

ROLE OF ENVIRONMENTAL PROFESSIONALS IN EMINENT DOMAIN VALUATIONS

Kenneth K. Hekimian, Ph.D., RCE, REA

HVN Environmental Service Co., Inc.

15561 Product Lane, Unit D1, Huntington Beach, CA 92649

hvnenvironmental.com - 310-984-3229

In his book *Environmental Liability and Real Property Transactions: Law and Practice* (Wiley, 1989), Attorney Joel S. Moskowitz presented the then state-of-the-art in “due diligence investigations” including chapters on “The Need for a Due Diligence Team” (Chapter 19) and “How to Choose and Manage Your Environmental Audit Consultant” (Chapter 21). Atty. Moskowitz pointed out that the temptation to be one’s own environmental consultant may arise because, after all, attorneys, realtors, appraisers and bankers are more familiar with property transfer than are engineers and scientists. However, Atty. Moskowitz advocated hiring the focused services of the expert engineer/scientist because what one buys in an expert in this area is not only knowledge, but experience and judgment.

In recent years, the impact of environmental contamination upon the real estate market has increased substantially, both as a potential health hazard and as a significant factor in the value of the real estate. This is particularly true in the field of “eminent domain valuations,” where a recent internet search identified over 10,000 related web sites. This paper will examine some issues where environmental professionals can play effective roles in the valuation of environmentally contaminated real estate.

1.0 ENVIRONMENTAL ASSESSMENTS IN THE ACQUISITION PROCESS

In the private sector, a parcel of property that is environmentally contaminated has a lower market value than a clean parcel, and may indeed be unmarketable because of the risk and remediation costs associated with the contamination (aka, Brownfields). In the public sector, likewise, an acquiring agency, exercising its power of eminent domain, is permitted to consider the environmental remediation costs associated with the property in determining the just compensation value of the property.

Acquiring agencies are required by either statute or due diligence practice to have environmental site assessments performed prior to acquisition. A Phase I environmental site assessment (ESA) must be performed on every parcel being acquired. It is vitally important for the acquiring agency to strictly define its requirements for the environmental assessment. Until the EPA adopts the All Appropriate Inquiries Standard Practices, ASTM-E1527-00 and E1528-00 Standards for the preparation of Phase I Reports will be acceptable.

The level of qualification required to perform a Phase I ESA in California is a Registered Environmental Assessor (REA), which requires minimal qualifications. The Brownsfields Law (Pub. L. No. 107-118, 115 stat. 2356) requires a higher set of qualifications (see Table 1). If a site investigation and/or remediation are required, the qualifications of the practitioner in California are: Registered Civil Engineer, Registered Geologist and Certified Engineering Geologist. Where excavation and construction activities are conducted in California, a Contractor A License with Hazardous Waste Classification (or equivalent) is required.

TABLE 1 – Roles of Environmental Professional

TASK	ROLE	CALIFORNIA LICENSES
Technical advice	Technical advice and analysis as required	Varies
Phase I - Environmental Site Assessment	Perform in accordance with ASTM E1527-00 and E1528-00 (until All Appropriate Inquiries is adopted)	Registered Environmental Assessor (REA) (or Environmental Professional*)
Phase II – Environmental Site Investigation	Perform in accordance with regulatory agency-approved Workplan: obtain permits, drill borings, log borings, take soil and/or groundwater samples, write and stamp report	Registered Civil Engineer (RCE), Registered Geologist (RG), Certified Engineering Geologist (CEG)
Phase IIIA – Site Remediation (Soil)	Perform in accordance with regulatory agency-approved Workplan: obtain permits, excavate contaminated soil, backfill with clean soil, write and stamp report.	RCE, RG, CEG, Contractor's License: A-Haz or specialty license
Phase IIIB – Site Remediation (Groundwater) (Gases)	Perform study of alternatives and system costs. Select most cost-effective option. Implement in accordance with regulatory agency-approved Workplan: obtain permits, design and install wells, design and install remediation system, perform quarterly monitoring, write and stamp reports.	RCE, RG, CEG, Contractor's license: A-Haz or specialty license

*EPA is considering requiring an “Environmental Professional,” the person which can perform the Phase I ESA, to hold a current PE, RG or CEG license and have the equivalent of three (3) years of full-time relevant experience, be degreed in the fields of engineering or science and have the equivalent of five (5) years of full-time relevant experience, or have a B.A. and the equivalent of ten (10) years of full-time relevant experience.

Phase I ESAs must answer the fundamental question of whether there are Recognized Environmental Conditions (RECs) at the site and whether further environmental investigation should be performed on the property (a Phase II investigation). The purpose of the environmental investigation is to gather sufficient data so that the acquiring agency knows precisely the condition of the property it will be acquiring with respect to possible environmental problems associated with the property. There are several reasons why complete and accurate environmental data are essential in a condemnation acquisition. **First**, in some governmental acquisition projects, the particular parcel of property may not be essential; environmental assessments can be used as an information tool which can assist the agency in its site selection, especially if the acquisition is in an industrialized area. **Second**, the Phase I ESA, and estimated remediation costs associated with the site, are vital information for decision makers to have early in the acquisition process in order to have an accurate picture of the real site acquisition costs (i.e., including any environmental remediation costs). **Third**, obtaining this information early will help in acquiring and budgeting adequate funds to complete the environmental work. The consequences of overstating and understating the environmental contamination are presented in Table 2.

TABLE 2 – Consequences of Phase I ESAs

1: The ESA overstates the environmental contamination	
Participant	Consequences
Seller	<ul style="list-style-type: none"> • Loses the sale • Sells the property below its uncontaminated value • Excessive withholds are placed on the sale • Closing of transaction is delayed • Incurs attorney and consultant expenses
Buyer	<ul style="list-style-type: none"> • Closing of transaction is delayed • Incurs attorney and consultant expenses
Investor/Lender	<ul style="list-style-type: none"> • Closing of transaction is delayed • Incurs attorney and consultant expenses
2: The ESA understates the environmental contamination	
Participant	Consequences
Seller	<ul style="list-style-type: none"> • Incurs liability to the Buyer for pre-existing contamination • Loses the opportunity to sell the property to another or for other uses • Incurs penalties for not reporting contamination • Incurs attorney and consultant expenses
Buyer	<ul style="list-style-type: none"> • Pays too much for the property • Purchases the property without adequate withholds to pay for remediation • Incurs substantial remediation costs • Loses the opportunity to invest in more profitable ventures • Incurs penalties for not reporting contamination • Incurs attorney and consultant expenses
Investor/Lender	<ul style="list-style-type: none"> • Security for the investment or loan is lost or impaired • Incurs attorney and consultant expenses

1.1 Innocent Landowner Protection

The new Brownfields law (Pub. L. No. 107-118, 115 stat. 2356) clarifies that until the United States Environmental Protection Agency (EPA) promulgates required regulations by January 2004, compliance with the

American Society for Testing and Materials (ASTM) due diligence standard meets the “all appropriate inquiry” standard to establish an innocent landowner defense for non-residential property. If a purchaser complies with the ASTM standard and finds no contamination, a liability defense would exist if contamination is subsequently discovered. The new law also provides protection for property owners from liability for contamination that migrated from a property under separate ownership (i.e., contiguous property owner protection).

1.2 Problem Properties

Strategies must be developed at the onset of the acquisition process to handle “problem” properties. The acquiring agency should consider retaining an environmental professional whose function will be to serve as the agency’s advisor on environmental issues that arise. This expert will also assist in directing the environmental contractors who will be doing the field work investigation and remediation. There are several advantages in utilizing this strategy. **First**, the expert’s loyalties lie exclusively in giving sound advice to the agency; the expert is not paid according to the number of soil borings or lab tests, but for his time as an advisor. **Second**, the strategy allows one expert to provide continuity in the environmental evaluation of the properties being acquired, particularly in a large acquisition process that employs numerous environmental firms that may have differing quality of work. **Third**, this practice gives the acquiring agency an in-house expert witness who can be used at trial to explain to the court or jury the procedures that were followed in evaluating the impact of the contamination upon the just compensation.

1.3 Site Contamination

If the Phase I ESA recommends a Phase II subsurface (intrusive) assessment because there is a probability of environmental contamination on the Site, the acquiring agency should proceed in anticipation that litigation will result. The agency’s purpose in its investigation of a contaminated parcel should be directed to determining the costs involved in cleaning up the parcel. These costs will (or should) be used as an offset or deduct from the just compensation offered for the property. This course of action will, in and of itself, virtually guarantee that the environmental issue will be litigated by the property owner.

Once it is determined that contamination exists, the contamination must be precisely defined. In real estate acquisitions, the most common type of contamination causing an environmental problem is soil and/or groundwater contamination. However, building contamination, for example asbestos in the building, should be factored into the valuation of the property. Buildings containing asbestos (which can either be encapsulated or removed) do have a market value. The same building free of asbestos would, of course, have a higher market value. If the building is so laden with friable asbestos or other contamination that it has no market value, that information must also be evaluated. The environmental information obviously has a significant impact upon the valuation of the property. In an eminent domain acquisition, defining the environmental contamination on a polluted site is, in effect, trial preparation.

1.4 Property Owner Participation

If the Phase I ESA determines that sufficient cause exists to justify additional environmental investigation, the acquiring agency should consider offering the property owner the opportunity to participate in the environmental investigation. The property owner should consider obtaining its own environmental expert and, at the very least, should obtain legal counsel immediately. The acquiring agency should formally offer to share split samples with the property owner. This strategy allows both parties the opportunity to work from the same samples and the same data, as well as avoiding future duplication.

1.5 Phase II Site Investigation

The goal of the Phase II environmental investigation of a property is to gather sufficient data to determine a realistic remediation strategy and cost that can be pursued with reasonable prospect of regulatory agency approval and can withstand adversarial scrutiny from the property owner’s counsel and experts. The major issues that will arise in even the most basic Phase II intrusive investigation are the cost and the extent of

the investigation. In an industrialized urban area, almost any large tract of land will invariably contain some environmental contamination. **The practical dilemma is that if one manages to not find contamination, then under the law contamination does not exist.** The more extensive the investigation, the more sampling, the more soil borings, the more likely it is that some contamination will be found. The acquiring agency must ensure that it has conducted a sufficiently thorough examination to reduce the risk of finding unknown contamination at a later date. The reasonableness of the investigation must be determined on a case by case basis.

The environmental investigation of the site should be conducted by a properly licensed person in a methodical, cost-effective manner directed at defining the contamination so that the cost of a realistic remediation plan can be quantified. The consultant and the agency should confer with the appropriate environmental regulatory agency to determine the most appropriate alternative remediation strategies for the site because some methods require special permits which are time-consuming. The process of compiling the scientific data, selecting a remediation strategy, and estimating the financial cost must be a completely defensible process. The property owner's condemnation attorney will very likely acquire his own experts and his own arguments questioning the acquiring agency's data, plan and cost estimate. The success of the agency's analysis will be based in large part upon the quality and experience of the experts. The agency should consider keeping its environmental consultant separate from the actual remediation contracting work in order to preserve the consultant's impartiality. The purpose of the site investigation is to select a remediation plan(s) and its cost(s) that will put the property in an environmentally "clean" condition so that the highest market value for the property can be realized, which is the basis of just compensation that the property owner will receive. Once the Workplan is approved by the regulatory agency, it must be implemented to achieve case closure.

2.0 THE "GOOD FAITH OFFER" FOR THE ENVIRONMENTALLY CONTAMINATED PARCEL

When property contamination is confirmed, the eminent domain process will slow down as environmental law issues come to the forefront of the process. Initially, the acquiring agency must put any transfer of title on hold pending resolution of the environmental contamination. The option of taking title of the property, and subsequently suing past property owners and/or polluters for cleanup costs, is forestalled because the prior property owner may very well insulate himself from any attempted financial collection.

2.1 Property Owner's Options

When the environmental contamination and the estimated cleanup costs have been quantified, the acquiring agency should give written notification to the property owner that the agency has confirmed a chemical release on the site and indicate to the property owner the owner's responsibilities for remediation under applicable state and federal statutes and regulation.

Under ideal conditions, the property owner would then make the required report to US EPA, and/or the state (or local) environmental regulatory agency; conduct the appropriate investigation; and then proceed with a (regulatory) agency-endorsed remediation and cleanup that would reduce the contaminants to acceptable levels. Thereafter, the acquiring agency could use its appraisal of the fair market value of the "environmentally clean" property and make a good faith offer for the property.

However, in reality, the property owner typically will reject the acquiring agency's contamination allegations, deny responsibility for the problem, and demand to receive the full value of the property as it is were clean. In this situation, the acquiring agency must notify the appropriate regulatory agency charged with the responsibility of enforcing the applicable environmental laws and regulations. The acquiring agency could further demand that the regulatory agency take the appropriate steps to enforce the contamination remediation requirements of the applicable statutes. This part of the process can be problematic since, in liability, environmental agencies do not have the resources to enforce the environmental regulations upon even a small percentage of offenders. If the property owner does not have an incentive to remediate the contamination, the environmental issues associated with a parcel could delay the transfer of the parcel for years.

2.2 Acquiring Agency's Options

The acquiring agency's next option to force resolution of the environmental issues is to proceed to take the estimated cleanup costs for the parcel as an offset to the fair market value for the "clean" parcel of property. The legal rationale to use the cleanup costs as an offset is that the acquiring agency is only obligated to pay the fair market value for the property. The fair market value is defined as the amount of money that a willing buyer and a willing seller will agree to in terms of a sale. The market value of an (unremediated) contaminated parcel of property is the fair market value of the "clean" parcel, less the cleanup costs, and whatever intangible costs may exist, such as continuing liability for the contamination. This rationale allows the agency to arrive at a "working" number for purposes of making a determination of estimated just compensation as well as starting the process of addressing the environmental contamination of the property.

Using the appraised market value of the clean parcel and the environmental cleanup cost, the agency should fashion a "good faith offer" that is contingent upon satisfactory remediation of the parcel. If the contamination is well defined and limited, the agency may be willing to take title of the parcel, making sure that it has escrowed sufficient funds to execute the cleanup. If the parcel is seriously contaminated, and there is danger of unknown liabilities for the contamination, the agency may wish to petition the court for an order forcing the property owner to remediate the parcel, or ask the court to appoint a third party, perhaps a master under Rule 53 of the Federal Rules of Civil Procedure, to prosecute the cleanup, funding it with the agency's cleanup offset funds.

2.3 Use of Cost Management Methods

Since the enactment of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), also known as the Superfund law, hazardous waste site owners, potentially responsible parties (PRPs), Brownfield redevelopers, insurance companies, and government agencies have spent billions of dollars trying to control or reduce their environmental liability. From 1980 to the mid-1990s, site owners were at the mercy of regulators, lawyers, and environmental practitioners who have determined owners' financial liability by establishing cleanup standards and remediation approaches with minimal material input from owners and other parties who were paying the bills. Studies by the U.S. government, universities, and private institutions consistently show that too much money has been spent to accomplish too little cleanup, and owners still face huge financial liabilities. Clearly, the old system has not worked well.

Beginning in the late 1990s, a new trend has developed. Owners, both public and private, of hazardous waste sites began taking direct control of remediation costs through better planning and cost management. Environmental consultants and remedial action contractors also began to be proactive on behalf of their clients in cost management issues, and were also forced to show better cost management to survive in the increasingly competitive hazardous waste market. Thus, owners and regulators are now taking a co-leadership role and detailed hands-on positions in establishing remedial goals, managing site remediation activities, and settling disputes.

An important part of this change has been the introduction of sophisticated cost management methods, tools, and cost estimating systems to the environmental remediation marketplace. These tools have allowed owners and regulators to understand the cost implication of the decisions they make *before* they make them, thus allowing better cost management. This, in turn, has led to documented savings of up to 75% of the total cost of remediation.

2.4 Advantages to the Property Owner to Manage the Remediation Process

Summarized in Table 3, there are several advantages for the property owner in an eminent domain case to manage the cleanup of the contaminated property prior to transferring title:

- a. If the site is an underground storage tank (UST) site in California, the cost of the site assessment and remediation may be recoverable by the UST owner and/or operator from the State UST Cleanup

Reimbursement Fund.

- b. Regulatory agency may allow property owners to use health risk assessments using a modified version of the Johnson-Edinger Health Risk Model to allow diminishing amounts of contamination to remain on site and still issue a “no further action” letter.
- c. Regulatory agencies may allow property owners to implement quarterly groundwater monitoring to prove that either the groundwater plume has moved off-site, the groundwater plume is stable and is undergoing natural attenuation and still issue a “no further action” letter.
- d. After a property owner has received a “no further action” letter from a regulatory agency, insurance may be available (from AIG and others) in case the regulatory agency ever decides to reopen the case.

If acquiring agency is allowed to cleanup contaminated property after taking title, there are fewer advantages for the property owner:

- a. If the site is a UST site in California, the new buyer may not qualify for reimbursement from the State UST Cleanup Reimbursement Fund.
- b. Acquiring Agency may not be as cost-conscious and may not select the “least cost” alternative assuming that the cost of cleanup will be deducted from the purchase price.
- c. Acquiring Agency may expend additional “soft” costs, such as extra emphasis on Health and Safety Plan and/or several layers of inspectors requiring an excessive amount of soil and groundwater sampling and testing.
- d. Acquiring Agency may have ulterior motives for removal of “minimally contaminated” soil, such as to build a subway station, grade separation or underground parking garages.

TABLE 3 – Advantages for Property Owner for Managing Cleanup Versus Acquiring Agency

1: If Property Owner Manages Cleanup
<ul style="list-style-type: none"> • Cost may be reimbursed from the State UST Cleanup Reimbursement Fund if contamination is UST-related • Regulatory agency may allow case closure based on Health Risk Model • Regulatory agency may allow natural attenuation with quarterly groundwater monitoring • After site closure by regulatory agency, insurance may be available
2: If Acquiring Agency Manages Cleanup
<ul style="list-style-type: none"> • No change for reimbursement from State UST Cleanup Reimbursement Fund • “Least Cost” technology may not be used • Additional “soft” costs may be expended • May have ulterior motive for removing “minimally contaminated” soil and/or groundwater

3.0 CONCLUSION

Recent federal law has caused the eminent domain process and environmental law to become more intertwined in most states. In many cases, Statutes and practices have been revised to provide an agreed-upon framework for the process to work. There are several roles for an environmental professional in eminent domain valuations to provide his knowledge, experience and judgment in an unbiased manner. There usually are more advantages for the property owner to manage the cleanup of the contaminated property prior to transferring title than to allow the acquiring agency to take title, manage the cleanup and then deduct the remediation costs from the fair market value of the “clean” parcel.

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