SELLING "AS IS" IN A CONTAMINATED WORLD

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"Darling, I have always told you some version of the truth."
Jack Nicholson to Diane Keaton in *Something's Gotta Give (2003).*

Commercial or industrial property is generally sold today in a marketplace of sophisticated sellers and buyers. Businesses conducted at these properties are often highly regulated, through local ordinances, state regulation, and federal laws. These properties are the subject of detailed building codes and permits, public inspection, and possibly licensing, monitoring, and reporting. Even in this market the knowledge that sellers have about their property can vary tremendously. Sellers may have detailed knowledge of the operational history of their property during their ownership or if the facility has been recently constructed. As to older facilities, sellers may not have actual knowledge of prior uses and practices at the facility. Around the buying and selling of these properties, there is a well-developed industry of property inspectors, consultants, and engineers, which may be employed to inspect and investigate properties being purchased. This article reviews the evolving public policy and legal practice that courts, legislative bodies, and practitioners have employed to allocate the risk of remediation costs between sellers and buyers.

Caveat Emptor

Historically, sellers were protected against claims after sale from buyers who became disgruntled as to the condition of property they purchased by the common law doctrine of *caveat emptor* (buyer beware). This common law doctrine is supported by the public policy favoring freedom of contract. Over time, the harshness of this historical doctrine has been tempered by courts' and legislatures' adoption of consumer protection public policies: the recognition of the existence of common law torts of negligent misrepresentation and fraud in the inducement; the enactment of statutory prohibitions of fraud and deceptive trade practices; and the creation of court-made implied warranties of habitability and suitability of real property for an intended use. These implied warranties have generally not been extended to protect purchasers of commercial and industrial properties, but have in some jurisdictions been recognized in commercial and industrial leases.

Allocation of Remediation Costs by Environmental Protection Laws

Buyers failing to undertake adequate inquiry prior to purchasing a property run the risk of acquiring contaminated property, and being liable for significant remediation costs. Federal laws, *e.g.*, the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (CERCLA), and corresponding state statutes can impose liability on persons identified by such legislation as "responsible parties" because of their status with respect to these properties. Under these laws a "responsible party" may be 100 percent liable for the cost of remediation of contaminated property even though it did not cause or contribute to the contamination. CERCLA and many of these corresponding state environmental protection laws grant to a purchaser a statutory right to obtain contribution from a prior responsible party for the costs it incurs in remediating contamination existing at the time of purchase.

Selling "As Is"

Reacting to these public policies, sellers and their counsel have sought to contractually allocate the responsibility for remediating property to buyers by selling property "as is." The use of "as is" provisions is derived from the UCC-recognized concept of an as-is disclaimer of implied warranties in the sale of goods between merchants. But, despite the presence of an as-is disclaimer, even the UCC does not preclude causes of action based on fraud. U.C.C. § 2-316. The as-is disclaimer is sometimes worded as a sale of property "in its present condition," e.g., contract forms

promulgated by the Texas Real Estate Commission do not use the as-is terminology but state that the property is sold "in its present condition." This same present-condition terminology is used in real estate contract forms promulgated by real estate broker regulatory commissions of a number of states and has its genesis in the plain English movement.

"Free Looks," Disclaimers, Waiver of Reliance, Sole Agreement, and Merger Clauses

Sales contracts may contain other provisions that are similar to and that supplement an as-is clause. Examples include the following provisions: a "free look" period to permit a buyer the opportunity to inspect the property and to conduct investigations as to its condition; contractual disclaimers of express or implied warranties; acknowledgments by buyers that they are relying solely upon the results of their inspections and investigations and not upon any statements or disclosures by the seller or its agents; clauses stating that the written contract between seller and buyer contains the entire agreement of the parties; and clauses which provide that all agreements are merged into and do not survive delivery of the conveyance to the buyer. Merger clauses have been held not to override fraud. *See, e.g., Italian Cowboy Partners, Ltd. v. The Prudential Ins. Co. of America*, 341 S.W.3d 323 (Tex. 2011).

Questions Clients Ask

Sellers often ask their counsel for advice on a variety of questions, like the following:

> "*Do I have a duty to speak, to disclose what I know about the property, even if I am not asked?*"

A duty of disclosure may hinge on whether the condition is readily discoverable. This duty is heightened by a seller's misleading statements. See *e.g.*, Florida: *Billian v. Mobil Corp.*, 710 So. 2d 984 (Fla. Dist. Ct. App. 1998)—negligent nondisclosure of a material defect does not require that the seller have intended to defraud buyer; Kansas: *McWilliams v. Barnes*, 242 P.2d 1063 (Kan. 1952)—negligent representation that drain pipes were connected to city sewer system; and Illinois: *Chapman v. Hosek*, 475 N.E.2d 593 (Ill. App. Ct. 1985)—negligent misrepresentation as to necessity of flood insurance and weather conditions. For further discussion of a seller's disclosure duty, see 36 AM. JUR. PROOF OF FACTS 3d, *Buyer's Claims Against Seller Who Fails to Disclose Environmental Condition of Property* 471 (2012); DRAPER, 12 A.L.R. 5th, *Vendor's Obligation to Disclose to Purchaser of Land Presence of Contamination from Hazardous Substances or Wastes* 630; and Mattox, *Common Law Approaches to Non-Disclosure/Limited Disclosure of Environmental Liabilities*, PRACTICAL REAL ESTATE LAW. (Jan. 2010); also see RESTATEMENT (SECOND) OF TORTS § 552. Such niceties of language and circumstance have led some legislatures to enact environmental condition disclosure laws, e.g., New Jersey's Industrial Sites Recovery Act.

> "*What if one of my employees knows something I do not know?*"

Some courts have found that a person is charged with constructive knowledge of all material facts that its agent or officer receives while acting within the course and scope of his employment. *See, e.g., Apollo Fuel Oil v. U.S.*, 195 F.3d 74 (2d Cir. 1999).

> "*How good does my memory have to be?*"

In cases of seller-forgotten contamination, the issue may revolve around intent to defraud. The RESTATEMENT (SECOND) OF AGENCY, § 272 contains the following comment as to forgotten knowledge:

> Matters once known may be forgotten when the event occurs to which notice or the lack of it is legally material. In some of such cases, as, for instance when the legal standard is "good faith" in the subjective sense, the forgetting is material; the law does not charge the party with the knowledge he no longer has. In other situations, forgetting does not help him; the law holds him bound by the notice or knowledge he once had, whether or not he has it now. In neither case is it material whether

he originally got the knowledge or notice himself or was charged with it because his agent had it. Cmt. e, Duration of Knowledge.

Statutorily Created Reimbursement Obligations

Under some states' laws, there is a statutorily created reimbursement obligation that further limits the effectiveness of as-is and similar provisions. The case of *Bonnie Blue, Inc. v. Reichenstein*, 127 S.W.3d 366, 368 (Tex. App.—Dallas 2004, no petition) is instructive. In *Bonnie Blue*, the buyer did not seek damages based on misrepresentations or a failure to disclose, but instead sought statutory contribution for environmental cleanup costs under the Texas Solid Waste Disposal Act (SWDA), as well as common law contribution and indemnity. The defendant, the Reichensteins, had operated a wood-preserving business on the property until 1982, when they sold to T.D. Corporation. The sales contract included the following provision:

> Purchaser acknowledges that he has inspected all buildings and improvements situated on the property and is thoroughly familiar with their condition, and Purchaser hereby accepts the property and the buildings and improvements situated thereon, in their present condition, with such changes therein as may hereafter be caused by reasonable deterioration.

T.D. Corp. then sold to Rex-Tex Equipment Company. In 1991, Bonnie Blue, Inc., bought the property. Eight years later, in 1999, after discovering contamination, Bonnie Blue entered the property into the state's voluntary cleanup program and began cleanup. Bonnie Blue then filed this cost recovery action. The trial court granted summary judgment for the sellers, the Reichensteins, on all claims. The appeals court disagreed. Noting that "no Texas case specifically addresses the effect of an 'as is' provision on a contribution claim under the SWDA," the court examined the broad remedial purpose of the SWDA, and the express statutory scheme that sets forth factors for the trial court to take into account in apportioning cleanup liability. The court noted that unlike CERCLA, the SWDA did not include a provision permitting parties to enter contracts affirmatively to insure or to indemnify against CERCLA liability (42 U.S.C.A. 9607(e)).

Use of a Three Contractual Provisions to Allocate Remediation Costs

It may be possible for a seller to contractually allocate remediation costs to a buyer by employing the following three contractual provisions: (1) an as-is clause coupled with a disclaimer of reliance by the buyer; (2) a specific release of claims, including statutorily granted contribution rights; and (3) a specific indemnity as to claims by third parties. These provisions must be entered into knowingly and voluntarily. See, e.g., Illinois: *Century Display Mfg. v. D.R. Wagner*, 376 N.E.2d 993 (Ill. 1978)—buyer informed of prior use of property sufficiently to alert as to hazardous condition; Michigan: *Niecko v. Emro Marketing Co.*, 769 F. Supp. 973 (E.D. Mich. 1991), aff'd, 973 F.2d 1296 (6th Cir. 1992)—buyer expressly assumed risk of unknown soil contamination; New York: *Long v. Fitzgerald*, 659 N.Y.S.2d 544 (N.Y. App. Div. 1977)—buyer's acknowledgment that it had inspected premises and was acquainted with the property barred claim of fraudulent inducement; Texas: *Trinity Industries, Inc. v. Ashland, Inc.*, 53 S.W.3d 852 (Tex. App.—Austin 2001, petition denied)—failure to mention fraud and negligent misrepresentation in release of cleanup liability precluded release of fraudulent inducement claim. Also see, Slavich and Goldman, *Allocating Environmental Liabilities and Risks by Contract and Making That Stick*, 33rd Annual Advanced Real Estate Law Course, State Bar of Texas, 2011; 34 AM. JUR. PROOF OF FACTS 3d, *Validity and Applicability of Contractual Allocations of Environmental Risk* 465; and 1 FED. ENVTL. REG. REAL EST. § 2:95, *Private Party Cost Recovery-Contractual Allocations of Liability* (2012). Texas courts have used the public policy of freedom of contract to uphold a party's contractual waiver of reliance, even in the face of fraud, if the parties are knowledgeable in business matters; represented by legal counsel; have specifically discussed the issue which became the topic of subsequent dispute; and the release language is clear.

The Texas Supreme Court in *Schlumberger Technology Corp. v. Swanson*, 959 S.W.2d 171 (Tex. 1997) upheld release language despite claims by the releasing party that it had been fraudulently induced by the fraudulent representations and non-disclosures of the released party. Subsequent to the *Schlumberger* decision, the Texas Supreme Court in *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51 (Tex. 2008) held that a "waiver of reliance" clause precluded a fraudulent inducement claim by a settling party (McAllen). McAllen unsuccessfully argued that he was not barred by the "waiver of reliance" clause from establishing that he was fraudulently induced into agreeing to arbitrate environmental claims he had specifically excluded from the scope of the release he signed at a mediated settlement. McAllen argued that there was no "meeting of the minds" regarding the arbitration of potential environmental claims because Forest Oil knew all along of the potential for environmental claims while simultaneously assuring McAllen "there [were] no issues having to do with the surface." The court concludes with the following admonishments:

> After-the-fact protests of misrepresentation are easily lodged, and parties who contractually promise not to rely on extra-contractual statements—*more than that, promise that they have in fact not relied upon such statements*—should be held to their word. Parties should not sign contracts while crossing their fingers behind their backs. . . . It is not asking too much that parties not rely on extra-contractual statements that they contract not to rely on (or else set forth the relied-upon representations in the contract or except them from the disclaimer). If disclaimers of reliance cannot ensure finality and preclude post-deal claims for fraudulent inducement, then freedom of contract, even among the most knowledgeable parties advised by the most knowledgeable legal counsel, is grievously impaired. . . .
>
> None of McAllen's arguments materially distinguishes our holding in *Schlumberger*: "a release that clearly expresses the parties' intent to waive fraudulent inducement claims, or one that disclaims reliance on representations about specific matters in dispute, can preclude a claim of fraudulent inducement." . . . Today's holding should not be construed to mean that a mere disclaimer standing alone will forgive intentional lies regardless of context. We decline to adopt a *per se* rule that a disclaimer automatically precludes a fraudulent-inducement claim, but we hold today, as in *Schlumberger*, that "on this record," the disclaimer of reliance refutes the required element of reliance.

Facts and Circumstances Supporting Effective Contractual Allocations

The following facts and circumstances support upholding an allocation of responsibilities through the use of these risk allocation provisions: knowledgeable parties; parties represented by counsel; a specifically negotiated result; the issue being discussed and disclosed; a recognition that these provisions are not boilerplate; and no state-specific legislation on topic. Further, there must be an absence of interference with the buyer's investigation.

Facts and Circumstances Undermining an Effective Contractual Allocation

Even the best-worded as-is clause coupled with an otherwise enforceable waiver of reliance clause does not overcome impairment, obstruction, or interference with the buyer's inspection. See, e.g., *Warehouse Associates Corporate Centre II, Inc. v. Celotex Corp.*, 192 S.W.3d 225 (Tex. App.—Houston [14th Dist.] 2006, review denied). The appeals court in *Warehouse Associates Corporate Centre II, Inc.* upheld the trial court's finding that a genuine issue of fact existed as to whether Warehouse Associates was induced to enter into an industrial site purchase contract by Celotex's alleged active concealment of buried asbestos, despite the presence of the following "as is" and waiver of reliance clauses:

> Other than the warranties of title contained in the deed, Purchaser acknowledges that Seller has not made, does not make and specifically disclaims any representations, warranties, promises, covenants, agreements or guaranties of any kind or

character whatsoever, whether express or implied, oral or written, past, present or future, of, as to, concerning or with respect to (a) the nature, quality or condition of the Property, including without limitation, the water, soil and geology, (b) the income to be derived from the Property, (c) the suitability of the Property for any and all activities and uses which Purchaser may conduct thereon, (d) the compliance of or by the property or its operation with any laws, rules, ordinances or regulations of any applicable governmental authority or body . . . (e) the habitability, merchantability or fitness for a particular purpose of the Property, or (f) any other matter with respect to the Property, and specifically that Seller has not made, and does not make and specifically disclaims any representations regarding solid waste, as defined by the U. S. Environmental Protection Agency regulations at 40 C.F.R., Part 261, or the disposal or existence, in or on the Property, of any hazardous substance, as defined by the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, and applicable state laws, and regulations promulgated thereunder. Purchaser further acknowledges and agrees that having been given the opportunity to inspect the Property, Purchaser is relying solely on its own investigation of the Property and not on any information provided or to be provided by the Seller. Purchaser further acknowledges and agrees that any information provided or to be provided with respect to the Property was obtained from a variety of sources and that Seller has not made any independent investigation or verification of such information. Purchaser further acknowledges and agrees that the sale of the Property at closing shall be made on an "as is, where is" condition and basis "with all faults."

Concluding Advice

When confronted with advising your client on selling property known to be contaminated, disclosure is the best policy, but reliance on a craftily worded as-is clause is not. Care in disclosure is required, as once the seller decides to speak about an issue, courts require that a full and accurate disclosure be made.