Project: *Corporate Counsel – Law Firms*

Real Estate, Construction And Environmental Compliance Challenges – Part II

The Editor interviews John E. Osborn, Partner, John E. Osborn, PC.

Editor's Note: As a result of the Sarbanes-Oxley Act of 2002, directors, management and in-house counsel of companies covered by the Act are justifiably concerned about liabilities arising from failures of compliance. Even those in organizations not covered by the Act will be judged by the courts on the basis of the new higher standards that it creates.

Today, losses resulting from perceived failures on the part of management and in-house counsel are likely to be characterized as compliance failures. This can expose the directors, management and in-house counsel to significant liability.

Mr. Osborn's firm specializes in real estate, construction and environmental matters. In Part II, Mr. Osborn continues his discussion of how outside counsel can help corporate counsel avoid compliance problems.

Editor: Is the help of outside counsel desirable in construing, drafting and negotiating architect agreements, construction contracts and environmental consultant agreements?

Osborn: In working with these contracts, the biggest problem is lack of expertise. It is perilous for relatively inexperienced corporate counsel to take sole responsibility. Many of the clauses, especially in the standard form contracts, have been heavily interpreted by courts and others. You also need to know the internal workings of the documents and how those documents fit together. The architect-owner agreement has to mesh with the contractor-owner agreement. The environmental consultant agreement has to be coordinated with the other two agreements. If they do not, you end up with confusion on the construction site because there is no clear delineation of who does what.

A good example of why the clauses of these contracts need to mesh is the dispute resolution clause. If one contract has an arbitration clause and the others have litigation clauses, the confusion may mean that you cannot resolve a dispute in a single forum. Also, it is often important from the standpoint of the owner not to have an arbitration clause in its standard form. Yet, a lot of the standard form contracts have an arbitration requirement. I have seen in-house counsel for an owner severely criticized when the owner is forced into arbitration where litigation would have been more favorable to the owner. Choice of law and venue is also important. New York courts may be the most favorable.

Editor: Can corporate counsel protect themselves when the client attempts to draw corporate counsel into what is essentially a business decision to purchase property without making inquiry about possible contamination?

Osborn: Many states do not restrict the transfer of contaminated property — unlike New Jersey, which in the mid-1980s passed a law whereby certain categories of property could not be conveyed without an environmental signoff. New York opted not to similarly restrict property transfers and continues to permit the transfer of contaminated properties to the unwary. Of course, lenders may require environmental representations as a condition to a loan. In New York, the buyer – consulting with its corporate counsel – has a judgment call to make. Does it want to take the risk and buy the property? What if it is near a contaminated site? In this way corporate counsel tends to get drawn into what is essentially a business decision – an age-old problem for lawyers. Unfortunately, when the blame game begins, the client is likely to contend that the in-house lawyer thought that it was okay to go forward from a legal standpoint. To avoid this situation, it would be wise to bring in an outside lawyer who, drawing on a wealth of experience, may be able to prevail on the client to undertake an appropriate investigation before going forward – but in any event, it will be clear that the client proceeded notwithstanding legal advice to the contrary. This should take inside counsel off the hook.

John E. Osborn

Editor: How do you assist in-house counsel in advising a company about environmental issues in New York City?

Osborn: We help them select and then ask the right question of environmental consultants. We recommend that companies get consultants that do hydrological work and understand the subsurface of Manhattan and where the flow of hazardous chemicals may go. If, down the block, there is a facility that used or stored petroleum products, the consultants can advise a potential buyer whether it is likely that the property is going to be contaminated from that source.

If you know that an electroplating plant was on that property, maybe you should do more investigation before you buy it. We advised a potential buyer of a residential building in Manhattan that had a dry cleaner on the first floor. I put the brakes on the deal after our investigation determined that all the contaminant was being dumped into the ground. We got the seller to clean it up, reduce the price significantly and buy insurance to protect the buyer if additional cleanup is needed. Today, a restaurant occupies the building. If the cleanup issue had not been resolved prior to closing, the purchaser may have been stuck coping with enforcement and paying the large cleanup costs – and without recourse. Our strength is knowing which consultants to hire. You may need as many as three consultants on one property because you want to get the best specialists in handling ground water, asbestos and mold issues. One size does not fit all when dealing with environmental consultants.

Editor: What about working with the regulatory agencies?

Osborn: We were recently retained to work with HUD and EPA on lead issues for a number of apartment complexes. A sizeable fine was going to be imposed on the owner for not having proper paperwork relating to lead disclosure. I had a full lead-based paint assessment done of all of the properties. We determined that one property had an exemption under federal law and that the others did not have a lead problem. I then talked with HUD and gave them my assessment that showed that – although we had deficient paper work on the exempt building – the other buildings had properly documented plans for addressing lead issues. This open approach satisfied the regulatory authorities because they respected our professionalism. In-house counsel might not have achieved the same result – simply because it is unlikely that they would have been able to develop the same level of trust with HUD and EPA.

Editor: What is happening with respect to Section 404 of Sarbanes-Oxley?

Osborn: The auditors who do the Section 404 review need to understand the nature of the contingent liabilities affecting the corporation's properties. Take asbestos for example. When you renovate a building with a construction manager, disclosure must be made and asbestos abatement may be necessary. This may constitute a contingent liability that reduces the value of the property even though you do not presently contemplate renovating it. Another example is that, under the federal laws, there is a requirement to report if you are polluting. Under the RCRA, you can get a permit that says you can pollute to a certain extent. This places a limit on the ability to use the site which also affects value. This, too, would have to be reported to the accountants. In-house counsel would benefit from using experienced outside counsel who can help identify contingencies that affect property values as well as find consultants to appraise their effect on the valuation of property.

Editor: It would be beneficial if discussions with counsel regarding the types of issues covered in this interview received the protection of the attorney-client privilege. How can the privilege best be protected?

Osborn: A significant problem, particularly in large organizations, is that in-house counsel frequently distribute information widely within the company and do not limit its redistribution. This can constitute a waiver of the attorney-client privilege. Outside counsel can help you develop procedures to limit the distribution of particularly sensitive information and to properly mark it to protect the privilege. Also, the confidentiality that attaches to documents prepared in anticipation of litigation and to attorney work product tends to be afforded greater protection if those documents are in the custody of outside counsel.

In-house counsel often lose the privilege because their functions include business as well as legal matters. Therefore, the courts tend to be reluctant to look at everything they do as being protected by the privilege. The intermingling of business and legal matters may be particularly pronounced in the case of in-house counsel serving clients in real estate and development-related businesses because they are well suited by virtue of their legal skills to make the kinds of business judgments required in those businesses. To increase the likelihood that the privilege will be available, it is particularly important that in-house counsel in those businesses consider the retention of outside counsel.

Editor: There is a multitude of regulations pertaining to real estate-related businesses that require that hazardous conditions and other events be reported. How can outside counsel help assure compliance?

Osborn: In a general sense, outside counsel are a resource for in-house counsel who, even in the largest departments, need the focused expertise that law firms can provide. Outside legal experts in real estate, construction and the environment know the regulations better because they work with them on an ongoing basis. They know the permissible exposure limits and other reporting thresholds from past experience with a wide spectrum of situations.

Outside counsel can advise you on environmental reporting requirements. A spill of a hazardous chemical has to be reported immediately. There are a vast number of regulatory requirements relating to lead-based paint and underground tanks, where you have to give notice and/or file a document. The consequences of failing to promptly report something that might affect health and safety are severe, including exposure to criminal penalties.

In-house lawyers are frequently asked to fill out forms and provide certifications with respect to matters in which they are not expert and where serious penalties apply to failures to file on time and to incorrect filings. Prudence would dictate that they call upon outside counsel for help.

Please email the interviewee at josborn@osbornlaw.com with questions about this interview.