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Deals in the Era of SRRA

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The phrase "buyer beware" has become a well-known mantra for purchasers of commercial or industrial property in New Jersey with known or potential environmental contamination. With the recent adoption of the Site Remediation Reform Act, P.L. 2009, c.60, which requires remediation activities to be overseen by private environmental contractors acting in a neutral capacity as quasi-agents of the state, and which adopts changes in existing law that will automatically trigger liability upon a responsible party's knowledge of contamination, that mantra might soon be re-phrased as "buyer and seller beware."

In either case, contracting parties must proceed with greater caution than ever in how they interact with consultants anointed as "Licensed Site Remediation Professionals," as well as each other, lest they find themselves saddled with unexpected liabilities for remedial costs over which they will have less control than before.

Designed to break a backlog of some 20,000 sites currently being remediated under the oversight of the New Jersey Department of Environmental Protection, SRRA provides for the transfer of site remediation oversight responsibility for most sites to specially licensed private environmental consultants, termed LSRPs under the law. The NJDEP is directed under the law to establish an LSRP program that will license and audit consultants who will perform site remediation projects without NJDEP oversight.

Once the remediation is complete, instead of obtaining a No Further Action letter from the NJDEP, the party performing the remediation will obtain a Response Action Outcome containing a certification by the LSRPP that the remediation was performed in compliance with applicable statutory and regulatory requirements.

In setting out the architecture for the LSRP program, SRRA also makes a number of important revisions to New Jersey's existing environmental law regime that, together with the LSRP concept itself, create what some have called a new world order in how contaminated sites will be remediated. These changes may be expected to have profound effects on how contracts involving contaminated or potentially contaminated property in New Jersey allocate risk between buyers and sellers.

While the full ramifications of the new LSRP program will not be fully known until the final details of the program are put into place with the NJDEP's adoption of implementing regulations over the next 18 months, several immediate impacts can be identified from the overall thrust of the program as set forth in SRRA.

In general, SRRA defines the role of the LSRP and directs the NJDEP to adopt regulations establishing minimum qualifications, licensing procedures and a code of conduct. The law also creates a Site Remediation Professional Board to adopt education, experience and training standards for environmental consultants applying for LSRP program licenses. Because it will take time for the NJDEP to develop and implement this program, the law provides for a temporary 18-month licensing program.

Even while the new LSRP regulations are being developed, a number of issues of concern for buyers and sellers of contaminated or potentially contaminated property are already evident from SRRA's broad language. These include:

• **RAO vs. NFA:** At the conclusion of remedial activities for a given site, the LSRP in charge of the site will issue the RAO certifying that the site has been remediated in accordance with applicable regulatory requirements. The RAO will be subject to audit and potential reversal for up to three years after it is issued. After three years, the NJDEP can reopen the RAO for any of the same reasons that it can currently reopen an NFA.

Reopeners of NFAs have been a relatively rare occurrence in the past, so it may be reasonably expected that more RAOs will be reopened than NFAs--at least in the early years of the program.

In addition, while a covenant not to sue is deemed to arise by operation of law upon the issuance of an RAO, it can be revoked if any conditions stated in the RAO, including maintenance of institutional controls, are not satisfied, as well as, presumably, if the RAO itself is reversed.

One of the chief questions presented by the use of RAOs in place of NFAs is whether they will be viewed sufficiently final in all cases by parties in real estate transactions. While the term "response action outcome" was borrowed from the Massachusetts Licensed Site Professional program in hopes that it would be familiar to real estate markets, and especially the lending community, it is not unlikely that these transacting parties will be concerned about the intrinsic value of an RAO as measured by the NJDEP's rate of RAO reversal, rather than merely by the similarity of their name to their counterparts issued under the Massachusetts LSP program.

At least until a track record is established, it is likely that RAOs will be viewed more skeptically than NFAs by all parties concerned, especially lenders still reeling from record losses in residential mortgages.

Given the uncertainties associated with an RAO's finality as compared with an NFA, purchasers and lenders should incorporate specific protections into their deal documents aimed at addressing the potential risks associated with an RAO being reversed and/or a CNS being revoked. Specific contractual protections also should be incorporated into the LSRP retaining agreement to address the risk that the NJDEP will overturn an RAO due to an LSRP's failure to comply with applicable regulatory requirements pertaining to the remediation of the site. In some cases, it also may be possible to bridge the gap associated with the relative uncertainty of RAO finality through contractual or third-party risk transfer mechanisms, like insurance.

• **The Cost of LSRP Independence:** Another concern associated with the adoption of the LSRP program is the extent to which it may chill investment opportunities in brownfields redevelopment projects in New Jersey, to the extent that it results in significantly higher costs for remediation projects. One common complaint is that LSRPs will tend to prefer more conservative remedial approaches in order to avoid the risk of incurring penalties or the loss of his or her license if the NJDEP determines that the remediation was not properly performed.

In addition, in view of the LSRP's role as an independent decision maker, parties who retain LSRPs to perform site remediation will find themselves deprived of a technical advocate to push for a less costly remedial approach than what the LSRP may prefer.

On the other hand, LSRP oversight might prove to be more cost-effective than the current NJDEP-oversight model in some cases. One potential cost-saving effect is that LSRP oversight will significantly reduce the amount of time for completing the investigation and remediation of contaminated sites, which will reduce the number of contract mobilizations at remediation sites to complete investigation work.

Second, additional changes being implemented under SRRA will provide for greater regulatory flexibility in the selecting approaches that can be taken to perform site investigation and remediation tasks. NJDEP officials responsible for implementing the program have said that LSRPs will have the latitude to depart from the highly prescriptive NJDEP Technical Requirements for Site Remediation, N.J.A.C. 7:26E, provided that the variance is justified because the NJDEP requirement does not fit the particular situation and the alternative approach is well-supported by established procedures employed by other federal or state environmental agencies.

Third, experience in other states that use similar programs, like Massachusetts and Connecticut, has shown that licensed site professionals are frequently more willing to employ less-expensive innovative remediation or site investigation technologies and methods than what state agencies may be willing to accept.

• **Mandatory Timeframes:** Another component of the LSRP program that will be important for parties of real estate transactions to address in their contractual arrangements involves the use of mandatory timeframes for key remedial milestones. While experience with similar programs in other states (like Massachusetts) that have been successful in eliminating huge case backlogs create cause for optimism, the new regulatory regime adopted under SRRA contains the added impetus of mandatory timeframes for achieving remediation goals--including the slightly draconian threat of being placed into an expensive, punitive enforcement category if a single regulatory deadline is missed.

It is unclear whether, or to what extent, the NJDEP will be willing to relax deadlines under appropriate circumstances to account for site-specific issues that may require more time to resolve. If not, many fear that any lack of flexibility by the NJDEP will put parties responsible for particularly complicated sites automatically at greater risk of being placed into the punitive category.

Unless and until this uncertainty is removed through the adoption of regulation or through NJDEP practice over time, the risk of missing a mandatory timeframe will be front and center in negotiations between buyers and sellers, lenders and borrowers and ultimately remediating parties and LSRPs.

Possible approaches for addressing the foregoing issues of concern may be summarized as follows:

• **LSRP Retaining Agreement:** If a seller or purchaser retains an LSRP, it is important to include a number of key provisions in the retaining agreement that will govern the parties' interactions until the project is complete. These include appropriate terms and conditions normally included in any consultant retaining agreement as to such matters as: (1) the scope of the contract; (2) the method of payment (fixed fee for specified tasks vs. billed at a time and materials basis); (3) any timelines that the consultant will be required to meet; (4) client authorizations prior to spending large sums of money; (5) minimum insurance coverages; and (6) confidentiality to protect the purchaser in the possibility of future litigation.

Retaining agreements with LSRPs also should include provisions specifically aimed at ensuring that any risks associated with the LSRP's new role are minimized to the greatest extent possible. For example, parties who are in the position of having to rely on the certainty of RAOs, such as purchasers, landlords and lenders, will be wise to demand extra contractual protection to offset the risk of RAO reversals--at least during the three-year audit review period.

While the environmental consulting community will no doubt resist changes in existing model forms of retaining agreements that are designed to ensure against the risk of a reopener due to the LSRP's failure to achieve the desired level of cleanup as determined by the NJDEP in hindsight during an audit, there is no reason why any LSRP should be unwilling to negotiate an appropriate level of contractual protection to cover the risk of RAO reversal. It is also possible that insurance carriers will offer coverage that are specifically designed to cover this risk.

LSRP retaining agreements also should contain appropriate contractual protections that will make the LSRP solely responsible for any incremental costs arising from the LSRP's failure to achieve mandatory timeframes adopted under SRRA. In addition, parties retaining LSRPs may want to consider including a provision in the retaining agreement that would automatically deem certain work tasks or reports approved if the retaining party has not responded within a certain timeframe, together with language requiring advance draft copies of reports and work plans to be provided with sufficient lead time for the client to review. Such a provision would ensure that the work proceeds in an uninterrupted fashion at all times and places the full risk of missed mandatory timeframes on the LSRP.

In some cases, especially at larger sites where the stakes are higher because the risk of significant delays to construction and development schedules could lead to cascading economic losses, it may be appropriate for remediating parties to retain consultants to monitor the LSRP's activities and advise the retaining party if it appears that the LSRP may be second-guessed by the NJDEP or if closer monitoring of the LSRP's work is desired.

In such a case, the remediating party may need to bring pressure to bear on the LSRP to undertake a different remedial approach that is less likely to result in an NJDEP reversal. The remediating party also should have the right in its retention agreement to terminate the LSRP under such circumstances. Since there is no prohibition in SRRA against terminating an LSRP for lack of diligence or malfeasance, this type of provision should not run afoul of the anti-retaliatory provisions in SRRA.

• **Purchase and Sale Contracts:** Given the sweeping scope of changes to the regulatory landscape wrought under SRRA, contracting parties such as sellers, purchasers and lenders would be wise to incorporate appropriate contractual protections aimed at addressing any additional areas of liability and/or business risk that may arise as a result of new requirements adopted under SRRA. Qualified environmental counsel should be engaged in order to negotiate these provisions.

In addition to modifying contractual provisions that currently premise cleanup obligations on the NJDEP's issuance of an NFA, the potential risk associated with an RAO being reversed by the NJDEP should be clearly allocated as between buyer and seller. If the purchaser and seller cannot fully agree as to such allocations, third-party risk transfer mechanisms such as guaranteed remediation cost contracts and finite risk and cost-cap insurance, may be considered.

It would also be prudent for contracting parties seeking to enforce contractual cleanup obligations to require the selection of the LSRP to be mutually acceptable to all parties. This will reduce the risk that the LSRP selected will not have any pre-existing allegiances to one side or the other, and will serve to enhance the LSRP's independence from the seller or purchaser.

Sellers also should require that in conducting any pre-closing environmental due diligence, the purchaser shall employ only environmental consulting firms that do not have an LSRP on staff. Under SRRA, LSRPs have an independent obligation to report any environmental conditions that rise to the level of an immediate environmental concern," i.e., a condition that presents a risk of imminent harm. Sellers now face the risk that if the purchaser's due diligence is handled through an LSRP, the LSRP will immediately report certain environmental conditions it discovers at the seller's property to the NJDEP.

In addition, because SRRA contains a new affirmative obligation for property owners to remediate any contamination that is above applicable cleanup criteria, any such report by an LSRP will effectively trigger an immediately enforceable cleanup obligation for the seller.

Moreover, if the contamination at issue is of such magnitude that it causes the purchaser to back out of the deal, the seller will find itself both without a deal and with a cleanup obligation it did not have before.

The sweeping scope of SRRA's changes have created in many ways a new paradigm that will alter the way in which parties in transactions involving contaminated or potentially contaminated property in New Jersey allocate risks of environmental liability in their private contractual arrangements.

While the details of this ground-breaking legislation continue to be formulated through NJDEP rulemaking, parties involved in such transactions should carefully consider the ramifications that the new regime will have in triggering liability for site cleanups, and the cost and timing of such cleanups, so that they can ensure that these risks are properly accounted for in their contracts.

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