions. Principle 17 of the Rio Declaration provides a good general idea in its statement that "EIA as a national instrument, shall be undertaken for proposed activities that are likely to have a significant adverse impact on the environment and are subject to a decision of a competent national authority".

Sands provides more detail in his definition of an environmental impact assessment as:

> 'a process which produces a written statement to be used to guide decision-making, with several related functions. First, it should provide decision-makers with information on the environmental consequences of proposed activities and, in some cases, programmes and policies, and their alternatives. Secondly, it requires decisions to be influenced by that information. And, thirdly, it provides a

25 Ganzi *et al.* 1998 *Corporate Environmental Performance as a Factor in Financial Industry Decision: Status Report.*
26 Richardson 2008 *Socially Responsible Investment Law: Regulating the Unseen Polluters*.
27 Van Gerber *et al.* 2011 *Enhancing Financiers' Accountability for the Social and Environmental Impacts of Biofuels*.

mechanism for ensuring the participation of potentially affected persons in the decision-making processes.'[28]

This definition by Sands conveys the impression that EIA not only focuses on projects, but can also be used to evaluate programmes and policies.

The distinction between EIAs and EDD assessment should be carefully noted as it may not be clear to the layman. Their apparent similarity may be deceptive. EIAs by their very nature always precede the development of a particular project, say the building of a housing complex. Normally the developer either conducts an EIA as required by law or voluntarily identifies the positive or negative impacts of such a project on environmental conditions (eg. biodiversity) in the area concerned. Whereas the law sometimes prescribes who (eg. environmental assessment practitioner) should conduct an EIA , what the investigation should comprise, timelines, and the like, EDD is critical as a means of determining not only the presence of contamination at sites in matters of property acquisition, but the apportionment of remediation costs to buyer and seller respectively.

International financial institutions like the International Monetary Fund and the World Bank have developed their own standards that have to be met as prerequisites for pledging support for a particular project. The World Bank insists on an EIA.[29]

The applications for finance received by these institutions are screened to determine whether a transaction entails environmental risks, in which case the risk element is classified under three possible categories as: low-risk (category C); medium-risk (category B); or high-risk (category A).[30] Usually medium-risk projects require an EDD report before final approval.

As noted earlier, EDD is decisive for corporate transactions because inherited pollution (ie. that occurred before change of ownership) could cost a company millions if not

28 Sands *Principles of International Environmental Law*.
29 Glasson *et al.* 2013 *Introduction to Environmental Impact Assessment*.
30 Case 1999 *Environmental Risk Management and Corporate Lending: A Global Perspective*.

billions to accomplish corrective measures in the long run, hence the essential need to assess the potential liability harboured by a property by conducting an EDD investigation before the proposed transaction is concluded. . At bottom the rule of *caveat emptor* remains in that the prospective buyer or lessee cannot escape the environmental liability that might accrue from acquisition of a property (ie. it is not transferable in the last instance). As noted, environmental laws are implacable where matters of pollution are concerned, hence appeals that the buyer/lessee was unaware of the existing pollution at the site in question at the time of purchase will not be countenanced in court. The information gained from an EDD investigation is a key bargaining tool that can be used to negotiate or even renegotiate the price of property or shares in favour of the buyer.

In many instances statutory and 'desktop' or executive EDD investigations are not exactly similar but differ considerably in accent. For example, whereas in the statutory sense the crux lies with an environmental issue that is definable in legal terms, the alternative in a more general sense, of industrial premises for example, involves a more detailed investigation 'on the ground', as it were, which may in fact include taking soil samples.[31]

Parties involved in property transactions need to keep abreast of issues that affect transactions as these may vary considerably, depending on the property and the transaction concerned,.

Besides providing a list of environmental hazards and formulating possible solutions, EDD inspectors also typically perform a cost analysis of the damage and required repairs.

31 Yates *et al.* 2010 *A Practical Guide to Private Equity Transactions*.

2.3 Foreign jurisprudence on EDD

In the past funding decisions did not hinge particularly on the potential environmental consequences of projects[32], but today many banks, including foreign banks, operating in the US, are required to conduct EDD investigations to protect themselves against unscrupulous sellers. Banks and other potential buyers can also take lessons from *Sugarhouse Realty Inc*. [33] which illustrated the importance of drafting property contracts with provisions that limit a prospective buyer's environmental liabilities. The court noted that the parties to the *Sugarhouse* contract did not intend to conduct a due diligence investigation before the contract was signed, with the result that the environmental *bona fides* of the prospective seller were prematurely approved and the buyer sought to resile from the contract upon noticing the extent of environmental contamination at the site in question.[34]

The provisions governing EDD cover a wide range of environmental risks and attendant liabilities (eg. water, waste, emissions, land acquisition, labour standards and impacts on cultural heritage).[35] The scope of EDD usually depends on factors such as the size and value of the asset concerned, as well as the nature of the transaction.[36] Hemmings J pronounced as follows in *State Pollution Control Commission v Kelly* (1991) 5 ACSR 607, which was heard in the New South Wales Land and Environmental Court in Australia :

> 'due diligence… depends on the circumstances of the case, but contemplates a mind concentrated on the likely risks. The requirements are not satisfied by precautions merely as a general matter in the business of the corporation, unless also designed to prevent the contravention. Whether a dependant took the precautions that ought to have been taken must always be a question of fact and, in my opinion, must be decided objectively according to the standard of a reasonable man in the

32 Mahidhara 2002 *The Environmental and Social Challenges of Private Sector Projects: International Finance Corporation's Experience*.
33 192 BR 355-DIST. Court, ED Pennsylvania, 1996.
34 Resnick *et al.* 2013 *Collier Guide to Chapter II: Key Topics and Selected Industries*.
35 Sengupta 1993 *Environmental Impacts of Mining Monitoring, Restoration, and Control*.
36 Bagley *et al.* 2009 *Managers and the Legal Environment: Strategies for the 21st Century*.

circumstances. It would be no answer for such person to say that he did his best given his particular abilities, resources and circumstances'.[37]

Hemmings J further noted that the findings of an EDD-investigation proffered in defence do not necessarily imply 'perfection', but they do require that everything be done that is properly regarded as due diligence.

In some places, EDD examinations are standard or even required for most commercial and industrial land and property purchases.[38] As noted, an EDD report can affect the funding of loans to purchase property.[39]

Naturally, the allocation of risk for environmental liabilities between buyers and sellers will be dictated by the terms of the purchase agreement.[40] Environmental terms, such as "environmental laws," "permit" and "hazardous materials" will be defined.[41]

It is generally accepted that prospective sellers of property (ie. real estate) are required to make certain disclosures regarding environmental conditions, such as:

(i) The absence of hazardous materials at any conveyed real estate

(ii) The absence of any claims lodged by government or third parties regarding contamination at any conveyed parcels

(iii) The absence of any past on-site disposal activities and/or hazardous materials usage

(iv) The seller's provision of all material environmental reports.[42]

In the US particularly, EDD practice takes place in phases depending on the type of property concerned. Phase I is regarded as the environmental site assessment, Phase II

37 1991 ACSR 607.
38 Carter *et al.* 2004 *Environmental Due Diligence: The Role of ISO 14015 in the Environmental Assessment of Sites and Organisations.*
39 Howson 2003 *Due Diligence: The Critical Stage in Mergers and Acquisitions*.
40 Carr 2013 http://www.ohiorelaw.com.
41 Anon 2013 http://www.lw.com.
42 Anon 2013 http://www.lw.com.

as the investigation proper, and Phase III as the aftermath of discovering contamination in the course of Phase II. These phases will now be discussed in outline.

2.3.1 Phase I

The purpose of the report emanating from this, usually the first step in the process of EDD investigation, is to identify potential or existing environmental contamination liabilities associated with the land in question as well as the improvements on it.43 A Phase I ESA is usually required for many property transactions irrespective of their type and size. The due diligence method is defined in the American Society for Testing and Materials (ASTM) Practice E 1527.44 This phase is important in many ways in that if conducted properly the buyer may qualify to employ the innocent land owner's defence in terms of CERCLA..[43] Activities falling under EDD provision include preliminary activities, site visits, records reviews, regulatory reviews, geological and hydro-geologic reviews and report development.[44]

In Japan Phase I is a standard requirement under the *Soil Contamination Countermeasures Act* 53 of 2003[45], which is intended to facilitate countermeasures against soil contamination by designated hazardous substances, as well as measures to protect human health against harm caused by such contamination.

2.3.2 Phase II

Phase II, which normally follows Phase I[46], entails a detailed investigation of critical issues arising during Phase I and necessitating collection of soil and water samples for laboratory analysis, as well as non-invasive inspection and sampling of materials

43 Missimer *et al.* 1996. *A Lender's Guide to Environmental Liability Management.*
43 Martin 2003 *Site Assessment and Remediation Handbook* 32.
44 Boss *et al.* 2009 *Building Vulnerability Assessment: Industrial Hygiene and Engineering Concepts*.
45 Soil Contamination Countermeasures Act 53 of 2003.
46 Witkin (ed) *Environmental Aspects of Real Estate and Commercial Transactions: From Brownfields to Green Buildings.*

containing asbestos, management of potentially hazardous equipment and containers, inspection of underground tanks, soil and subsoil sampling and analysis, drawing and analysis of subsurface waters.[47]

2.3.3 Phase III

Phase III of the EDD process may be necessary when contamination has been confirmed by Phase II. Phase III investigation involves remediation and is intended to fully characterise and assess the nature and extent of site contamination[48], which involves identifying appropriate clean-up technologies based on the nature and extent of contamination, potential clean-up goals, technology applications, and costs. Its activities may comprise more extensive sampling to assess the full extent of contamination, evaluating the contamination risk in relation to future land use, evaluating the technological viability and costs of clean-up alternatives, and developing the Phase III report.[49]

The importance of EDD investigation was emphasised in *The Corporation of the City of Kawartha Lakes v. Director, Ministry of the Environment*[50] in Canada. The court held that liability for environmental contamination may settle on the occupier of a property regardless of whether the contamination in question was caused by that party. This determination was borne out by the authority granted to the Ministry of the Environment to instruct innocent owners to perform clean-up actions.[51] A prospective buyer who fails to conduct an EDD investigation as a preemptive measure will certainly be ordered to remedy this oversight later.[52]

47 Boiron *et al.* 2009 *Commercial Real Estate Investing in Canada: The Complete Reference for Real Estate Professional.*
48 Hess-Kosa 2007 *Environmental Site Assessment Phase I: A Basic Guide*.
49 Blackman Jr 2001 *Basic Hazardous Waste Management*.
50 [2012] O.J. No. 2378.
51 [2012] O.J. No. 2378.
52 [2012] O.J. No. 2378.

2.4 Conclusion

It seems clear that owners or lessees who occupy property that was contaminated before their occupation may not be held liable for the damage caused by the contamination, but that such liability would devolve on them if they controlled or caused the contamination of the sites concerned personally. It therefore seems prudent for property purchasers in areas where EDD investigations are a standard requirement to comply with such requirement at an appropriate level since remediation can be a costly exercise and conducting an EDD investigation as a precautionary measure can be a significant cost-saving measure that enables the prospective buyer to conclude the envisaged transaction with confidence.

Financial institutions such as the IMF and the World Bank have learned the hard way when it comes to financing projects that have resulted in environmental damage. They now use different environmental management tools such as EIA and EDD investigations as a precautionary measure to improve the relative acceptability of risks attending projects they are financing.

Finally, as noted in matters of foreign jurisprudence, EDD investigations offer many benefits to buyers and sellers, such as *bona fide* prospective purchaser defence in real estate transactions concluded in the US.

3. EDD in US industrial property agreements

3.1 Introduction

The previous chapters covered the evolution of EDD, foreign cases and the phases of the EDD process. The present chapter is concerned with the *bona fide* prospective purchaser defence in real estate transactions concluded in the US, and with the process of including EDD investigations as a contractual obligation in real estate agreements or

agreements relating particularly to industrial property. If the said legal protection is to be effective the prospective buyer must adduce evidence in court effect that under the provisions of CERCLA he/she cannot be held liable for the contamination in question despite his/her awareness of its existence. Given its relative novelty, the limits of applicability of the prospective purchaser defence are still being tested as court cases proceed.

3.2 Bona fide prospective purchaser defence in the US under CERCLA

The importance of EDD investigation as a prerequisite for the effectiveness of the *bona fide* prospective purchaser defence, which is crucial for buyers and sellers alike to ward off environmental-damage liability that could be incurred by entering into property transactions. If a buyer successfully adduces the EDD report to gain exemption from liability for environmental damage [53] the previous owner may be held liable instead.

CERCLA requires that the owner or buyer bear the burden of proving by a preponderance of evidence each other element of the *bona fide* prospective purchaser defences, including that of the buyer:

(a) post-closing exercise of "appropriate care";
(b) lack of any release, disposal, or exacerbation of hazardous substances;
(c) cooperation, assistance and providing of access to conduct a response action;
(d) compliance with any institutional controls and land use restrictions;
(e) compliance with any subpoenas; and
(f) lack of affiliation with a potentially responsible party.[54]

The Fourth Circuit Court of Appeals in *PCS Nitrogen Incorporated v. Ashley II of Charleston LLC* pointed out that "an owner of real property claiming the *bona fide*

53 Rogers *Financial Reporting of Environmental Liabilities and Risks after Sarbanes-Oxley* 35.
54 Davis (ed) *Brownfields: A Comprehensive Guide to Redeveloping Contaminated Property*.

prospective purchaser defence under section 107(r)(1) of CERCLA has the burden of establishing all eight criteria to be protected by the defence".[55] The owner, Ashley II, argued that the Brownfields Amendments to CERCLA require a less stringent standard of "appropriate care" and "reasonable steps" than that applied by the district court.[56] Ashley also contended that landowners would not undertake voluntary redevelopment of Brownfields if there was a risk of incurring full liability for the clean-up costs arising from a minor mistake that might not even cause harm to the facility.[57] The Small Business Liability Relief and Brownfields Revitalisation Acts were signed into law in 2002 and have resulted in the amendment of various provisions of CERCLA.

Notwithstanding these arguments, the court found that Ashley II was not entitled to the *bona fide* prospective purchaser defence because it did not clean out or fill in sumps when aboveground structures were demolished, thus failing to exercise appropriate care. The court also found that Ashley II failed to monitor and address environmental conditions at a debris pile and limestone run of crusher cover on the site. In the court's opinion this dereliction amounted to a failure to take "reasonable steps to…prevent any threatened future release," as required by CERCLA, section 101(40)(D).[58]

Since Ashley II failed to establish the *bona fide* prospective purchaser defence, the court found it and the other defendants liable under CERCLA, affirmed the district court's finding of Ashley II's liability to contribute under section 113(f) of CERCLA, and allocated 5% of the response costs to it. [59] This decision basically serves as a warning that a party satisfying all appropriate requirements to qualify as a *bona fide* prospective purchaser must continue post-closing to abide by its continuing duty of appropriate care with respect to hazardous substances located at the facility in order to maintain the *bona fide* prospective purchaser defence.

55 2013 WL 1340018 (4th Cir, 2013).
56 2013 WL 1340018 (4th Cir, 2013) at* 13.
57 2013 WL 1340018 (4th Cir, 2013) at*13.
58 2013 WL 1340018 at*14.
59 2013 WL 130018 at*18.

At the end of the day, in order to be deemed a "*bona fide* prospective purchaser" pursuant to CERCLA, a property owner must be able to demonstrate that pollution on the acquired property occurred before the change of ownership. In *City of Wichita, Kansas v. Trustees of APCO Oil Corp. Liquidating Trust* the court held that the *bona fide* purchaser defence permits a person to purchase a contaminated facility without incurring liability under CERCLA despite having intelligence of the contamination.[60]

3.3 EDD issues to address in drafting property agreements

The level of EDD investigation basically covers legal and consulting expertise but the investigation can vary depending on the nature of the transaction, the property, requirements of financiers, and the degree of risk the parties may be willing to assume.[61]. Performing the appropriate EDD investigation, obtaining a record reflecting the condition of the site, negotiating an agreement of either lease, purchase or sale, or obtaining environmental insurance, all these are avenues to manage environmental risk in a real estate transaction.[62] No two transactions are identical. Understating the regulatory framework and potential liabilities clearly influences how properties need to be investigated and agreements need to be drafted. If a transaction is negotiated as it should be the environmental risk attaching to the property concerned should be clearly and mutually understood and perhaps not entirely quantified, but allocated appropriately in terms of risk tolerances.[63] Transactions will not fail if a full assessment of environmental risk has been undertaken, unless there are other reasons that hold the transaction back, as is usually the case. If improper allocation of environmental liability is the obstacle causing failure of a transaction outright transfer of ownership may not solve the problem.[64]

60 306 F. Supp. 2d 1040, (D. Kan 2003) 153.
61 Anon 2013 http://www.mneguidelines.oecd.org.
62 Sherman *et al* 2006 *Mergers and Acquisition from A to Z*.
63 Farber Date Unknown http://www.millerthomson.com.
64 Farber Date Unknown http://www.millerthomson.com.

The need for EDD investigation depends on various factors, such as the type of transaction and lender's risk tolerance. In general, however, the possibility that it may be required should be considered whenever a commercial real estate loan is in prospect since it affords an opportunity for the lender to:

- assess any risk involved with using the property as collateral for a loan. In some instances lenders who are otherwise entitled to foreclose on real property are forced to abandon their collateral when the environmental hazards on the property pose a significant risk of liability;
- properly evaluate the loan-to-value ratio of the property. Environmental issues and remedies to cure them can be very expensive and have a substantial effect on property value.[65]

EDD is also important to lenders because it identifies the presence or threat of any *liens* of an environmental nature encumbering the property.[66] As noted the nature and extent (steps involved) of a required EDD investigation differ according to the demands of each transaction. For example, the site of a former petrol station is likely to require more extensive investigation than a former residential site, and the complexity of investigation may range from simple Phase I site inspection to a comprehensive Phase II site investigation including subsurface sampling and environmental risk evaluation.[67]

Normally the role of the lawyers in an EDD process includes conducting or overseeing the following activities:

(a) permit compliance review;
(b) review of files and records of owner, governmental agencies, and occupants;
(c) inquiries addressed to governmental agencies and officials;

65 Whetzel *et al.* 2013 http://www.rlf.com.
66 Whetzel *et al.* 2013 http://www.rlf.com.
67 Whetzel *et al.* 2013 http://www.rlf.com.

(d) analysis of results of investigation; and

(e) legal evaluation of risks.[68]

Knowledgeable and experienced corporate practitioners now recognise the value of identifying and confronting environmental issues as early as reasonably possible in the negotiation process,[69] and that a comprehensive EDD investigation in the interest of buyer and seller alike is essential to establish the environmental concerns at stake as an aid to drafting risk-shifting provisions that support the structure of the deal. In short, an early and complete EDD investigation allows the parties to manage the environmental risks of the transaction more effectively.[70]

For instance, the parties and their lawyers would be able to consider and, perhaps, take advantage of state voluntary remediation programmes and environmental insurance policies that have become widely available in the last five to ten years;[71] alternatively failure to investigate will forfeit this advantage as well as the possibility of affording the relevant transaction the best possible protection of environmental insurance policies. To reiterate, then, the advantages of EDD investigation as noted can hardly be overstated.[72]

Again, if the object is to transfer controlling shares of a corporation, an early and thorough EDD investigation will identify regulatory and permit compliance issues, as well as potential environmental liabilities adhering to the corporation's formerly owned properties and/or discontinued operations.[73]EDD investigation is inherently more involved and extensive for a stock transaction than for an asset transaction.[74]

68 Falk *et al.* 2008 http://www.media.mofo.com.
69 Vroman 2007 http://www.IICLE.com.
70 Vroman 2007 http://www.IICLE.com.
71 Witkin (ed) *Environmental Aspects of Real Estate and Commercial Transactions: From Brownfields to Green Buildings.*
72 Witkin (ed) *Environmental Aspects of Real Estate and Commercial Transactions: From Brownfields to Green Buildings.*
73 Martorano *et al.* 2012 http://www.millercanfield.com.
74 Mendoza *et al.*2006 http://www.haynesboone.com.

The nature of a deal (eg. stock or asset) and the attendant environmental liabilities must be known before terms and conditions can be drafted that shift or allocate environmental liabilities,[75] to which end property deals should be subject to EDD-determination by the parties to their satisfaction of the presence, if any, as well as the nature and extent, of contamination on the property and of the concomitant liabilities.[76] Such determination falls within the discretion of the transacting parties.

It is routinely expected of a seller to hand over all relevant documentation concerning environmental conditions at the site in question to the prospective buyer while negotiations are in progress, and at the same time to allow the latter to perform soil and other physical tests on the site in question if documentary evidence or visual inspection suggests the possibility of on-site contamination.[77] While the precise access terms will depend on and may reasonably be constrained by a variety of issues, it is generally better for these terms to be included in the initial purchase agreement or even the memorandum of intent, rather than to try and negotiate them in the midst of the EDD process.[78]

The following are noteworthy concerns in planning and negotiating an EDD investigation:

(i) gaining owner's cooperation to access that party's records;
(ii) ascertaining the right to seek information from government authorities;
(iii) ascertaining the scope of entry and testing rights; and
(iv) determining the positions and rights of the parties if a problem is discovered, including the right to terminate the purchase agreement, the right to extend the closing date or EDD period, the obligation/option of the seller to correct the problem, the buyer's right or duty to report the problem to authorities,

75 Vroman 2007 http://www.IICLE.com.
76 Civins "Drafting Real Estate Contracts to Address Environmental Concerns" 1-22.
77 Nathanson 2001 www.couzens.com.
78 Falk *et al* 2008 http://www.media.mofo.com.

and apportioning/allocating the respective contributions of buyer and seller to clean-up operations.[79]

The seller usually wants information resulting from investigations to be kept confidential and made available to him/her in confidence if the transaction fails to materialise. Such confidentiality may be permissible, provided the parties remain in the clear as regards compliance with governmental reporting requirements.

In determining the level of EDD investigation required for the purposes of a particular transaction the parties must balance their need to identify and assess potential environmental issues with their monetary, time or contractual constraints, to which end contractual negotiations relating to the nature and extent of EDD investigation must take cognisance of the following:

(1) characteristics of the real property;
(2) nature of the transaction;
(3) past uses of the land or property;
(4) the buyer's prospective use of the land;
(5) mitigating factors such as the availability of indemnification or insurance.[80]

The following practical issues are crucial in drafting EDD provisions into an agreement:

(i) Physical constraints: for example, the size (m2) of the site, enclosed parts of structures, locations of underground storage tanks, structures on top of former manufacturing locations, and contamination problems that may be visible to the naked eye.
(ii) Time constraints: Protestations of urgency cannot override the need to allow time for an EDD investigation as a precautionary measure in closing a deal, particularly if prior use of the property suggests potential contamination.

79 Falk *et al.* 2008 http://www.media.mofo.com.
80 Whetzel *et al.* 2013 http://www.rlf.com.

(iii) Cost constraints: comprehensive environmental reviews can be expensive, particularly if extensive physical and laboratory tests are done under the goad of urgency. Significant cost savings can be realised by splitting the costs in a phased investigation.

(iv) Concerns of the current owner: contractual provisions concerning EDD investigations should take account of the need to obviate disruptions of existing operations at a property and/or what will happen where a potential buyer or lender discovers a problem and reports it to the government authorities and/or aggravates conditions at the site in the course of testing activities.[81]

The lender or buyer should identify potential sources of environmental risks early in the EDD process.[82] Although new sources of environmental risks may be discovered as EDD investigation continues, a basic understanding of a property's risks is important at the onset to help determine the scope of EDD investigation required.

Environmental risks can arise from various sources, such as:

(a) current and past uses of the property;

(b) known contamination on and around the property;

(c) non-compliance with applicable laws and regulations.[83]

The lender should also consider the form of the transaction. There may be different environmental liabilities if the acquisition is in free title as opposed to a lease or mortgage.

Often the suspected but unknown environmental issues present the greatest challenge for lawyers and the contracting parties. For example, a long history of industrial use

81 Falk *et al.* 2008 http://www.media.mofo.com.
82 Anon Date Unknown http://www.kbcat.com.
83 Whetzel *et al.* 2013 http://www.rlf.com.

accompanied by frequent changes of ownership is bound to take an environmental toll that should be investigated. The consultant's finding in Phase I may be characterised as "potential" or "historic", in which case the buyer may want to conduct soil and groundwater testing to determine whether there is substance in the finding; however the seller may be concerned that intrusive testing may increase his/her liability, which implies that the lawyers handling the case should resolve such issues in a manner that preserves each party's limited liability for unknown issues.

Beyond drafting contractual terms to allocate environmental liability, the parties may choose to explore environmental insurance policies to cover worst-case scenarios and facilitate the resolution of environmental liabilities.[84] Insurance brokers can offer a number of competing quotes, each with its own terms, conditions and exclusions. The insurer will base the coverage decision on the same EDD materials used by the deal team to assess environmental documents. Where buyers and sellers are confronted with an impasse over potential or known environmental contamination the former may push aggressively for a steep price cut or even seek to carve out the suspect parcel altogether. Environmental insurance can help eliminate the "worst case" scenario and monetise the risk at substantially lower than "worst case" levels. The challenge for environmental and real estate lawyers is to arrive at a mutually accepted risk allocation to cover known and unknown environmental issues, while preserving and protecting the limited liability of each entity.

3.4 Management and allocation of risks

Parties negotiating real estate agreements can settle their risk apportionment among themselves by employing the following methods (which may not be admissible in all jurisdictions)-

84 Gosdin 2007 *Title Insurance A Comprehensive Overview*.

3.4.1 Indemnity/ Guarantee

Buyers naturally want to be protected against contingent after-sale environmental liabilities, and sellers are naturally unwilling to give such a blank cheque, hence both parties tend to use indemnification either in a separate contract or as a clause in an existing contract to allocate environmental liabilities and risks,[85] essentially in that

one party promises to save the other from loss caused to him/her by the conduct of the promisor himself, or by the conduct of another.[86] Indemnification may subsist in existing statutory provision or as an express agreement to that effect.[87]

The concepts of indemnity and guarantee tend to be used interchangeably in light of considerable overlap in their meaning. Where property contracts are concerned a guarantee is a contractual provision that contingently requires the guarantor (or seller) to make payments to the guaranteed party (or buyer) if and when specified events or conditions (eg. environmental liability) realise.[88]

Conditions of indemnity must preclude misconstrual of the allocation of liability. In *Schiavone v. Pearce*, Honourable Leonard B. Sand of the United States District Court for the Southern District of New York[89] found that the specific language in an indemnification agreement did not transfer the seller's direct liability under CERCLA for contamination found at a plant operated in Connecticut by its wholly owned subsidiary. In 1964 Union Camp Corp. sold its subsidiary, American Creosoting Company (AMCRE Corp.) to Kerr-McGee, and Union Camp agreed to indemnify AMCRE and Kerr-McGee against certain claims and suits filed against them before 01 August 1965.[90] The indemnification agreement read as follows:

> "Union Camp hereby indemnifies and agrees to hold [AMCRE Corp.] harmless from and against any and all of the following:

85 Roger 2005 *Financial Reporting of Environmental Liabilities and Risks after Sarbanes-Oxley.*
86 Mathur 1974 *Business Law*.
87 Mathur 1974 *Business Law*.
88 Roger 2005 *Financial Reporting of Environmental Liabilities and Risks after Sarbanes-Oxley.*
89 79 F.3d 248 (2d Cir. 1996).
90 79 F.3d 248 (2d Cir. 1996).

Any obligation or liability of [AMCRE Corp.] under or pursuant to any legal action or other proceedings, now or hereafter instituted, based on a cause of action arising out of or attributable to the operations or activities of [AMCRE Corp.] prior to the time of closing hereunder; and Union does further indemnify and agree to hold Kerr-McGee harmless from any and all loss or expense, of whatsoever nature, which Kerr-McGee may sustain or incur by reason of any such liability or obligation".[91]

Several years later Kerr-McGee was sued for clean-up costs at the Connecticut plant, with the result that Kerr-McGee sued Union Camp, who argued that under the indemnification agreement of 1964 its liabilities relating to the plant were transferred to Kerr-McGee with effect from 1st August 1965. The court found that the indemnity agreement included only AMCRE Corp's liability, and not that arising from Union Camp's own culpable conduct, as opposed to its status as owner of AMCRE Corp.[92]

3.4.2 Insurance

Since parties who own or operate facilities, as well as the persons involved when the property concerned changed hands, as well as those who arranged for the transportation or disposal of any hazardous substances at the site, as well as persons who transported hazardous substances to the site are obliged under CERCLA to indemnify or insure each other against any environmental liability.[93] As noted, the same can be said in the South African context about NEMA, NWA and NEMWA as these instruments impose liability on a number of people associated with property, and one way of enabling companies or individuals to finance remediation is to utilise environmental insurance to cover and facilitate resolution of liabilities arising from contamination, such coverage to be specific to certain issues. If limiting measures are

91 79 F.3d 248 (2d Cir. 1996).
92 79 F.3d 248 (2d Cir. 1996).
93 Section 107 CERCLA.

not provided as pollution exclusion clauses insurance companies will probably be liable for response costs incurred under CERCLA in the context of general liability policy.[94]

Traditionally insurance companies in South Africa only cover environmental liabilities that result from sudden accidental pollution as opposed to gradual pollution that occurs with the passage of years.[95] Insurance cover in such instances can be very expensive because the risks, and therefore the remediation costs, are unpredictable. Far-reaching provisions of NEMA, NWA and NEMWA have imposed more liabilities against which insurers may wish to provide cover.

3.4.3 Remediation options

To allocate liability for contamination discovered in the course of an EDD investigation buyers and sellers usually enter into a remediation contract under which restorative measures are allocated to the parties as contractual obligations. Here too the terms of contract must leave no room for error so that parties are exactly apprised of their respective obligations.

An apt illustration in this regard is provided by *Sumimoto Machinery Corp. of America v. Allied-Signal, Inc*.[96], which hinged on an environmental issue arising from the transaction whereby *Sumitomo* acquired property from *Allied*. The parties' respective responsibilities were stated in an environmental agreement which incorporated a clean-up plan approved by the New Jersey Department of Environmental Protection (NJDEP).[97] NJDEP tightened the radioactive remediation requirements imposed on the property in 1994, effectively giving Sumitomo the choice of either executing a Declaration of Environmental Restrictions and Grant of Easement, or of remediating to a higher standard than originally approved.[98] The substance of the dispute over which *Sumimoto and Allied* went to court hinged on the appropriate remediation level for the

94 Knebel 2011 *Fordham Environmental Law Review.*
95 Schoeman 2007 http://www.guardrisk.co.za.
96 81 F.3d 328 (1996).
97 81 F.3d 328 (1996).
98 81 F.3d 328 (1996).

property because the parties' settlement agreement lacked clarity about the clean-up standards required[99] in that it failed to specify exactly which of the various clean-up options available under New Jersey's Industrial Site Recovery Act should be adopted.[100] *Sumimoto* considered a stringent residential standard necessary while *Allied* held out for a less stringent standard and the imposition of a deed restriction.[101]

3.4.4 Other options

The following is a consideration of other means of allocating liability for environmental pollution in compliance with statutory or common law. CERCLA states, for instance, that all or part of "responsible costs" incurred in the process of remediation where contamination with "hazardous substances" has occurred may be recovered from the party who owned the property at the time when the release of 'hazardous substances' took place, including the seller.

3.5 Conclusion

Purchase agreements are critical events in the history of properties since activities on or around them can cause contamination with the passage of time that remains undocumented and undiscovered, with the result that obligations to deal with the liabilities arising from such contingencies have to be addressed when the properties change hands, thus assigning a pivotal role to the contracting parties to whom remediation has to be allocated.. The existence and extent of environmental issues affecting the relevant property have to be ascertained within the framework of the change of ownership by conducting an EDD investigation.

It should be clear from the above that under CERCLA buyers of fixed property may be liable in virtue of the purchase contract for clean-up operations occasioned by

99 81 F.3d 328 (1996).
100 81 F.3d 328 (1996).
101 81 F.3d 328 (1996).

contamination that predated the purchase. However, such liability can be circumvented by taking advantage of the *bona fide* prospective purchaser defence. In *PCS Nitrogen Incorporates* the court found that "in order to be deemed a *bona fide* prospective purchaser pursuant to CERCLA, a property owner must be able to demonstrate that pollution on the acquired property occurred before the new owner acquired it. Furthermore, in *City of Wichita* the court held that "the *bona fide* purchaser defence also permits a person with actual knowledge to purchase a contaminated facility without becoming liable under CERCLA".

As noted, the crux of the matter for parties contracting a change of property ownership is to settle on a risk allocation that will take care of environmental contingencies while limiting the liability incurred by the parties toward each other.

Penalties exacted for contamination may be in proportion to the nature and severity of the contamination but may be daunting obstacles in the way of acquiring property for individuals as well as small and medium enterprises; hence due caution is advisable for such parties.

Finally, as noted, property agreements must take cognisance of practical constraints affecting the transaction concerned and must specify how such constraints will be dealt with. Costs are a significant constraint, particularly where EDD investigations are concerned, hence parties should settle the apportionment of costs to best advantage among themselves.

4. EDD in the South African legal context

4.1. Introduction

The exposure of parties to claims arising from environmental issues is a crucial matter that needs to be addressed in commercial property transactions in South Africa. As indicated in previous chapters, EDD investigations are not required by law in South Africa, yet many international companies investing in South Africa, as well as local companies, do conduct EDD investigations to protect themselves[102], first of all by saving costs and avoiding environmental liabilities[103], and secondly by making sure that their acquisition and future development of the relevant property or facility will be premised on the outcome of the EDD investigation.[104]

EDD investigations are common in transactions relating to asset and share sales in South Africa[105] because contamination issues are brought out in the open by such means and prospective property purchasers can therefore include condign environmental warranties and indemnities in their transactions. Bearing in mind that EDD investigations are not compulsory, the legal instruments used in South Africa to deal with contamination issues will be surveyed in this chapter.

4.2 Environmental legislative framework in South Africa

As noted, the fact that contamination occurred before the act of purchase does not exempt the new owner from liability for pollution caused by a previous owner. The

102 Bethlehem and Goldblatt (eds) *The Bottom Line: Industry and the Environment in South Africa* 27.
103 See chapters 2 and 3 above.
104 Corrigan Date Unknown http://www.kleinfelder.com.
105 Gillman *Due Diligence: A Strategic and Financial Approach.*

principal motivation for EDD investigations is the question of liability allocation in property transactions.

NEMA, NWA and NEMWA empower the authorities to determine whether land is contaminated, and if so, to issue directives to the responsible person to clean up the land.

4.2.1 National Environmental Management Act

NEMA contains a general "duty of care" environmental clause that reads as follows:

> "Every person who causes, has caused or may cause significant pollution or degradation of the environment must take reasonable measures to prevent such pollution or degradation from occurring, continuing or recurring, or in so far as such harm to the environment is authorised by law or cannot reasonably be avoided or stopped, to minimise and rectify such pollution or degradation of the environment".[106]

NEMA imposes liability for the costs of cleaning up contaminated land on any person:

(a) who can be causally linked to the pollution.

(b) who is the owner of the land or premises.

(c) who is in control of the land or premises.

(d) who has a right to use the land or premises.[107]

Unlike the US ('superfund'), there are no statutory limits on liability for contaminated land in South Africa.[108] According to NEMA an owner or occupier of contaminated land can be called upon to clean it up even if it was not contaminated by the said owner's

106 Section 28, NEMA.
107 Section 28, NEMA.
108 Gillman *Due Diligence: A Strategic and Financial Approach* 116.

actions.[109] Previous owners or occupiers are not exempt as they may be called upon to make good on contamination emanating from their past actions in virtue of the polluter-pay principle. As noted earlier, the best proposition in the circumstances would be for the parties to negotiate contractual conditions that are calculated to limit their liability, or to insure against environmental damage.

The penalties for non-compliance depend on the nature and severity of contamination. In general, a Schedule 3 offence under NEMA attracts a criminal charge and renders the offender liable to a civil lawsuit for recovery of damages.[110]

As noted in chapter 2, EIA as a precautionary measure taken before a project is started is equally valuable as an environmental management tool where activities envisaged in connection with a particular project are likely to have a significant impact on the environment.. EIA and EDD investigations have different objectives but do intersect.[111] For example, information obtained during an EIA process may be useful when conducting an EDD process. In South Africa EIAs are required in terms of section 24 of NEMA for activities that are likely to result in a significant environmental impact, whereas EDDs are voluntary.

4.2.2 National Environmental Management: Waste Act

As indicated below, a part of NEMWA came into effect on 2 May 2014, while the main body of the Act came into effect on 1 July 2009. This Act provides comprehensive and integrated waste management legislation for all the phases of disposal. The relevant provisions are contained in

109 Section 28, NEMA.
110 Section 34, NEMA.
111 Petts (ed) *Handbook of Environmental Impacts Assessment: Volume 2: Impacts and Limitations* 99.

(i) section 18, which extends the person's duties relating to the product to include a financial or physical responsibility adhering to the post-consumer stage;

(ii) part 8 of NEMWA, which came into effect on 2 May 2014 and regulates retrospective handling of contamination (see below);

(iii) Chapter 5, which regulates issuance of licences for waste management activities

According to NEMWA (part 8 promulgated 2 May 2014) significantly contaminated land, as well as the act of significant contamination by human agency, must be reported to the Minister of Environmental Affairs and the MEC for the environment with the least delay on discovery. Failure to comply with this injunction is a criminal offence.[112]

A general duty of care to the effect that owners and occupiers of land are required to take reasonable measures to remediate significantly polluted land and water resources has existed since the late nineties in terms of NEMA, NEMWA and the Water Act. More recently, regulations under the *National Building Regulations and Building Standards Act* 103 1977 have empowered local authorities to request for geotechnical investigations into potential contamination and to restrict building on contaminated land. Unfortunately, however, there was no uniform approach to assessing the risks posed by contamination, determining the status of contaminated land or setting standards to which the land should be remediated.

The legal regime (ie. remediation of contaminated land) was changed by a notice published by the Minister of Environmental Affairs on 11 April 2014 and then promulgated as part of NEMWA on 2 May 2014.[113]

112 Proc R26 in GG 37547 11 April 2014.
113 Proc R26 in GG 37547 11 April 2014.

4.2.2.1 NEMWA (Part 8 of Chapter 4)

This much-anticipated promulgation introduced a new legal regime to identify contaminated land, determine its status and the attendant risks, and regulate the remediation process. The new legislation imposed significant legal obligations on landowners and persons causing contamination, proclaiming potentially serious financial consequences, including an obligation to pay the costs of remediation and compliance with conditions imposed by authorities as prerequisites for a change of ownership. Some prominent features of the new regime include its retrospective operation and the power of the Minister of Environmental Affairs or the provincial MEC to restrict the transfer of land as well as its future use;[114] furthermore a new duty to report significant contamination and formal offences relating to non-compliance in terms of the said Part 8.[115]

4.2.2.2 Defining "contaminated land"

The NEMWA definition is wide: For the purposes of Part 8 'contaminated' indicates:

> "the presence in or under any land, site, building or structure of a substance or micro-organism above the concentration that is normally present in or under that land, which directly or indirectly affects or may affect the quality of soil or the environment adversely."[116]

Part 8 is applicable to contaminated land even if the contamination originated from a source other than the land itself[117] and was not discovered for some time after its occurrence and was changed by human intervention (eg. excavation for development).

114 Section 35, NEMWA.
115 Kvalsvig 2014 *FootPrint Limited*.
116 Section 1, NEMWA.
117 Section 35, NEMWA.

If contamination can only pose a risk to human health or the environment under circumscribed conditions and the consequent risk does not amount to undue cause for concern, the land where the conditions causing the said relatively inconsequential risk may nevertheless be classified as contaminated.[118]

4.2.2.3 Obligation of the owner or person who causes significant contamination

As noted, the owner of land that is significantly contaminated, or a person who causes significant contamination of that land, is deemed under an obligation to notify the relevant Minister and MEC as soon as possible on becoming aware of said contamination.[119] This obligation is rather broadly phrased, however, and raises a number of questions that must be addressed with due reference to the individual circumstances of each case. For example, is there a duty to investigate where contamination of land is believed to exist for cogent reasons but the owner is ignorant of such existence or reasons for believing that contamination exists?[120] And further: What procedures should be followed if a decision is made to investigate after all, and what standards will be applied to determine whether land is "significantly" contaminated?

The Minister or MEC responsible for the environment may designate land as an "investigation area" where "high-risk activities" are likely to result in contamination; moreover if the said functionaries have reasonable grounds to believe that the land in question is contaminated the owner of the land or the person responsible for the high-risk activity can be instructed to undertake a site assessment at his or her own cost within a certain period to determine whether the land is in fact contaminated.[121]

118 Section 36(6), NEMWA.
119 Section 36(5), NEMWA.
120 Section 36, NEMWA.
121 Section 37, NEMWA.

The notice promulgating Part 8 was accompanied by the Minister's publication of *Norms and Standards for the Remediation of Contaminated Land and Soil Quality*.[122] Remediation in this instance includes screening to determine whether and to what extent the land in question is contaminated.[123]

The purpose of the norms and standards is to:

(i) provide a uniform national approach to determining the contamination status of an investigation;

(ii) limit uncertainties about the most appropriate criteria and method to apply in assessing contaminated land; and

(iii) provide minimum standards for assessing necessary environmental protection measures for remediation.[124]

The norms and standards list certain contaminants and specify "soil screening values" for human health and for environmental protection in respect of those contaminants. Values relating to sites that are in formally zoned residential areas are different from those applying in informal settlements.[125] A "contaminant" is defined as a substance that is present in an environmental medium at concentrations in excess of natural background concentrations that have the potential to cause harm to human health or the environment.[126] The soil screening values must not be seen as absolute minimum values or default remediation values. If a contaminant is found that does not appear in the tables, then values which are "scientifically validated" for the contaminants in question must be used for screening. If the Minister decides in light of the site assessment report that the land is contaminated, he or she may decide:

122 Gen Not 467 in GG 36447 of 10 May 2013.
123 Gen Not 467 in GG 36447 of 10 May 2013.
124 Gen Not 467 in GG 36447 of 10 May 2013.
125 Gen Not 467 in GG 36447 of 10 May 2013.
126 Gen Not 467 in GG 36447 of 10 May 2013.

(i) that the land must be remediated immediately;

(ii)that the land must be remediated within a certain period; or

(iii)that the contamination does not pose an immediate risk but requires measures to monitor and manage the risk.[127]

In the first two cases the Minister must designate the land a remediation site and issue a remediation order. If there is no immediate risk the Minister may order that measures be implemented at his discretion, whereupon it will be incumbent on the recipient to carry out such order at his or her own cost. A remediation order may also impose restrictions on future use of the land in question.[128]

Land that has been declared contaminated may not be sold unless the prospective purchaser is informed in advance of the contaminated status; moreover the Minister must be informed of the prospective sale and may impose conditions on it.[129] Failing to notify the Minister or comply with conditions imposed by that functionary is deemed an offence.[130]

4.2.2.4 Remediation in progress

Before Part 8 came into effect a person who wished (or was directed by the authorities) to remediate contaminated land had to apply for a waste management licence and then comply with its conditions.[131] That is no longer the case. Since 2 May 2014, if a licence applied for before that date was not received by that date it was considered withdrawn and the applicant had to comply with the norms and standards instead.[132] However, a person who was implementing the terms of a directive or compliance notice, or the

127 Gen Not 467 in GG 36447 of 10 May 2013.
128 Gen Not 467 in GG 36447 of 10 May 2013.
129 Gen Not 467 in GG 36447 of 10 May 2013.
130 Gen Not 467 in GG 36447 of 10 May 2013.
131 Section 39, NEMWA.
132 Section 39, NEMWA.

terms of a waste management licence, on 2 May 2014 would have been expected to complete the remediation exercise begun according to the relevant directive, notice or licence before 2 May 2014.[133]

4.2.2.5 Implications of Part 8 of NEMWA

The regulation contained in Part 8 has important implications for the sale of land. Failure to disclose contamination of land is a criminal offence if the prospective seller proceeds with the intended transaction despite being aware of the contamination. A person who buys contaminated land without ascertaining its environmental status beforehand also potentially acquires the obligation to pay for a site assessment to be done in accordance with NEMWA, as well as the obligation to pay for remediation of the land.[134] Besides the ordered remediation the future use of the land may be restricted, for example in that residential development may not be allowed on land with a history of severe long-term contamination.[135] The stricture to obtain the Minister's consent to transfer contaminated land and comply with his or her conditions may also cause considerable delays in some transactions.[136]

Purchasers, in particular, should consider steps to protect themselves, for instance by ascertaining the nature and extent of contamination, if any, and its influence on the value of the land in question; requiring suitable warranties; determining the extent and allocation of liability for remediation costs resulting from the contamination; and determining whether restrictions have been imposed on future use of the land.

133 Section 39, NEMWA.
134 Section 40, NEMWA.
135 Section 40, NEMWA.
136 Section 40, NEMWA.

4.2.3 National Water Act

Finally there is the NWA which is aimed at ensuring that water resources are protected, used, developed, conserved, managed and controlled in a sustainable manner for the benefit of everyone in South Africa. The relevant stipulation (s. 19(1)) for present purposes reads as follows:

> "An owner of land, a person in control of land, or a person who occupies or uses the land on which-
>
> (a) any activity or process is or was performed or undertaken; or
>
> (b) any other situation exists, which causes, has caused or is likely to cause pollution of water resources, must take all reasonable measures to prevent any such pollution from occurring, continuing or recurring."[137]

The above provision is pivotal for the allocation of liability for costs arising from water pollution, which is a prime consideration in reaching a decision about buying a property. As in other instances, the value of EDD investigation in determining whether the activity on the property has polluted the water there is inestimable as a means of determining the allocation of liability for pollution costs, a determination that implicates current and previous owners as well as current and prior lessees.

4.3 Conclusion

This chapter provided a survey of the application of three legal instruments that deal with contamination issues, bearing in mind that EDD investigation is not enforcible in South Africa. A significant conclusion suggested by the survey is that albeit not compulsory in South Africa it could greatly assist buyers and sellers of property in

137 Section 19(1), NEMA.

assessing environmental risks and allocating remediation liability accordingly when crafting property transactions.

The legal provisions of the surveyed instruments catering for environmental issues in South Africa are largely similar to those offered by CERCLA. For instance, as in local (SA) legislative provision, neither current nor previous owners nor occupiers of property are exempt from liability for contamination under CERCLA in the US.

Part 8 of Chapter 4 of NEMWA became a game changer on 2 May 2014 in that it imposed an obligation on land owners to report contamination of their land on pain of facing criminal charges for non-compliance.

Finally, the takeaway message from the discussion overall is that an EDD process is an indispensable aid for buyers and sellers alike to apprise themselves of environmental risks attaching to the properties concerned so that, armed with the resultant information, they can be sure that contamination issues will not crop up after the fact that might have precluded the relevant property transactions in the first place.

5 Summary, conclusion and recommendations

5.1 Summary

The main aim of the study was to examine the role of EDD investigation in transactions involving industrial property or real estate. In chapter 1 a survey was mapped out for the study in this regard.

Chapter 2 began with an overview of EDD development, with particular reference to EDD in an international context and in foreign jurisprudence. The *bona fide* prospective purchaser defence used in the US, the role of EDD in drafting property agreements, the effect of EDD investigations on agreements relating to industrial property and real

estate, and the place of EDD in the South African legal context were also covered. These topics were fragmented into subtopics to ensure detailed coverage. For instance, the legal implications were examined of how EDD investigations affect application of the environmental regulatory framework of South Africa as embodied in NEMA, NEMWA and the National Water Act (NWA)[138]. Finally recommendations were offered with regard to the allocation of liability to parties who contract property agreements.

5.2 Conclusion

Environmental claims arising from pollution to property can have a significant if not dramatic impact on property transactions, and lessees too are not exempt from such claims, even if no contamination or even a risk of contamination of the leased property emanated from their conduct on the property.[139]

As noted in the body of the present dissertation, EDD is a particularly significant aspect of law that is developing in South Africa, especially in the area of environmental risk management. As noted, prospective property buyers and sellers can avoid heavy losses that might be incurred after the envisaged property transaction (eg. loss of property value, liability for remediation costs) by taking the precautionary measure of an EDD investigation before the sale or lease is concluded[140] in order to ascertain the contamination status of the property in question and thus gain the opportunity to explore and negotiate various options to either mitigate or allocate the risk that might

138 See paragraphs 4.2.1 – 4.2.3 above.
139 See chapters 3 and 4 above.
140 See paragraph 3.3 above.

attend any contamination that comes to light, and to contend with the management and remediation of environmental problems that might arise at a future date as a corollary of owning or leasing the property in question. For instance, if a project is envisaged for the property EIA will be required by law in addition to the EDD investigation, mainly to identify activities that pose an environmental threat.[141]

In order to avoid unnecessary disputes after conclusion of the agreement the parties must ensure that its provisions are carefully drafted to eliminate ambiguity. *Schiavone v. Pearce*[142] and *Sumimoto Machinery Corp. of America v. Allied-Signal Inc*.[143] are cases that demonstrate the costly consequences of avoidable contractual ambiguity (ie. unclear formulation).

Finally, the parties are at liberty to include indemnities or guarantees, insurances, or other remediation options, or other mechanisms that they might contrive, when negotiating management and allocation of risks, and if the parties cannot agree at all in the end, then either or both can simply withdraw from the transaction.

141 See paragraph 2.2 and 4.2.1 above.
142 79 F.3d 248 (2d Cir. 1996). Rather cross-reference to where you discussed these cases.
143 81 F.3d 328 (1996).

5.3 Recommendation

There can be no doubt that EDD investigation is a prime necessity for parties engaged in buying, selling, renting or managing properties since environmental issues attaching to properties involved in purchase or lease agreements are prevalent and could lead to the imposition of costly liabilities on the transacting parties (eg. loss of property value and , thereby incurring the risk of a loss of property value and remediation costs).

In the US especially in commercial or industrial setting, from time to time a buyer's purchase offer is subject to EDD including the right to inspect the property and perform environmental testing this has a potential of being a seller's nightmare. While doing their tests, the buyer's consultants encounter or release hazardous materials. The buyer then backs out of the deal and fails to pay it consultants. The seller is concerned about its environmental liability and whether it might be at a risk to a mechanic's lien in favour of the consultants. Some of the seller's worries have now been eliminated by either courts' interpretation of legislation or legislation itself. Washington courts have recently ruled the buyer's consultant in this scenario would have no mechanic's lien right under state law. The consultants have a contractual claim against the buyer, but no recourse against either the seller or its property. For years, prudent sellers have had buyers enter a separate contract if the buyer intended to do on-site testing. The contract bound the buyer to pay its consultants, keep the property free from lien claims, indemnify the seller for environmental and other claims arising from the work performed by the buyer's consultants, and provide insurance benefiting the seller.

Washington seller can now relax somewhat knowing their properties are not at risk for mechanic's lien in favour of the buyer's consultants. However, wise seller should still insist upon a contract that indemnifies and insures them with respect to environmental hazards and other liabilities which might expose sellers to claims as a consequence of a buyer's action**.**

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