THE COST OF IGNORANCE: Closing the Deal

Sherri Zendri[*]

INTRODUCTION

The alphabet soup of federal and state statutes and rules regulating the purchase and sale of property can quickly become overwhelming. Nevertheless, parties to commercial and residential real estate transactions ignore such laws at their own peril: failure to comply with these regulations, whether intentional or not, can impose serious costs on all parties involved.

This Article focuses on some practical approaches to due diligence inquiries and allocations of potential liabilities, and includes only brief comments on some of the legal liabilities regarding environmental disclosure requirements in real property transactions. The main take-away from this article is that the Arizona Department of Environmental Quality ("ADEQ") is the key environmental regulatory agency in Arizona with a mission to protect the environment. As such, the Agency is a great resource for information and cooperative ideas to ensure the deal will close.

I. A PRACTICAL APPROACH TO RISK

Environmental considerations and risk allocation strategies play major roles in most property transactions, and certainly all commercial transactions. Unlike other real estate risks, environmental issues associated with a business or property cannot always be identified prior to closing; indeed, in some cases, such issues remain undiscovered even after parties invest significant sums in environmental due diligence.[1] The potential economic impact of environmental problems and risks goes far beyond the

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1. Charles P. Efflandt, *When the Tail Wags the Dog: Environmental Considerations and Strategies in Business Acquisitions, Sales, and Merger Transactions*, 39 WASHBURN L.J. 28, 28–29 (1999).

mere possibility of losing some portion of the benefit of the bargain:[2] some environmental laws impose upon business owners strict, retroactive and joint and several liability to the government for a wide range of environmental problems. Where such laws are implicated, the economic stakes may be much higher if due diligence is ignored or mishandled.[3]

In practical terms, due diligence and full disclosure should involve more than just a review of documents and a walk-through of a facility or property. At a minimum, would-be buyers or their agents should engage in thorough fact-finding with the state's environmental regulatory agency. In Arizona, that agency is the Arizona Department of Environmental Quality ("ADEQ").[4]

ADEQ's mission is to protect and enhance the public health and environment of Arizona, which it achieves by carrying out several core functions related to air quality, water quality and waste programs.[5] These core functions include pollution control, compliance management, monitoring and assessment, environmental cleanups, policy development, education and outreach, and financial assistance.[6] But ADEQ is more than just a regulatory agency charged with protection of the environment and enforcement of Arizona's environmental rules and statutes. In addition to issuing permits and inspecting facilities, the agency provides compliance assistance to help responsible parties obtain the "environmental holy grail" of a "No Further Action" letter.[7]

The Department maintains a vast repository of public records for facilities that are subject to ADEQ regulation, with well over 100,000 files[8] estimated to contain up to 60 million pieces of paper relating to suspected and confirmed spills, permit documentation, compliance records, analytical data and more. Currently all of this documentation is available in paper format. Additionally, much of the compliance documentation and most permits and permit correspondence documents are also available in electronic format. Given the breadth of information available from ADEQ,

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2. *Id.*
3. *Id.*
4 *About Us*, ARIZ. DEP'T OF ENVTL. QUALITY, http://www.azdeq.gov/function/about/index.html (last visited May 4, 2014).
5. ARIZ. REV. STAT. ANN. § 49-104 (2013).
6. *Core Functions*, ARIZ. DEP'T OF ENVTL. QUALITY, http://www.azdeq.gov/function/about/core.html (last visited May 12, 2014).
7. ARIZ. REV. STAT. ANN. § 49-181(F) (2013).
8. These are 2014 estimates based upon a recent data migration of 101,114 files. (May 2014).

records reviews for a potential property transfer can yield significant information and assist with important liability allocation decisions.

Regardless of what is written in the purchase contract, at some point one or both parties must take action to evaluate, mitigate, accept or transfer potential or actual liability. Like most areas of law, there is no end to the steps one could take to ensure such actions occur as smoothly as possible. The following, however, offers practical suggestions on how to achieve a smooth transition.

II. RESPONSIBILITIES IN PROPERTY TRANSACTIONS

A. Seller's Disclosure

A full discussion of the common law requirement for disclosure of known liabilities is beyond the scope of this article; however, a brief summary of the law of disclosure is helpful as a starting point. Under Arizona common law, sellers are generally required to disclose any known latent defects or problems with the property to be sold, including any environmental problems or adverse environmental conditions that exist on the property.[9] Sellers must also disclose any known environmental conditions.[10] Beyond the common law, Arizona imposes a specific statutory duty to disclose any soil remediation at a property to a potential purchaser.[11] It may not be necessary to disclose all federal, state, county or municipal permits and licenses or certificates to operate. However, these instruments pertain either to the property or to any operations conducted on the property and may be considered assets to the property if transferrable. In such cases, disclosure may increase the value of the transaction.

Concealing relevant information or misstating certain facts may lead the purchaser to bring an action for rescission or damages against the seller.[12]

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9. S Dev. Co. v. Pima Capital Mgmt. Co., 31 P.3d 123, 129 (Ariz. Ct. App. 2001) (Held that "a vendor *must* disclose *latent* defects in property that are known to the vendor, notwithstanding the existence of a burden-shifting "as is" clause or disclaimer of warranties.")

10. Alaface v. Nat'l Inv. Co., 892 P.2d 1375, 1384–85 (Ariz. Ct. App. 1994) (finding that sellers have a common law duty to disclose when such an act "amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing") (internal quotations omitted) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 161 (1981)).

11. ARIZ. REV. STAT. ANN. §§ 33-434.01 (duty to disclose soil remediation), 49-701.02 (duty to disclose prior storage of hazardous waste).

12. *See, e.g.*, *Alaface*, 892 P.2d at 1384–86 (explaining that the Arizona common law has imposed a duty to disclose when nondisclosure amounts to bad faith).

Moreover, attorneys who do not disclose their knowledge of fraudulent behavior may be violating the ethical obligations of their profession, despite the confidential setting in which they may have acquired the facts.[13]

B. Buyer Due Diligence

The primary purpose of any due diligence in real estate transactions is to facilitate an informed decision. For transactions with environmental considerations, due diligence can afford an equitable allocation of known or suspected environmental risks between the seller and purchaser in the present, as well any potential risks still unknown.

It may be in the interest of both parties to conduct a defined, cost-effective environmental investigation; however, it is the buyer's ultimate responsibility to assess the property in consideration. Phase I and Phase II Site Assessments for environmental due diligence are usually the first line of defense, regardless of the site or the circumstances of the particular transaction. A detailed Phase I Site Assessment is important to determine whether the negotiated price approximates the property's fair value, in light of any environmental conditions. However, if the property is known or suspected to be contaminated, or is located in an area of documented soil or groundwater contamination, the cost of a Phase I may sometimes be avoided as unnecessary.[14] In such situations, a carefully planned Phase II Environmental Site Assessment with a more intrusive investigation of the soil and/or groundwater quality may be more appropriate, and could even result in an overall lower environmental due diligence cost.[15] Any such findings from these assessments can be remedied contractually as a condition of closing the transaction, or an appropriate reduction of the purchase price.[16]

In addition to environmental liabilities, a due diligence inquiry should evaluate the property's compliance with environmental laws. The purchaser

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13. *In re* Kersting, 726 P.2d 587, 593 (Ariz. 1986) (suspending a lawyer because he knew about misrepresentation of sale prices of lots held as securities, but failed to disclose, meaning he was not protected by the attorney-client relationship).

14. A "Phase I" assessment involves record reviews and site evaluations of the surface only. If it is known that a soil or groundwater sampling at depth will be necessary, it may be cost-effective to simply skip the surface-only investigation and proceed directly with the subsurface investigation.

15. Eva M. Fromm et al., *Allocating Environmental Liabilities in Acquisitions*, 22 J. CORP. L. 429, 458 (1997) ("A prudent consulting firm may conduct a limited Phase II assessment at any site where significant industrial activity has taken place . . . .").

16. *See* Efflandt, *supra* note 1, at 48–51.

should not only require the seller to provide information such as: engineering studies, reports, memoranda, tests relating to spills, releases, or disposal of materials on, at, or underlying the property; but also reports or documents concerning the on-site existence of hazardous materials, documentation of any facility inspections, copies of any notices of non-compliance, and reports of any equipment or performance tests.[17] A buyer would be well-advised to augment this information with his or her own evaluation of the public files available on the property. Any previously known environmental issues or non-compliance would be available from ADEQ as a public record. This would include any records of compliance history, copies of any permits or agency approvals, and any data collected either as part of the permit application process or as part of compliance with its terms.[18]

While the primary purpose of an environmental site assessment is to evaluate a site for potential environmental contamination, the environmental compliance audit focuses on the whole of the business—site conditions, as well as operational compliance. Such audits focus on whether required permits have been obtained and whether the business' current and historic operations are otherwise in compliance with applicable regulations. In addition, the company's compliance with federal and state "record-keeping" laws and regulations is also important because of the significant statutory non-compliance penalties.[19] Arizona Revised Statutes section 49-1403 describes the protection afforded a party who has conducted an environmental audit in Arizona. While a prospective purchaser might not be able to demand that a seller provide copies of any existing audits, this law does not relieve a seller of the responsibility to disclose any known environmental issues to a prospective purchaser.[20]

17. In addition to permit requirements to test and maintain equipment, there are other programmatic requirements for equipment testing such as drinking water backflow devices, underground storage tank leak detection. Documentation submitted to ADEQ will be part of the public record and available as part of a public record request. However not all data is required to be submitted to the agency, but rather "available upon request;" therefore, purchasers should proactively ask for any information as part of deal negotiation.

18. *See* ARIZ. REV. STAT. ANN. § 41-151.18 (2013).

19. *See* Fromm et al., *supra* note 15, at 450 (citing 42 U.S.C. § 7413(c)–(d) (penalty statute under the Clean Air Act ("CAA"))).

20. *See supra* notes 9–11 and accompanying text.

C. Regulatory Disclosure

It should be noted that the information and data provided by environmental site assessments present both purchasers and sellers with disclosure considerations. The parties' full understanding of a facility's environmental condition is essential to achieving the objectives of environmental due diligence. Additionally, the property owner should disclose any information related to environmental problems at the property to ADEQ. The following information must be reported to ADEQ:

- Leaking underground storage tank release[21]
- Aquifer Protection Permit unauthorized discharge[22]
- Arizona Pollution Discharge Elimination System[23]
- Hazardous waste[24]

In extreme cases, even if the results of a purchaser-initiated site assessment are kept from the seller, but the deal is terminated because of those results, the seller is still confronted with having knowledge of potential environmental concerns that should be researched and/or potentially disclosed to ADEQ and future prospective buyers.[25] From a practical standpoint, both parties would be well advised to assume that the results may be subject to discovery or disclosure.[26]

Another area of inquiry relating to environmental liability is whether pollutants are migrating from the contaminated property to adjoining properties. ADEQ will not get involved in private causes of action between neighboring landowners for cleanups.[27] However, as discussed more fully below, ADEQ generally gives a higher priority to contamination resulting from a violation of an environmental law versus an accident, and/or contamination that has migrated offsite.

21. ARIZ. REV. STAT. ANN. § 49-1004(A) (2013).

22. ARIZ. ADMIN. CODE. § R18-9-A207 (2005).

23. ARIZ. REV. STAT. ANN. § 49-263.01(A)(2) (2013); *see also id.* § 49-255.01(E)(1)(c) (establishing an affirmative defense).

24. ARIZ. ADMIN. CODE. §§ R18-8-262, -265 (2008).

25. Efflandt, *supra* note 1, at 47.

26. *Id.*

27. ADEQ has authority under Arizona Revised Statutes section 49-287(E) to enforce remedial actions requirements; however due to the resources involved in any legal actions it is generally not in the best interest of the public for ADEQ to get involved in other private causes of action.

III. Environmental Compliance

Determining compliance with environmental laws is imperative for two reasons: (1) without the proper permits, a facility may not be able to continue operations after purchase, and (2) substantial penalties may accrue for ongoing violations of environmental laws after purchase.[28] Most operations that use chemicals or generate waste materials must have a permit or other authorization from one or more federal, state, or local agencies to handle, store, transport, treat, or dispose of such materials. Some activities may only require notification to, and/or authorization from, ADEQ to allow the facility to conduct the regulated activity. Other more significant activities will require a permit. As a general proposition, a facility will be required to obtain a permit to dispose of wastes or discharge pollutants into the environment (air, water, soil).[29] What follows is a summary of actions a purchaser or a seller may take to remediate an issue that may arise as part of a disclosure or due diligence inquiry.

A. Soil staining or a spill

If one is aware of soil staining or a potential spill, it should be reported to ADEQ immediately.[30] The obligation to investigate and remediate will fall upon the Responsible Party (RP), as defined in Arizona's contamination statute.[31] Generally, the RP will be the owner or operator of the property at the time of a hazardous material release.[32] Under Arizona law, a bona fide purchaser is not likely to be held responsible for a release prior to the acquisition of the property, provided he or she did not exacerbate the contamination.[33] However, it is imperative that both parties work

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28. For a complete list of penalty authorities, see ARIZ. DEP'T OF ENVTL. QUALITY, COMPLIANCE AND ENFORCEMENT HANDBOOK, app. M2 (2003), *available at* http://www.azdeq.gov/function/forms/download/ce_handbook.pdf.

29. *Permits: Do I Need a Permit*, ARIZ. DEP'T OF ENVTL. QUALITY, http://www.azdeq.gov/function/permits/doineed.html (last visited May 4, 2014).

30. ARIZ. REV. STAT. ANN. § 49-284 (2013).

31. *Id.* § 49-283 ("[A] person is deemed the party responsible for the release or threatened release of a hazardous substance if the person: (1) Owned or operated the facility [under certain conditions].").

32. *Id.* § 49-283(A)(1)(c). Other potentially responsible parties include owners or operators at the time the substance was placed on the facility or was located at the facility. *Id.* § 49-283(A)(1)(a), (b).

33. *Id.* § 49-283(B)(4) ("[A] person that owns real property is not a responsible party if there is a release or threatened release of a hazardous substance from a facility in or on the property unless . . . [he or she] took action which significantly contributed to the release after he

cooperatively with ADEQ and disclose the potential release as soon as possible. The longer contamination persists, the more expensive it can be to remediate.

If the seller is already engaged in the investigation or remediation of a known environmental condition, ADEQ will consider the remediation as the seller's responsibility until the remediation is "satisfactorily" completed, unless the agency receives documentation that the buyer will assume responsibility for completing the work after closing.[34] If a buyer does not assume responsibility, ADEQ will expect the parties to negotiate language providing the seller with reasonable post-closing access to the property so as not to impede cleanup and/or exacerbate any current contamination.[35] Ideally, both parties will agree that the remedial work will continue to be performed in a good and workman-like manner, in accordance with all applicable laws and regulations.[36]

Remediation of contamination can be extremely expensive and can easily threaten the success of a property deal. Arizona law requires owners and operators of contaminated property to remediate the contamination to levels appropriate with use of the property.[37] The Soil Remediation Rules under chapter 7, article 2 of title 18 of the Arizona Administrative Code outline the levels of soil remediation to which the responsible party will be expected to adhere, depending upon the current zoning of the property.[38] Neither the federal government nor Arizona law requires that contamination be cleaned up so that it is no longer detectable.[39]

Requirements for cleaning up soil and groundwater are based on levels that protect human health and the environment, as well as the expected use of the property. In order to provide levels of protection that are achievable across the state, the cleanup standards in the rule are necessarily based upon a number of conservative assumptions. Alternative cleanup standards that protect human health and environmental quality are calculated using site-specific information gathered during site characterization. The resultant site-specific standard may be a higher concentration than the statutory,

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knew or reasonably should have known that a hazardous substance was located in or on the facility.").

34. ARIZ. REV. STAT. ANN. § 49-285 (2013).
35. *Id.* § 49-253(B)(3).
36. Efflandt, *supra* note 1, at 51.
37. ARIZ. ADMIN. CODE. §§ R18-7-203, -204 (2007).
38. ARIZ. ADMIN. CODE §§ R18-7-201 to R18-7-210.
39. ARIZ. ADMIN. CODE § R18-7-203(B) (naming water quality standards, dangerous characteristics, and threats to ecology as the factors that determine whether more remediation is necessary).

predetermined standard, and it may cost less to attain. Additionally, property owners may request ADEQ approve specific restrictive covenants on a property to limit the use of the property and allow for closure, using non-residential cleanup standards.[40]

One such restrictive covenant, which allows the closure of a site with contamination above residential soil remediation levels, is the Declaration of Environmental Use Restriction (DEUR).[41] A DEUR is a recorded instrument that runs with and burdens the land to prohibit residential use of the property.[42] It allows ADEQ to take actions necessary to ensure that engineering or institutional controls are maintained throughout the life of the DEUR, which will remain in effect and be monitored by ADEQ until the property owner demonstrates that the area of the property subject to the DEUR has been remediated to meet the requirements of Arizona Revised Statutes sections 49-152(D) and 49-158(L). Pursuant to Arizona Administrative Code sections R18-7-605 and -606, property owners must pay a fee to cover ADEQ's administrative costs for processing the DEUR release or modification. This tool often allows properties to be closed safely in less time—and at less expense—than a full-scale cleanup, which in turn allows the property to be redeveloped, sold, or otherwise put to productive use earlier.

Another risk allocation tool for bona fide purchasers, the Prospective Purchaser Agreement (PPA), can also help buffer some liability concerns. Arizona law authorizes a PPA for remedial actions under chapter 2, article 5 of title 49.[43] If all conditions are met, ADEQ may enter into a PPA with a prospective buyer that provides a written release and covenant not to sue for potential Water Quality Assurance Revolving Fund (WQARF) liability, as well as for potential owner liability to the State under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) for the existing contamination at the property.[44] The release and covenant not to sue are not effective until the purchaser has performed all obligations under the PPA.[45] ADEQ may also agree to seek a court-approved consent decree that will provide contribution protection from claims under section 107 of

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40. ARIZ. REV. STAT. ANN. § 49-152(C) (2013).
41. *Id.*
42. *Id.* § 49-152(F).
43. *Id.* § 49-285.01.
44. *Id.*
45. *Id.* § (D).

CERCLA.[46] The decision to enter into a PPA is solely within ADEQ's discretion and is not an appealable agency action.[47]

For qualified facilities, ADEQ's Voluntary Remediation Program (VRP) can help property owners remediate their land.[48] Through the VRP, property owners, prospective purchasers, and other interested parties may investigate or clean up a contaminated site in cooperation with ADEQ.[49] VRP results in a streamlined process for program participants who work with a single point of contact at ADEQ to address applicable cross-program remediation efforts.[50] ADEQ reviews these voluntary remedial actions and can provide a closure document, the coveted "No Further Action" or "NFA" letter, for successful site remediation that is accepted by all relevant ADEQ programs. ADEQ can provide a NFA determination for a site, or a portion of a site, that can be clearly defined, as well as for soil, groundwater, or both.[51]

As ADEQ is a fee-funded agency, these assistive programs do come with a cost for application submittals and agency review.[52] However, since remedial cleanups generally become more expensive as contamination spreads over time, costs at this stage are often well worth the effort.

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46. *Id.* § (C)(5).
47 *Id.* § 49-298.
48. Anyone can participate in VRP except those conducting:

> a. Remedial activities subject to corrective action at or closure of a facility, as defined in Arizona Revised Statutes section 49-921(2), which has qualified for hazardous waste interim status, or to which a hazardous waste permit has been issued pursuant to Arizona Revised Statutes section 49-922;
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> b. Remedial activities pursuant to a written agreement between the applicant and the director;
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> c. Remedial activities subject to a judicial judgment or decree;
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> d. Remedial activities required by an administrative order issued by the director or a judicial action filed and served by the state prior to the submission of a VRP application;
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> e. Remedial activities at a site listed on, or proposed to be listed on, the WQARF Registry [*see* ARIZ. REV. STAT. ANN. § 49-287.01(D) (2013)];
>
> f. Corrective actions being taken pertaining to a regulated underground storage tank (UST) pursuant to Arizona Revised Statutes section 49-1005, unless a waiver of state assurance fund reimbursement is completed.

Id. § 49-172(B).

49. *Id.* § 49-174.
50. *Id.*
51. *Id.* § 49-287.01(G).
52. Fee rules for a Prospective Purchaser Agreement can be found at ARIZ. ADMIN. CODE § R18-7-301; fee rules for the Voluntary Remediation Program can be found at ARIZ. ADMIN. CODE § R18-7-501 to -507.

B. Permits and Permit Transfers

Most ADEQ-issued permits may be transferred to new property or facility owners. In cases where there are Financial Assurance (FA) requirements,[53] the new permittee will need to provide to ADEQ the appropriate revised FA mechanism and cost estimates.[54] Depending upon the financial situation of the parties, the new FA may differ. ADEQ will work closely with the permittee to update FA either prior to, or post transfer.[55]

If parties are unable to negotiate a permit transfer, or if no permit exists, the facility may be unable to operate until the permit has been acquired. Penalties may accrue at a rate of up to $25,000 per day, per violation, for each day the facility is out of compliance by operating either without a permit or with an incorrect permit.[56] Furthermore, a permit can take several months to obtain,[57] so a purchaser should exercise caution when acquiring a company that lacks a key permit, especially if that permit is material to its operations. Parties in doubt should contact ADEQ or the appropriate local county environmental health department to determine whether they may operate their facility while the permit application is pending.

If a facility does have appropriate permits in place, a purchaser should next consider the facility's compliance history. While it is unlikely that a new owner would be responsible for past non-compliant activities, if non-compliant equipment or conditions remain subsequent to the property transfer, the new owner could be held responsible if conditions are documented during the next compliance inspection.[58] ADEQ inspection documentation is available upon request through the agency's Records Management Center (RMC). Although inspection reports may not list all

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53. ARIZ. REV. STAT. ANN. §§ 49-770 (solid waste landfills); -1006 (USTs); -243 (aquifer protection permits); -922 (hazardous waste facilities).

54. ARIZ. REV. STAT. ANN. § 49-770 (solid waste landfills); ARIZ. ADMIN. CODE. §§ R18-12-301-310 (USTs); R18-9-A203243 (aquifer protection permits); R18-8-264 (M) (hazardous waste facilities).

55. ARIZ. REV. STAT. ANN. § 49-770 (solid waste landfills); ARIZ. ADMIN. CODE. §§ R18-12-301-310 (USTs); R18-9-A203243 (aquifer protection permits); R18-8-264 (M) (hazardous waste facilities).

56. *See* ARIZ. DEP'T OF ENVTL. QUALITY, *supra* note 28, at app. M2.

57. Average permit processing times as of December 31, 2013: Aquifer Protection Program Permits – 155 days; Air Major Sources (Title V) – 287 days. Data based upon internal ADEQ database and performance tracking measurements.

58. ADEQ inspection frequencies generally allow sufficient time for a new owner to correct deficiencies or negotiate with previous owners regarding deficiencies such that any conditions documented during the next inspection would likely be attributed to the new owner.

potential violations, they will document any conditions the inspector observed during the site visit or inspection.[59]

C. Violations

A review of any non-compliance notices and follow-up correspondence will provide documentation of what ADEQ has alleged as a violation and what was resolved.[60] ADEQ uses a "Notice of an Opportunity to Correct" (NOC) or a "Notice of Violation" (NOV) to informally enforce alleged violations.[61] An NOC puts a RP on notice that ADEQ believes a violation of an environmental law or statute has occurred, and provides the RP with an opportunity to resolve the alleged violations. Once the issue has been resolved, ADEQ issues a closure letter to the RP.[62] Similarly, an NOV also puts an RP on notice; however, an NOV documents more serious violations that pose greater environmental risks if left unaddressed. If an NOV is not corrected within the agency-specified timeframe, ADEQ will likely initiate formal enforcement such as an administrative or judicial order.[63] Parties would be well-advised to resolve any violations still outstanding at the time of sale, as this may limit complications in dealing with ADEQ after the sale. While ADEQ would likely not impose penalties on the new owner, the new owner may still be responsible for returning the facility to compliance.[64] However, it is also important to note that under common law, a seller cannot walk away from non-compliance liability simply by selling a facility.[65] Even if the new owner agrees to assume the cost of returning the facility to compliance, the former owner may be subject to civil penalties

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59. ARIZ. REV. STAT. ANN. § 41-1009(D) and (E) (2013).

60. The public file for a facility will include any inspection reports, deficiency notices, and documentation of deficiency resolution.

61. ARIZ. REV. STAT. ANN. § 41-1009(J) (2013).

62. *Id.* § 41-1009(I).

63. ARIZ. REV. STAT. ANN. §§ 49-461 (air quality generally); -354 (B) (drinking water); -334(A) (dry wells); -923(A) (hazardous wastes); -781 (solid and medical wastes); -1013(A) (USTs); -862 (special wastes); -142(A) (tires and lead acid batteries); -812(A) (used oil); -261 (water quality); and -287(E)(3) (water quality assurance revolving fund).

64. Arizona statutes define the responsible party of a facility slightly differently for various programs. The responsible party at the time of inspection will ultimately be the one responsible for proper operation of a facility, irrespective of the condition in which the facility was purchased.

65. S Dev. Co. v. Pima Capital Mgmt. Co., 31 P.3d 123, 129 (Ariz. Ct. App. 2001) (Arizona law "implies a covenant of good faith and fair dealing in every contract" so that "neither party will act to impair the right of the other to receive the benefits which flow from their agreement or contractual relationship." (quoting Rawlings v. Apodaca*,* 726 P.2d 565, 569 (Ariz. 1986))).

based upon the specific non-compliant conditions created and the particular program involved.[66]

D. Formal Versus Informal Enforcement

In addition to the informal enforcement tools mentioned above, ADEQ can "formally" enforce compliance for specific program violations through administrative orders or by seeking a judicial judgment or decree with the court.[67] ADEQ can provide a prospective buyer with copies of any formal enforcement documents through a request to the department's RMC. By contrast, unlike informal enforcement, a seller cannot terminate or walk away from an administrative or judicial order through the sale of a facility or property. Most orders do have successor liability language; however, to the extent that the purchaser has not contributed to a non-compliant condition, the purchaser's liability under Arizona law is limited.[68]

E. Once the Deal Closes

While seller disclosures and buyer due diligence are meant to spread the risk of potential environmental issues during property transactions between the buyer and seller in a sales contract, not all conditions can be ascertained prior to closing the deal. In the event that an issue is discovered, whether it is a contaminant release, a missing permit, or some other noncompliant condition, the first step toward mitigating the situation is to inform ADEQ. To minimize the potential cost of environmental compliance to a client, act quickly and early.

New owners who intend to force the previous owner to respond to the newly discovered issues should expect to cooperate fully with both the previous owner and ADEQ. While ADEQ will not get involved in a private action between a buyer and a seller, in order to ensure that human health and the environment are protected, ADEQ may consider all parties potentially liable for specific performance or monetary relief. New owners

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66. ARIZ. REV. STAT. ANN. §§ 49-462(3) (air quality generally); -354 (drinking water); -334(B) (dry wells); -923 (hazardous wastes); -783 and -768 (medical wastes); -783 (solid waste); -1013(A) (USTs); -861 (special wastes); -142(C) (tires and lead acid batteries); -812(A) (used oil); -261 (water quality); and -287 (water quality assurance revolving fund).

67. *See* ARIZ. DEP'T OF ENVTL. QUALITY, *supra* note 28, at app. M2.

68. ARIZ. REV. STAT. ANN. § 49-283(B) (2013).

who limit or impede a previous owner's ability to address an issue may find themselves on the wrong side of the negotiation table from ADEQ.[69]

In any agreement allocating responsibility for returning to compliance, whether remedial efforts or otherwise, key issues such as a clear understanding of what is a return to compliance, exactly what equipment must be repaired or permitted, and just how "clean" must the property be prior to closing the deal, should be resolved at the outset. Additional language should clearly indicate what verification or documentation from ADEQ regarding compliance will be expected. Purchasers may wish to assume responsibility for returning the property or facility to compliance if they believe they can perform the work better or faster, or if they want to have more control over the methods and the costs. As mentioned earlier, ADEQ will generally respect private contract agreements between current property owners and legal responsible parties as long as progress is being made toward a return to compliance.[70] Nevertheless, ADEQ is not bound by such private contractual allocations of responsibility and may impose potential liability on all parties.

Should litigation develop between former and current owners, ADEQ is unlikely to get involved as a litigant. Instead, ADEQ staff will most likely refer parties to the official file with respect to any questions on a compliance action or remedial project.[71] ADEQ records are available to litigants through a public records request, but ADEQ staff will not provide additional comments or opinions on the documents.[72]

Additionally, the purchaser should be concerned about off-site liabilities, and in the case of purchasing an existing business, corporate succession liability, as a successor corporation may be liable for not only the predecessor's on-site liabilities, but its off-site liabilities as well.[73]

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69. *Id.* § 49-283(B)(4). Liability may be imposed on a new owner who "took action which significantly contributed to the release after he knew or reasonably should have known that a hazardous substance was located in or on the facility."

70. ADEQ's Fiscal Year 2014–2018 Strategic Plan identified a 50% reduction in the time it takes facilities to return to compliance as a five year goal. To that end, ADEQ will not insert itself into a process and risk slowing progress towards compliance as long as there is no immediate risk to human health and the environment.

71. The public record is ADEQ's official opinion on an issue and staff is instructed to refer to the official documents whenever possible.

72. As a practical matter, ADEQ staff cannot act as third party "expert witnesses" and comment or opine on agency documents.

73. 42 U.S.C. § 9607 (2012); Fromm et al., *supra* note 15, at 431.

IV. ADEQ PRIORITIES

As stated earlier, ADEQ's mission is to protect and enhance public health and the environment of Arizona. To that end, it is important to ADEQ that facilities are in compliance. This should be important to property owners as well: facilities in compliance avoid enforcement actions altogether. Even so, the reality is that many properties will require some type of assistance to comply with all applicable environmental requirements. In these instances, ADEQ prefers that parties invest their resources in bringing the property or facility in line with regulations, not fighting about who bears responsibility for any noncompliance. ADEQ may compel cleanups for off-site and groundwater under aquifer protection statutes,[74] and if there is evidence to suggest an off-site contamination that poses a threat to human health or the environment, ADEQ will initiate an investigation under its remedial programs.[75] If there is no off-site or ground water contamination, ADEQ will likely not require the previous owner to clean up for the new owner.[76] It will be the current property owner's responsibility to comply with land use restrictions based upon the levels of any soil contamination that may be present.[77]

CONCLUSION

Allocation of environmental liabilities is an important area of focus in real estate transactions and corporate acquisitions. Significant environmental liabilities may be imposed upon an unsuspecting or unsophisticated purchaser who fails to make adequate inquiries. To avoid assuming undesired environmental liabilities, a purchaser must conduct appropriate due diligence. This may include conducting an environmental site assessment, reviewing agency and company files, and inquiring into other potential areas of liability, such as permit compliance.

The extent to which it is in the buyer's interest to undertake, or require the seller to perform, a detailed environmental site assessment depends, in part, upon its success in allocating unknown risks to the seller. It is also important to factor into the decision of which party will bear the responsibility to perform the assessment, whether the seller will continue to

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74. ARIZ. REV. STAT. ANN. § 49-203(B)(2) (2013).

75. *Id.* § 49-282.02.

76. Off-site and ground water contamination is generally higher risk to human health and the environment and as a general practice ADEQ is focusing scarce resources on issues with higher risk.

77. ARIZ. REV. STAT. ANN. § 49-152(B) (2013).

exist, and thus whether the seller's financial resources will be available to address problems discovered in the future. If the seller agrees to assume such risks and liabilities, and has sufficient financial resources to back up this agreement, a buyer may not require (or even want) an extensive environmental site assessment.[78] On the other hand, if the seller's continued existence is in doubt, such an assessment could provide peace of mind to the buyer. If the parties choose to have such an assessment performed, once the environmental liabilities have been identified, the purchase and sale agreement can be structured to reflect the allocation of environmental liabilities negotiated by the purchasers. However, parties should remember that ADEQ is not bound by these agreements.

If prospective buyers and sellers walk away with only one message from this article, it is this: work with ADEQ. The goal of the agency is not to punish but to protect.

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78. Efflandt, *supra* note 1, at 48–51.