Arkansas Oil Marketers Association Environmental Workshop

Identifying and Addressing Environmental Issues in Petroleum Marketing Agreements

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I. Introduction

The Arkansas petroleum marketing industry utilizes a number of types of facilities. Depending upon the petroleum jobber or marketer, such facilities might include:

- Bulk oil plants
- Retail convenience stores
- Fixed Base Operations ("FBOs")
- Service stations
- Lube oil facilities
- Card/Key lock operations
- Terminals
- Carwashes

One or more environmental issues may have to be addressed at such facilities. They can range from complying with underground storage tank ("UST") leak prevention/detection regulations at a convenience store to obtaining a water discharge permit for a car wash. Additional responsibilities may involve investigating or remediating historical or current petroleum contamination in some circumstances.

Addressing these issues may become more complex if the facility is the subject of a commercial transaction. Difficulties may arise in allocating responsibilities between the parties

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and/or ensuring the responsible party fulfills the allocated responsibility. The issues may arise in many types of petroleum marketing agreements whether they involve supplying motor fuel or the purchase, sale, lease, etc. of a facility.

A common scenario in the petroleum marketing industry involves leasing of retail and other facilities. For example, a typical Arkansas petroleum marketer or jobber may own the real property and improvements on which one or more of its operations are located. However, jobbers will sometimes acquire needed properties or facilities by leasing them from another entity or company. Of course, it is also common for jobbers to forego operation of some of the facilities in their portfolio of properties. Instead, they may lease the facility to another company or entity who wishes to operate them. Finally, sometimes sale-leaseback is an alternative to typical debt financing for petroleum marketing facilities (providing deductibility of lease payments).

Regardless of whether a jobber owns a facility that is being leased to another company or it has acquired the ability to use someone else's property, a key component in these arrangements is the lease. An important lease issue is the allocation of environmental regulatory and liability responsibilities. This is accomplished in the document's terms and conditions. The lease memorializes the terms, conditions and responsibilities of the party supplying the facility ("lessor") and the one acquiring the rights to use it for a period of time ("lessee").

The significant value of a typical retail motor fuel or other petroleum marketing facility magnifies the importance of the lease. No prudent jobber fails to clearly document important provisions in a lease such as the term of the occupancy and amount of rental (including how it is calculated). The failure to do so risks a misunderstanding of the projected costs (in the case of the lessee) or revenues (in the case of the lessor) associated with a particular facility. However,

by way of example, failing to allocate UST regulatory requirements (inspection, fees, registration, upgrade, etc.) between the lessor and lessee can be equally important. This issue can obviously pose a significant financial risk for the lessee or lessor if not addressed.

Other environmental examples involving a leasing scenario might include:

- Lessee did not recognize the lease requires it to maintain all property improvements such as upgrading USTs, etc. resulting in unexpected costs in operating the retail motor fuel outlet.
- FBO/lessee storing/supplying fuels at an airport with multiple tenants is among a number of operators that is the subject of a governmental request to address historical contamination the source of which is unclear.
- The lessor allocated the responsibility for Arkansas Petroleum Storage Tank Trust Fund fees for the leasehold's underground storage tanks to the lessee but failed to ensure payments were timely made negating eligibility for coverage of a significant leak.

A cautious petroleum marketer or jobber will ensure that such issues are clearly addressed and responsibilities explicitly allocated in all written agreements. By way of example, they may also need to be addressed in other agreements such as:

- Terminaling Agreements
- Motor Fuel Supply Agreements
- Sub-Jobber Contracts
- Purchase/Sale of Retail/Bulk Plants/Other Facilities

Note, however, simply identifying an obligation/condition has risks. It is important that the language in such agreements adequately describes each term or condition relating to an environmental issue.

The purpose of this presentation is to briefly identify terms or conditions relating to environmental matters when negotiating various types of agreements involving petroleum marketing facilities. A number of terms, conditions or issues relevant to some or all agreements involving petroleum marketing facilities are discussed in this paper. The list is not exhaustive.

A jobber's perspective on an identified condition or term will, of course, depend on whether he or she is a buyer, seller, lessor, lessee, etc. Further, the ability of one party or the other to dictate certain terms or conditions will be driven to a great extent by which party has greater leverage. Nevertheless, it is still important prior to entering into an agreement to identify/quantify what terms/conditions are included so that the jobber can plan for the associated financial responsibilities.

The measures a jobber undertakes to address an environmental issue in a transactional context will therefore depend on:

- Type of transaction (lease, buy/sell/financing, asset v. stock, etc.)
- Party represented (buyer, seller, lessor, lessee, secured creditor, investor, etc.)
- Type and materiality of the environmental issue in the context of the transaction
- Relative leverage of the party
- Tools reasonably (cost-effective?) available to allocate responsibility and/or quantify issue

Environmental issues are of course not the only material issue in a petroleum marketing transaction. The viability of any transaction is dependent upon the resolution of a variety of operational, tax, financial and/or other legal issues. Nevertheless, they can sometimes be as important in some transactions and should therefore be considered.

II. Key Petroleum Marketing Facility Contractual/Environmental Issues

A. Leases

1. Parties

a. Who are the parties to the agreement?

The agreement should clearly specify the parties that are to be bound by its terms. This will include the relevant business entity (i.e., limited liability company, corporation ["LLC"], partnership, etc.) and/or individuals. The question of whether a guaranty should be obtained

from an additional entity or individual must also be addressed. This is particularly important if the jobber is relying on the other party to incur significant costs to address environmental regulatory responsibilities. Also, are all the jobber's entities covered by an indemnity obtained from the other party?

b. Is the party a viable entity?

Has or should the jobber ensure that the entity executing the agreement has the financial or operational capability to address the responsibilities (financial and otherwise) for which it has assumed responsibility. Many businesses use multiple corporations or LLC's to segregate their liability. Some of these entities will have minimal assets. An environmental indemnity is obviously worthless if the entity providing it has no financial ability to support it. Again, if there is a concern about financial viability, a jobber might seek additional security or a guaranty by an affiliated entity or individual.

2. Property/Facility

a. Property Description

The property or facility that is the subject of the agreement must be clearly identified. This is particularly important in a scenario where there may be historical environmental contamination at a facility being leased. The lessee would have a strong incentive to ensure it is only leasing the portion of the property that is uncontaminated.

b. Facility/Equipment/Fixtures

(i.) Access

For example, does a lease clearly delineate which (if any) equipment (tanks, pumps, etc.) or parts of the facility to which the lessee does or does not have access? This will be particularly important for terminals, FBOs or other facilities utilized by multiple parties.

(ii.) Installation/Modification

(1.) Does the lessee have the right to install fixtures, equipment (gasoline dispensing equipment, tanks, etc.) and/or make alterations to the facility?

(2.) Does the lease determine ownership of installed fixtures/equipment? This is clearly important in the event of a leak or spill in terms of responsibility or liability.

(iii.) Environmental Maintenance/Compliance Responsibilities

Should environmental compliance responsibilities/equipment be specifically identified such as:

(1.) Operation of oil/water Separator

(2.) UST

- Closure
- Release reporting
- Leak detection/prevention
- Trust fund

(3.) AST SPCC requirements

(4.) Wastewater/stormwater discharge requirements

(5.) Bulk plant general air permits

3. Term of the Agreement

a. Extensions/Holding Over (Lease)

What if a lease's term expires and a petroleum spill or release or pending closure of a UST impedes the subsequent rental of the facility (i.e., these events/conditions cannot be accomplished by the end of the lease terms)? Should these possibilities be addressed and deemed "Hold Over?" A lessee may argue that they are not holding over if not physically present. If so, should the rent obligation continue even though they no longer occupy the facility? Should that scenario (i.e., referencing contamination that impairs use of the property, materially affects the value, closure, etc.) be described as holding over (i.e., closure or no further action must be obtained) and then sample language might read:

> By holding over by lessee after the expiration or sooner termination of this lease shall be treated as a daily tenancy at sufferance at a rate equal to 1.5 times the rent and other charges herein provided. (pro-rated on a daily basis).

4. Use of Premises

a. Does the lease prohibit activities that lessee will or may undertake in the future?

The petroleum marketing industry is constantly innovating and evolving. What if the jobber wishes to add natural gas dispensing or electric charging stations to a leased facility? If there is some possibility of lessee/jobber desiring to engage in such activities, problematic language should be identified and eliminated prior to entering into the lease.

b. Should the lease prohibit certain activities or uses that could damage the property or subject the lessor to liabilities (i.e., long term storage of hazardous waste, waste tires, etc.)? Does a lessor need a restriction on the types of fuels that can be placed in the facility's tanks?

5. Storage Tanks

a. The importance of storage tank issues.

UST requirements are some of the most costly and complex issues associated with petroleum marketing facilities. Similar concerns may be applicable to above ground storage tanks ("ASTs"). The various UST and AST regulatory responsibilities should be allocated between the parties to a lease.

The lessor should recognize that allocating liability related to these regulatory requirements to the lessee does not protect it from liability to the government (if it is the owner of the UST or AST). The regulations usually impose responsibility on both the owner (lessor) and operator (lessee).

Because the lessor and lessee may both be liable for violations as owners or operators, lessors often have an incentive to ensure that lessees expediently address UST releases on the leased premises. An important reason for providing incentives to the lessee for strict compliance/responding to a UST release is maintaining eligibility with the Arkansas Petroleum Storage Tank Trust Fund ("Trust Fund").

b. Arkansas Petroleum Storage Tank Trust Fund

A careful Arkansas jobber should consider the Trust Fund eligibility issue in structuring a lease. Obviously, a key provision in the lease is language requiring compliance with all applicable federal and Arkansas environmental statutes and regulations. Some retail facility leases go further and specify various UST or AST related requirements

to ensure that the lessee is more specifically informed as to the regulatory requirements that have to be addressed. While this is an important provision, it is critical that the jobber recognize that such lease provisions do not by themselves ensure that a Trust Fund ineligibility scenario will not occur.

Consider a scenario in which a lessee violates the regulatory compliance provision in the lease by failing to report a suspected release in a timely manner to the Arkansas Department of Environmental Quality ("ADEQ"). The lessor would certainly have some type of contractual claim against the lessee. However, the fact that the lease contractually required the lessee to report would be irrelevant to ADEQ's review as to whether the UST release is Trust Fund eligible. Therefore, it is critical for Arkansas lessors to not simply rely on a contractual provision that very well may be violated by the lessee.

c. Lease Language

In terms of lease language, what other provisions might be added and/or considered to attempt to address tank issues? Lessors sometimes include provisions in the lease requiring that the lessee provide the lessor copies or access to leak detection records on a periodic basis. In other words, the lessee may provide monitoring well measurements, etc. to the jobber on a specified schedule. This might provide the jobber/lessor the ability to ensure that leak detection is being undertaken as required by the regulations and that there does not appear to be any data or indication of a suspected release which may need to be reported.

Another basic provision that should be included in the lease is a requirement that the lessee immediately give notification to the lessor of ADEQ inspections, correspondence, reports, demands, etc. along with copies of any associated documents, reports, etc. Correspondence or oral reports from the lessee to ADEQ or other government agencies should also be provided to the jobber/lessor.

Language is sometimes added to the lease that is intended to incentivize the lessee to strictly comply with the rules (including reporting). This might be done by a provision that makes the lessor responsible for the Trust Fund deductible and any required investigation/remediation if the lessee maintains compliant leak detection and fulfills any required reporting. In such a scenario, the lessee would presumably be less hesitant to fulfill these responsibilities or ignore a suspected release. Some jobbers/lessors

even contractually assume certain repair/leak detection responsibilities to ensure compliance.

d. Indemnity

None of this discussion is intended to discount the continued importance of requirements that the lessee indemnify the lessor in appropriate circumstances (i.e., non-compliance with environmental regulations, etc.). The lessee should insist that an indemnity provision exempt it from responsibility for liability/damages related to lessor's action. Even better, the lessee will obtain a reciprocal indemnity from the lessor.

e. Inspections

Other provisions, such as right to inspect the facility, including relevant leak detection documents, is a key need. In addition, the lease should clearly identify and delineate the various UST regulatory obligations (including registration/payment of fees) and allocate them between the parties. Further, in some instances the lessor may find it prudent to ensure on a regular basis it verifies UST/AST registration/payment and/or undertake these tasks.

f. Due Diligence.

A lessee or lessor of a property with USTs or ASTs may consider doing some due diligence prior to execution of lease. The lessor may do so to ensure lessee cannot argue there were leasehold environmental issues prior to execution of the lease. Similarly, the lessee may want to ensure the absence of issues prior to entering the premises. The investigation would include an examination as to whether the tanks are Trust Fund eligible.

g. Allocation of Costs/Expenses

It is in the best interest of both the lessor and lessee to identify and quantify to the extent possible relevant costs and expenses associated with the facility. The lease should allocate responsibility for such costs and expenses between the lessor and lessee. This is particularly true in the case of environmental regulatory requirements. These may include:

(i.) UST/AST Fees

(ii.) Repairs/maintenance

(iii.) Insurance

(iv.) Sampling/leak protection

If costs are being passed through to lessee are there any caps on increases?

h. Right of Entry/Inspection

The lessor may want to include a provision in the lease allowing inspection of the facility to ensure the lessee is meeting his or her obligations under the lease. The lessee should ensure this right is exercised in a reasonable manner.

i. Warranties/Representations

The lease will typically require the lessor and lessee to agree to undertake certain tasks, not engage in specified activities or provide representations regarding the facility. Examples might include:

j. Compliance with laws (tank, wastewater permits, etc.)

(i.) Maintenance/repairs

(ii.) Insurance

(iii.) Prohibit waste, contamination, etc.

(iv.) Condition of facility (from lessor's viewpoint)

Lessee may be well advised to recognize that without explicit warranties he or she may be leasing the facility on an "as is" basis. Therefore, some inspection of the facility and its equipment is advisable prior to finalizing a transaction.

k. Surrender of Premises

Language may be included that requires that lessee leave the facility in the same condition it was in at the initiation of the lease. The prudent lessee would ask for a qualification that the obligation excepts "normal wear and tear".

l. Termination/Non-Renewal Provisions

The lease should include grounds or reasons the lease can be terminated. The notice or other procedural requirements that must be followed should be outlined. However, it is also important that non-compliance with environmental requirements be a potential grounds for termination or non-renewal.

(i.) Petroleum Marketing Practices Act

The Petroleum Marketing Practices Act ("PMPA") prohibits a branded refiner/oil jobber from terminating or failing to renew a lease/motor fuel supply contract with a retailer without complying with notice provisions and unless termination/non-renewal is based on certain statutory grounds. These grounds are identified in the statute. These PMPA grounds for termination/non-renewal should be included in agreements with covered branded retailers. Further, the PMPA notice provisions should be followed in undertaking termination/non-renewal.

(ii.) Grounds

The grounds for termination should be identified. Should they clearly include environmental issues such as noncompliance, payment of registration fees, etc.?

m. Insurance?

(i.) Types?

(ii.) Amounts?

(iii.) Documentation?

(iv.) Waiver of subrogation?

B. Supply Agreements

1. Regulatory Compliance (with or without provision of storage tanks, pumps, etc.)

a. Dealer, consignee, commission agent, sub-jobber, etc. must comply with all governmental statutes, regulations, etc. (UST, AST, fuels/additives regulations, etc.)

b. Require notification of governmental investigations/inspections, alleged violations, correspondence, product/petroleum releases

c. Authorization to inspect equipment, facilities, leak detection records, etc.

d. Non-compliance with governmental requirements as a basis for termination

2. Indemnification

Even if tanks, equipment, etc. are not supplied various scenarios could arise where jobber faces lawsuits or actions arising out of operation of supplied facility.

- Example might include retailer UST leak migrating to adjoining property. Lawsuit attempts to include jobber supplier arguing negligence in transferring fuel to leaking USTs

C. Facility/Purchase Sale Agreements

1. UST Issues

a. Purchaser environmental assessment/due diligence

(i.) trust fund eligibility determination

(ii.) identification of pre-closing contamination

(iii.) determination of regulatory compliance

(iv.) agency "no further action" determinations

Potential issues can arise when an environmental obligation is dependent on a no further action letter authored by a governmental environmental agency. Consider the following example.

The Minnesota Court of Appeals addressed contingency language in the sale of a fuel-oil business in the case of *Hager's of Cohasset, Inc. v. Charles F. Nelson, et al.* The Seller agreed, in the purchase document, that the sale was contingent on:

> Hager giving Nelson a letter from the Minnesota Pollutoin Control Agency ("MPCA") stating the land is free from any future cleanup.

A disagreement arose subsequent as to the adequacy of the document from MPCA relied on by the Seller. The Seller argued that the language in the purchase document concerning the Buyer's requirements were ambiguous because "neither respondents nor appellants knew what type of letter would satisfy such a condition".

The Court disagreed stating that the only document obtained from MPCA was issued in conjunction with the previous removal of two underground storage tanks. The Court agreed that the condition precedent language was not ambiguous and the condition had not been fulfilled.

(v.) Warranty/indemnity

(vi.) Contamination action level issues

A colleague in another Little Rock law firm discussed with me an issue he was addressing in a facility purchase. Specifically, his client was in the process of buying a facility that included underground storage tanks to determine if there had been a release. The seller of the facility had agreed, at its expense to perform a UST closure (i.e., remove the tanks and sample) in compliance with the applicable federal and Arkansas regulations. Such closure would entail sampling adjacent or around the USTs. In the event the samples were below action numbers specified by ADEQ for certain constituents, then the closure would likely be deemed approved by the agency.

It is entirely possible that the samples obtained would of course be above zero. The question we discussed was whether such non-background results should still be considered some type of material issue despite the fact the ADEQ deemed the closure complete and this particular aspect of the facility in compliance with the applicable federal and Arkansas regulations?

We both agreed that the answer depends upon whether such results might now or in the future materially affect the value of the property, impact future uses, the client's appetite for risk, and the potential for movement (particular across property lines) of such contamination. In other words, we both agreed that despite the agency approving the closure, the client should at least still be apprised of the possibility of some effect on property value, etc. in the event the numbers were somewhat above background.

(vii.) Identifying equipment/fixtures being purchased

Some purchase agreements (particularly when buying "businesses") have broad language stating the buyer is purchasing all (i.e., a general reference) property, fixtures, equipment, etc. associated with a particular business. It is critical to ensure that all equipment or properties encompassed by such language are identified and any environmental liabilities assessed. Jobberships being purchased may have supplied (leased, loaned, etc.) ASTs and USTs to businesses and farms in the area for years. Does the buyer understand what tanks are being purchased (intentionally or not) and whether these have any environmental problems? Should some be excluded or disclaimed?

b. Seller environmental liability reduction efforts

(i.) Limitations of "as is" clauses

(ii.) Documenting absence of historical (pre-closing) contamination

(iii.) Limiting warranty/indemnity

1. To knowledge of Seller
2. Time/amount limitation
3. Scope of coverage
4. Release of liability

c. Addressing orphan/unknown USTs

d. Properties on which USTs have been removed

(i.) Post 1989 – Closure report/sampling results

(ii.) Pre 1989

The current UST regulations of course require that tanks be assessed at the time of removal through sampling, etc. Because the USTs removed in the mid 1980s did not have to go through such closure requirements (in Arkansas like most states at the time) no sampling/closure records were available. Therefore, the potential buyer's dilemma was whether or not to undertake sampling of the area in which the USTs were formerly located.

Despite the fact that USTs have been previously been removed in compliance with pre-1989 state law, if contamination is present,

there would still be potential liability and/or responsibility (common law or otherwise) to address this contamination. Consequently, this scenario serves as a reminder that even if a property is being acquired that no longer has USTs, this issue should still be addressed in the appropriate circumstances because of the possibility of historical releases that may not have been identified.

e. Post-closing issues

The purchase or sale of a retail motor fuel outlet, bulk plant or other petroleum marketing facility sometimes involve the discovery or disclosure of a preexisting environmental condition. A common example is the presence of soil or groundwater contamination that may require delineation and/or remediation. Even if such issues are significant or material, the parties may choose to address them through purchase price adjustments, post-closing cleanup obligations, etc.

One scenario may involve the seller agreeing to investigate and/or remediate contamination subsequent to closing. Documenting this post-closing obligation will require the parties to address such issues as:

- At what point is the seller's obligation to remediate completed?
- Is there a timing requirement as to how quickly the seller must accomplish investigation and/or remediation?
- May the seller at its own discretion choose the investigative and/or remediation methods?

Purchase/sale documents sometimes contain language allocating how pre and post-closing environmental contamination or releases are addressed. This is particularly important when pre-closing soil or subsurface contamination is identified.

Often, the Seller agrees to remediate it. However, the contractual language may include an exception to the Seller's liability if there is "new contamination" discovered after closing attributable to Buyer's activities. If may be particularly problematic when a particular facility will continue the same type of activities that caused the prior environmental releases. A typical example is the transfer of a retail motor fuel outlet that utilizes petroleum underground storage tanks.

D. Environmental Consultant Issues

1. Limitation of liability clause

Environmental consulting agreements executed in Arkansas and elsewhere often contain limitation of liability clauses prepared by the environmental consultants. They provide that the consultant's liability for negligence, errors, etc., is limited to the fee for the work or a set amount. A compromise provision that is sometimes agreed to is to limit liability to the consultant's insurance coverage limits.

2. Reliance Issues

An issue of some importance in transactions that use consultants for assessments is which parties can rely on their work. For example, what if a facility purchaser having an assessment undertaken wishes its affiliated entities or lender to be able to rely on the conclusions? If so, it is imperative that this be documented in the service agreement and assessment itself.

3. Arkansas Storage Tank Trust Fund Issues

(a.) Does a consultant's responsibilities include preparing and submitting trust fund reimbursement?

(b.) Is the client or consultant responsible for reimbursement, for costs and expenses disallowed by ADEQ?

4. Should the agreement include a confidentiality provision?

E. Integration clause – Applicable to All Agreements

Disputes sometimes arise over what a particular condition or term in an agreement means. One of the parties may cite a prior agreement or claim a verbal commitment was made regarding a particular issue. This may lead to expensive legal disputes.

An "integration" clause is often included in an agreement to make certain that the final document constitutes the final agreement of the parties.

The integration clause makes it more difficult for one of the parties to cite prior representations, whether written or oral, to attempt to change the terms of the lease. An example of such a clause in the lease context might reads as follows:

Except as is otherwise provided herein, this lease constitutes the entire agreement among the parties with respect to the subject matter contained herein and supersedes all other agreements, letters, memoranda, or any other prior understanding of any type whatsoever, whether written or oral.