

Developments in Federal
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Development and Redevelopment of Gas Station Properties

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potential pitfalls of such restrictions, requirements, and environmental risks. However, if sufficient preparation, time, and thought are given to the due diligence process, gas stations make attractive development sites.

Introduction

Gas stations are highly valued development sites because they are spacious slabs of concrete and asphalt, typically located at key intersections with great visibility and easy access. Due to their attractiveness, buyers, investors, developers, and owners are constantly exploring new and creative alternative uses for gas stations. Moreover, relevant changes in the economy, governmental policy, and petroleum industry custom over the past several years have contributed to a growing trend in the conversion and redevelopment of gas station and service station sites into alternative uses. In most areas of the country, not only have real estate values skyrocketed, the costs of operating and maintaining gas stations and repair shops have also increased. This is in part due to pervasive local, state, and federal regulations, particularly environmental regulations, which require costly compliance programs. In addition, over the last couple of decades, there has been a significant consolidation in the oil industry due to mergers and acquisitions. In conjunction with these changes, industry participants have recognized that a gas station or a service station with a repair shop is rarely the highest and best use of valuable real estate. Consequently, not only have the oil companies sold off their gas stations to strengthen their balance sheets, but the number of operating gas stations in the

The high opportunity cost of maintaining gas stations, in the face of rising real estate values and increased environmental and other regulatory compliance costs, has decreased the number of gas stations across the country. Over the last ten-plus years, oil companies have divested most of their retail gas station properties both for continued petroleum uses and for non-petroleum uses. These circumstances have presented opportunities for gas station property owners, developers, investors, purchasers, petroleum marketers, and attorneys, but also challenges. In the divestment process, oil companies customarily impose various requirements, use restrictions, covenants, and obligations on buyers of gas stations. Additionally, gas stations often present environmental issues and conditions that can complicate development. Appropriate due diligence is essential to avoid the

U.S. has steadily declined¹ and many gas stations have been redeveloped and converted to other uses. It may seem obvious that when purchasing or developing any type of asset, you must perform a certain amount of due diligence, but when working a deal to develop or redevelop a gas station or service station property, due diligence is paramount. The devil is in the details.

This article describes special characteristics of deals for gas station sites and discusses essential steps for parties considering acquisition and development of these sites.

Downstream Divestment—Selling the Crown Jewels

Over the last 15 years, the major players in the oil industry² (the “majors” or “big oil”) divested the vast majority of their gas station real estate holdings in the U.S. For instance, Shell Oil Company and Motiva Enterprises LLC divested approximately 5,000 to 6,000 of their retail gas station properties, either in a single-site or portfolio (bulk sale) format. During that same time frame, all of the other major oil companies, e.g., ExxonMobil, ChevronTexaco, BP/Arco, likewise divested several thousands of their retail gas station holdings, primarily in portfolio sales.³ After the portfolio sales were completed, the oil companies concentrated on the remaining single-site sales. As it stands today, very few retail gas stations in the U.S. are owned by big oil.⁴

One consequence of this divestment has been the increased availability of gas station sites for redevelopment, often by parties that may not be aware of the development challenges posed by the sites.

Solid and Comprehensive Due Diligence—Environmental and Otherwise—Is Essential

Prior to jumping into a full due diligence plan for a specific gas station or former gas station site, which is costly and time

consuming, you should conduct a high-level mini-review of the site, including its history, proposed use, and zoning, and assess the developer’s tolerance for risk and patience for navigating the due diligence process. Title should be preliminarily reviewed for the various deed restrictions, covenants, and access agreements of record. This quick research often can identify big oil restrictions and covenants instituted by big oil, or big oil rights of first refusal that may affect or stand in the way of a purchase or development plan (more on all of these below). If the gas station is currently operating, check on the tenant’s or operator’s lease rights and rights under the Petroleum Marketing Practices Act, which provides franchisees with certain rights.⁵ Zoning is also a key factor, and a determination should be made up front whether the desired new use for the property is reasonably attainable under current zoning laws and use restrictions of record.

In developing your due diligence plan, you should consider and analyze the following basic components: (i) environmental; (ii) title/oil company indemnities, restrictions, and requirements; (iii) land use and zoning; (iv) risk and liability; and (v) financial review/cost recovery. Gas stations are not like other commercial properties, as they come with a unique set of restrictions, obstacles, and environmental risks from petroleum hydrocarbon contamination. Additionally, in the case of service station sites with repair shops, there is often evidence of chlorinated solvents such as TCE (trichloroethylene) and PCE (tetrachloroethylene) arising from the use of cleaning agents for metal engine parts. Every developer is different; some are risk prone and some are risk averse. For certain properties and developers, a go/no-go decision is reached at this very preliminary stage of review.

Those Pesky PSAs, Conveyance Documents, and Restrictions

The majors have invested considerable sums in building their brands and marketing networks over many decades, and they generally value each and every branded retail site. In the

¹ The actual number of gas stations varies depending on the source. According to the Gasoline and Automotive Service Dealers Association, as reported in the *New York Times* in April 2016, the number of gas stations nationwide decreased from 300,000 a decade earlier to less than 140,000. See Sarah Maslin Nir, *With Gas Station’s Closing, a Fuel Desert Expands in Manhattan*, N.Y. TIMES (Apr. 15, 2016), <https://www.nytimes.com/2016/04/16/nyregion/a-gas-station-closes-in-soho-making-lower-manhattan-a-gasoline-desert.html>. See also NACS, 2015 RETAIL FUELS REPORT 30 (2015), http://www.nacsonline.com/YourBusiness/FuelsReports/2015/Documents/2015-NACS-Fuels-Report_full.pdf (“There were 152,995 total retail fueling sites in the United States in 2013, the last year measured by the now-defunct *National Petroleum News*’ Market Facts. This was a steep and steady decline since 1994, when the station count topped 202,800 sites.”). The *Times* article also noted that a *Wall Street Journal* analysis in 2014 had said there were only 12 gas stations in Manhattan below 96th Street but that several of those stations had since closed.

² The oil industry has come a long way from the domination by the “seven sisters” in the period leading up to the oil crisis of the 1970s. See ANTHONY SAMPSON, *THE SEVEN SISTERS: THE GREAT OIL COMPANIES AND THE WORLD THEY SHAPED* (1979); Carola Hoyos, *The new Seven Sisters: oil and gas giants dwarf western rivals*, FIN. TIMES (Mar. 12, 2007), <http://www.ft.com/cms/s/471ae1b8-d001-11db-94cb-000b5df10621.html>.

³ Various articles reported on the industry-wide divestment activity. See, e.g., Angel Abcede & Bill Donahue, *Battle Zones: Are Major Oil Sell-Offs ‘Last Stand’ for Jobbers, Retailers?*, CSP MAG. (Mar. 2007), https://matrixcmg.com/wp-content/uploads/2014/11/matrix_news_55.pdf; Alan Chernoff, *ExxonMobil to sell 2,220 gas stations*, CNN (June 13, 2008); *Exxon to sell all of company’s gas stations*, NBC NEWS.COM (June 13, 2008), http://www.nbcnews.com/id/25126563/ns/business-oil_and_energy/t/exxon-sell-all-companys-gas-stations/#.WQ4C0oWcFm8; Steven Mufson, *Local Firms Snatch Up More Gas Stations as Big Oil Moves On*, WASH. POST (July 20, 2009), <http://www.washingtonpost.com/wp-dyn/content/article/2009/07/19/AR2009071901916.html>.

⁴ The thesis and guidance of this article apply to any gas station site, not solely “big oil” sites.

⁵ Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801–2841. You should also obtain and review the dealer lease and ancillary agreements, confirm the status of termination or non-renewal, and research relevant state law.

process of developing their divestment strategies and plans, the oil companies for legitimate business reasons have sought protection, comfort, and control from the grave to protect their interests. The purchase and sale documents used by different big oil companies may have varying terms, but they are all very similar in that they convey the gas station or former gas station real property and related assets to the buyer while tying up and restricting the use and terms under which the developer or buyer can subsequently use or sell the property. Gas station sites sold by big oil in a portfolio or “market” sale to a wholesaler, or in single-site sales to retailers or developers, consistently have certain subsequent conveyance requirements, use restrictions, reservations of rights, covenants, rights of first refusal (ROFRs), indemnity obligations, and access requirements that encumber the property on and after the closing of the sale. These obligations, requirements, and restrictions are usually found, not just in the deed from big oil (which ordinarily contains several covenants and restrictions agreed to in the deed by the buyer’s counter-execution), but also in other deal documents, such as the purchase and sale agreement (PSA), the branding agreement, the wholesaler marketer agreement, the access agreement, and the indemnification and release agreement.

As a result of the majors’ divestment activity, there has been a significant reduction and reshuffling of oil company personnel and counsel, and you should allow for extended lead times in dealing with any of these issues, particularly if you are seeking a waiver of any of these requirements or restrictions. When big oil is in the chain of title, you should start the due diligence process by analyzing the terms, conditions, restrictions, and requirements attached to the sale or purchase of the property. Otherwise, you may find yourself in the position of being two weeks away from the closing, only to discover that there are several time-consuming big oil contractual requirements, consents, or internal approvals that have not yet been addressed that will delay, or in some cases kill, the closing. Be aware that the PSA and related conveyance documents may contain certain unfamiliar traps for the unwary or inexperienced, some of them constituting title objections that need to be cleared to satisfy investors, lenders, purchasers, developers, or title companies. Common big oil requirements and restrictions may include the following:

- Future conveyance requirements, usually for a set term of years, that require the buyer prior to any subsequent sale or conveyance of a site to obtain a Phase II Environmental Site Assessment (Phase II) and provide a copy of such Phase II to the big oil seller.
- Requirement to obtain a written access agreement from any subsequent purchaser in a form agreeable to or approved by the big oil seller (i) acknowledging the environmental risks and the oil company’s continuing access rights, and (ii) making the subsequent purchaser assume (a) the prior buyer’s indemnity obligations to the big oil seller under the prior PSA, and (b) the future conveyance requirements of the PSA, thus extending these future

conveyance requirements to the next deal in the chain (sometimes *ad infinitum*).

- Use restrictions that prohibit competitive petroleum and related uses.
- Use restrictions that prohibit environmentally sensitive uses.
- Development restrictions and requirements, including capping requirements, excavation and subsurface disturbance restrictions, and clean fill requirements.
- Requirements for vapor mitigation barriers and sub-slab depressurization systems (SSDSs).
- Brand covenants and restrictions governing future gas station use for sites remaining “in commerce.”
- For sites being taken “out of commerce,” non-petroleum use restrictions prohibiting any gas station use.
- ROFRs and rights of first offer (ROFOs) that need to be extended by the owner/seller to the oil company by formal notice, with appropriate recordable waivers obtained.

How Restrictive Are Use Restrictions?

Use restrictions are typically contained in the deed from big oil, and may include, among other conditions, prohibitions on the installation of wells, tanks, pumps, or related equipment for the storage or use of potable water, and prohibitions on residential, child care, elder care, hospital, school, playground, or park uses. They also prohibit basements (which increase an oil company’s environmental risk and exposure due to the possibility of vapor intrusion), and often require an asphalt or concrete cap to be maintained on the site. Use restrictions may also involve a requirement of no material change in the use of the site that would increase the level of cleanup required by any governmental entity for any preexisting environmental condition affecting the site prior to the closing date.

If the site is sold by big oil in a single-site sale to go “out of commerce,” there will likely be a non-petroleum use restriction contained in the conveyance deed, requiring that for a certain lock-out period—typically 10, 15, or 20 years—the site may not be used for the sale, storage, advertisement, or distribution of motor fuel or petroleum products. Also, be aware that other use restrictions affecting a site could be contained in a separate environmental deed notice recorded against the property. The deed notice typically controls the uses to which the site can be put.

Depending on how many years have passed since the sale of the site by big oil, some of these restrictions and requirements may be negotiated out or waived by big oil. However, you should have that discussion early in the process so that the parties will have time, if needed, to obtain the Phase II, negotiate any required access agreement form with big oil’s counsel, and negotiate an assignment and assumption document with big oil’s counsel under which the PSA indemnity and future

conveyance obligations can be assumed. Be aware that even though most big oil documents require the subsequent buyer to assume the indemnity obligations owed to big oil, it is unlikely that big oil will release the current property owner upon assignment of these indemnity obligations to the subsequent purchaser. In addition, any indemnities owed by big oil to its original buyer, even if still in effect, will probably not transfer to the subsequent purchaser.

If a site is being purchased for development, the release or modification of one or more use restrictions may be negotiated with big oil. For example, the residential use restriction might be released by big oil if the subsequent purchaser agrees to assume all environmental liability at the site and to release and indemnify big oil for all claims, and also agrees to certain building requirements such as, for example, the installation of a vapor barrier. Similarly, the release or waiver of the “no basement” restriction might be achieved with the developer’s assumption of environmental liability, release and indemnity of big oil, and agreement to certain building requirements. Likewise, the requirement of a concrete or asphalt cap might also be released, at least as to a portion of the site, with the same purchaser assumption of environmental liability, release and indemnity of big oil, agreement to certain no-dig requirements, installation of several feet of clean soil at the site, and other building requirements. Each oil company is different, and in some cases letters of credit, significant environmental insurance policies, and credit-worthy guarantors are required for certain deed modifications, such as allowances for basement or residential use (particularly when working with ExxonMobil).

ROFRs and Brand Covenants—The Sacred Cows?

In addition to use restrictions, sites sold by big oil will generally be subject to a brand covenant and a ROFR for a certain time period (10, 15, or 20 years) after closing on the initial sale of the property by big oil. The purpose of the brand covenant and ROFR is to allow big oil to control and maintain its brand at a site for a certain term after the sale and to thwart competition. The brand covenant and ROFR are considered non-cash consideration received by big oil for the sale of the site and there is a significant value attributed by big oil to each of these rights. They are typically set out in the conveyance deed from big oil and in the branding agreement, which is an exhibit to the PSA.

The brand covenant, which runs with the land, would only apply to continued future petroleum use of a site where motor fuel will be sold, stored, advertised, or distributed from the premises. In other words, if a site is purchased for “out of commerce” future development and use—as a CVS drugstore, for example—the brand covenant will not apply to the proposed non-petroleum use of the site even though it may still be in effect. Since the brand covenant runs with the land, if the CVS site were to revert back to petroleum use it would then have to comply with the brand covenant. In some rare cases, a brand covenant may require a property to be used solely for petroleum use, in which

case a negotiation to obtain a waiver or to take that site “out of commerce” may fail or become very costly. Also, in many cases, taking a branded gas station “out of commerce” involves compensating the oil company for its loss of volume and brand awareness, either by substituting replacement volume at another location, or by providing cash consideration.

The ROFR, in addition to providing big oil an opportunity to step back into ownership of a site that it may not want to go “out of commerce,” is also a valuable tool that allows big oil to make sure that future conveyance requirements such as those discussed above are addressed and met, and that compliance with all use restrictions is maintained. The ROFR typically requires notice of a subsequent conveyance of the site. The notice is provided by (1) a good-faith affidavit that affirms that the proposed sale is a bona fide offer from a third party and (2) a copy of the executed sales contract so that the big oil ROFR holder may determine whether it desires to exercise or waive the ROFR. Keep in mind that the ROFR will grant the big oil ROFR holder a time period—typically 20, 30, or 45 days—to make its determination to either exercise or waive the ROFR. Thus, you cannot wait until two weeks before closing to provide notice of sale to the ROFR holder and expect to be able to timely close the subsequent conveyance deal, particularly since the ROFR waiver, in recordable form, is generally required by most title companies to clear the related title objection.

A release of the brand covenant or the ROFR may be negotiated, but the branding agreement contains a “brand covenant payment” formula that defines the liquidated damages to which big oil would be entitled for release of the brand covenant of record and to amend a distributor/purchaser’s branding agreement to drop the site from that agreement. The brand covenant payment reflects the present value over the remaining term of the minimum annual gallons projected to be sold at the site multiplied by the liquidated damages cents-per-gallon multiplier (anywhere from \$0.02 to \$0.06 per gallon). If the brand covenant payment is made, a recordable release will be provided that releases both the brand covenant and the ROFR. If only a release or waiver of the ROFR is requested, big oil will provide a recordable waiver or release of the ROFR in consideration for a much smaller dollar amount, and in some cases no payment is required.

Let’s Talk About Environmental Indemnities and Access Agreements

As mentioned above, the big oil PSA will contain certain indemnity obligations, including environmental indemnity obligations, that a subsequent purchaser will be required to assume. Furthermore, be aware that under at least some big oil PSAs, the indemnity obligations owed by big oil to its original buyer will expire after a certain time period or upon certain action or inaction of the buyer. In particular, the environmental indemnity obligations owed by big oil to its buyer will ordinarily expire after 36 to 60 months as to the majority of the sites in a portfolio sale. Once those environmental indemnity obligations expire, big

oil will transfer its environmental liability and remediation and monitoring obligations to the buyer and the buyer's subsequent purchaser.

If your client is the subsequent purchaser, make sure to carefully review the indemnity obligations that your client is being required to assume. Often a buyer has obligations to comply with certain conditions to obtain the benefits of an oil company's environmental indemnity. You should make sure that those obligations and conditions were fully satisfied and not breached if you are seeking to recover costs or to hold the oil company responsible under the environmental indemnity. Some majors' PSAs and conveyance documents contractually absolved and released them from all environmental liability. In the case of ExxonMobil's divestment program, it paid and contracted with a third-party environmental consultant to assume responsibility for remediating all existing "covered contamination" identified in the transactional documents and data room prior to the sale, and was released from liability. The various ExxonMobil purchasers assumed liability for "non-covered contamination."

When big oil sold off retail sites, as part of the closing deliverables, the parties executed an access agreement for each site, which granted big oil a license for access and right of entry onto the site after closing. As mentioned above, a requirement for any future conveyance of the site will be for the subsequent purchaser to execute a new access agreement with big oil granting that same license for access and entry into or onto the premises. Instead of creating a new access agreement document, the subsequent purchaser may assume the existing access agreement obligations with big oil's consent.

As part of your initial due diligence, you should request that big oil's counsel provide you with information on the current environmental conditions at the site and whether closure or a "no further action" (NFA) letter has been obtained by big oil. You should also request a waiver of the requirement for a new access agreement and a termination of the existing access agreement of record if big oil is no longer in need of, or entitled to, access to the site. Whether or not the oil company or seller has given an environmental indemnity, and notwithstanding the existence of an NFA letter or other closure determination, when it comes to environmental due diligence, significant thought needs to be given and preparation needs to be done before purchasing or developing a gas station site.

The "Phase I" Should Not be Taken for Granted

The environmental due diligence review starts with a Phase I Environmental Site Assessment (Phase I ESA) performed in

accordance with ASTM standard E1527-13. (Such review constitutes the "All Appropriate Inquiry" necessary as a threshold matter to take advantage of certain liability defenses and protections for purchasers of contaminated properties.⁶) The scope and purpose of a Phase I are tailored to the interests and goals of the developer. The value of a well-done Phase I ESA cannot be overemphasized. A Phase I is non-invasive, relying on the use of an environmental database search report produced by a third-party environmental data company, such as Environmental Data Resources (EDR), from public records and governmental sources. An EDR Environmental Database Search Report customarily includes some or all of the following environmental data: Site History; Prior Uses; Radius Map; Spill Reports; Sanborn Maps; Aerial Photos; Surrounding Property Map; CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act) and RCRA (Resource Conservation and Recovery Act) records; Environmental Liens; Ground Water Flow Direction Map (if available); and LUST (Leaking Underground Storage Tank) Records, among other data.

The Phase I process also includes an on-site inspection, an interview with the property owner or owner's representative, and appropriate freedom of information law (FOIL)⁷ requests made to local, state, and federal agencies including the U.S. Environmental Protection Agency, the respective state environmental regulatory agency,⁸ and local fire and health departments and other agencies having jurisdiction over underground storage tanks (USTs) and environmental matters. In New York City, for example, there is overlapping jurisdiction by several different City and State agencies and departments, including the New York State Department of Environmental Conservation (DEC) (petroleum bulk storage systems and environmental remediation and compliance), New York State Department of Health (soil vapor issues), New York City Fire Department (USTs), New York City Department of Buildings (USTs), and the New York City Mayor's Office of Environmental Remediation (OER) (environmental zoning designation ("E"-designation, discussed below), environmental remediation, and Voluntary Cleanup Program).

The prior uses of the property, and building department records, should be analyzed for evidence of other environmentally sensitive uses that might be prone to the release of hazardous materials other than gasoline, and evidence of abandoned USTs. Diesel fuel, waste oil, TCE, and PCE are common contaminants found at gas station sites in addition to gasoline. For remediation and disposal purposes, petroleum-impacted soil and groundwater are in many cases considered contaminated but "non-hazardous" and are considerably less expensive to remediate than "hazardous"

⁶ Amendment to Standards and Practices for All Appropriate Inquiries Under CERCLA, 78 Fed. Reg. 79319 (Dec. 30, 2013) (codified at 40 C.F.R. Part 312).

⁷ The federal Freedom of Information Act is codified at 5 U.S.C. § 552. New York's freedom of information law is codified in Article 6 of the Public Officers Law (Sections 84-90). A complete list of states' freedom of information laws compiled by the National Freedom of Information Coalition is available at <http://www.nfoic.org/state-freedom-of-information-laws>.

⁸ A comprehensive list of health and environmental agencies for each U.S. state can be found at <https://www.epa.gov/home/health-and-environmental-agencies-us-states-and-territories>.

substances. Diesel fuel,⁹ TCE, and PCE are considered “hazardous” materials in most jurisdictions,¹⁰ and this classification increases the cost of removal, transportation, disposal, and remediation by a factor of approximately two to four times the cost of transportation, disposal, and remediation of petroleum contamination. The typical cost associated with excavation and remediation of petroleum hydrocarbon contamination in the soil, if encountered during construction excavation, ranges from approximately \$50,000 to \$150,000¹¹ in the normal course, not including costs of disposing of hazardous waste, USTs, groundwater treatment, engineering controls (vapor barrier, SSDS), etc. The building department and historical review, coupled with the on-site inspection, should also shed light on possible asbestos and lead paint issues that would require special handling in demolition and redevelopment and increase costs. The potential presence of asbestos or lead paint should be noted in the Phase I report, or surveyed independently.

Records and environmental data—including data on environmentally sensitive uses and spill and discharge histories—for adjacent and nearby properties must be analyzed to assess the potential for environmental impacts to the target property. During the Phase I review process, you must also review environmental zoning issues and institutional environmental controls, restrictions of record, environmental and other liens, and building department violations. For example, New York City has a unique environmental zoning law that authorizes the Department of City Planning to rezone environmentally sensitive properties such as gas stations with a so-called “E”-designation. The program was designed to ensure that the provisions and requirements set forth during rezoning actions are implemented to avoid significant adverse impacts to human health or the environment through exposure to potentially hazardous materials, unwanted sound on sensitive noise receptors, and mobile or stationary pollutants in the ambient air.¹² At an “E”-designated property, a developer cannot obtain a building permit from the Department of Buildings without (i) performing a Phase I ESA and Phase II ESA in conformance with an investigative work plan approved by OER; (ii) developing and obtaining OER’s approval of a remedial action work plan (RAWP); and (iii) implementing the RAWP and obtaining OER’s issuance of a Notice to Proceed to the Commissioner of the Department of Buildings indicating that OER has no objections to the issuance of a building permit. Until the Notice to Proceed is obtained, the development project is dead in the water.

Some states, such as Connecticut, have institutionalized “Environmental Land Use Restriction” (ELUR) programs as part of the menu of remedial approaches available to responsible parties in lieu of remediation. ELUR programs can affect future development and use.¹³ New Jersey has a similar deed notice use restriction law for environmental purposes.¹⁴ The use of institutional ELURs and authorized environmental deed restrictions are similar to the oil company use restrictions contained in various deeds and conveyance documents in that they restrict the property from being used in the future for environmentally sensitive purposes, such as residential, child care, elder care, hospital, school, drinking water, or playground uses. The failure to identify an “E”-designation, ELUR, or deed restriction can have a material adverse impact on gas station property acquisition and development plans.

As part of the Phase I review, all of the key environmental reports, documents, and correspondence to and from the applicable state environmental regulatory agency, the seller, and oil company/last owner (if not the seller), should be obtained and reviewed. Any spill case, whether active or closed, should be discussed with the respective state case manager and environmental consultant of record in order to determine areas of concern (AOCs), subsurface conditions, and the potential for residual contamination and USTs not evident from the environmental reports. Typically, key reports and environmental documents would include Investigative Work Plans, Remedial Action Plans, Quarterly Monitoring and Sampling Reports, Tank Closure Reports, Petitions for Spill Closure, and no-further-action determinations. This information is vital for determining the depth to groundwater and groundwater flow direction and the need for a Phase II ESA, as well as for preparing cost-benefit analyses, construction budgets, and development time-tables; for determining eligibility for state and local brownfields programs and benefits; and for assessing potential impacts to acquisition and construction budgets and financing.

These issues and reports are also relevant, if not essential, to negotiating and obtaining appropriate environmental and Pollution Legal Liability (PLL) insurance coverage, which is highly recommended. The reports also provide information about the current on- and off-site remedial requirements, the presence or absence of active and abandoned underground storage tanks, the presence or absence of monitoring wells (which should be confirmed by the on-site inspection), engineering controls and remedial systems, and potentially responsible parties (PRPs).

⁹ This is because diesel fuel is a far heavier fuel than gasoline; thus it is more pervasive, and its excavation and remediation require more intensive removal procedures.

¹⁰ See, e.g., N.Y.C. MAYOR’S OFFICE OF ENVTL. COORDINATION, CEQR TECHNICAL MANUAL (Mar. 2014), http://www1.nyc.gov/assets/oec/technical-manual/12_Hazardous_Materials_2014.pdf. See also 6 N.Y.C.R.R. § 597.1.

¹¹ Typical transportation and disposal costs range from \$30 to \$50 per ton. Disposal proposals should be competitively bid. Note that there is also usually a cost for transporting and disposing of “clean” soil.

¹² See *E-Designation Program*, N.Y.C. OFFICE OF ENVTL. REMEDIATION, <http://www.nyc.gov/html/oer/html/e-designation/e-designation.shtml> (last visited Sept. 11, 2017).

¹³ See CONN. AGENCIES REGS. § 22a-133q-1. See *Environmental Land Use Restrictions*, CONN. DEPT. OF ENERGY & ENVTL. PROT., http://www.ct.gov/deep/cwp/view.asp?a=2715&q=438254&depNav_GID=1626 (last visited Sept. 11, 2017).

¹⁴ See N.J. STAT. ANN. § 58:10B-13 (enacted in 1993 and amended in 1997 and 2009).

The Phase I ESA also contains a description of recognized environmental conditions (RECs) and AOCs, and makes recommendations to address them. If proposed acquisition or construction financing through a lending institution is involved, the lender will often require a peer review of all Phase I ESAs provided by a developer's or purchaser's environmental consultants due to increased federal government supervision and scrutiny of banks and tightening credit. This often results in further environmental investigation including recommendations for Phase II ESAs.

Yes, You Really Should Perform a Phase II . . . Because It's a Gas Station!

A Phase II ESA is an invasive method of investigating subsurface environmental conditions and is the recommended and preferred due diligence tool in acquiring or developing a former gas station site. It provides a reasonable analytic snapshot of the current subsurface environmental conditions of the three media—soil, groundwater, and soil vapor—which affords the buyer and developer critical information for further negotiations, budgeting, and go/no-go decision-making. A Phase II ESA is often recommended in a Phase I ESA, and is essential for line-item construction budget estimation, particularly where substantial excavation and soil disposal or construction dewatering will be required. The results of the Phase II are often used for waste characterization to identify appropriate state-licensed disposal facilities authorized to receive contaminated soil and groundwater from the site, and to obtain competent and accurate bids and proposals from the facilities and truckers for disposal and transportation costs. In connection with residential development, there are more stringent soil and groundwater quality cleanup standards and criteria that need to be achieved in the remedial process, which can be significantly more costly than remediation for retail or other commercial use.

Generally, when conducting a Phase II investigation in conjunction with an acquisition, the buyer and seller will execute an access agreement with the owner/seller providing the buyer and its consultants access to drill and sample and requiring, in return, indemnification and insurance of the seller for any damage and injury caused during the site work. Both the seller and developer would be named as additional insureds on both the environmental consultant's and the drilling company's certificates of insurance. The insurance coverage should include environmental (PLL) coverage. If the consultant or driller does not have environmental (PLL) coverage, you should use a different consultant or driller, because since it is a former or current gas station, they are likely to find contamination and in some cases puncture a fill or return line or UST or exacerbate the environmental conditions.

The consultant should prepare an investigative work plan, scope of work, and proposed sampling map indicating the proposed sampling locations and testing protocols that would be tailored to the specific development project and site history. This must be done to obtain the most valuable real-time data for further deal negotiations, budgeting, decision-making, financing, insurance, brownfields eligibility, and development and remedial design/engineering purposes. Environmental counsel and the developer should consult and agree on the sampling plan. The sampling map should take into consideration the RECs and AOCs identified in the Phase I as well as the locations of active and former USTs, hydraulic lifts, and repair shop bays. The sampling plan should provide for testing the soil and groundwater for gasoline constituents (benzene, toluene, ethylbenzene and xylene, and MTBE) and for diesel fuel, PCE, and TCE, as well as for testing for the full complement of volatile organic compounds and semi-volatile organic compounds and their constituents (using the testing procedures commonly referred to as EPA Methods 8260 and 8270¹⁵).

In addition, appropriate soil vapor samples from the proposed construction excavation depth and below the existing slab should be taken as well to determine the potential need for installation of a vapor mitigation barrier and an SSDS system. Most environmental regulators, building departments, and lenders will require a vapor barrier and usually a passive SSDS system at former gas station sites. If the development plan calls for excavation for a single- or double-level cellar, the removal of the soil generally would remove critical source material and facilitate a simpler remedial action plan post-excavation. For the installation of an underground parking garage, building codes generally require a sophisticated air exchanger system to mitigate carbon monoxide vapors, which often satisfies most vapor mitigation requirements (such as an active or passive SSDS system) that would otherwise be required by local regulators and building departments. Groundwater at or near the proposed ultimate construction excavation depth should be sampled for dewatering analysis, dewatering system design, and budgeting purposes since contaminated water encountered in the excavation will need to be treated and filtered prior to disposal into the local sewer system or into a portable "frac tank."¹⁶

The proposed Phase II sampling plan and sampling map should be submitted to any regulatory agencies—such as zoning agencies, environmental regulators, etc.—for review and approval if current or future approvals may be sought or needed from those entities to avoid having to repeat or duplicate the Phase II. If the property borders on a subway or underground improvements owned or controlled by a governmental agency or public utility, the consultant would be required to submit the sampling plan and map and evidence of insurance, and to obtain prior approval to drill. All states require that the driller obtain utility mark-outs prior to drilling to ensure no utility lines

¹⁵ See Method 8260B: Volatile Organic Compounds by Gas Chromatography/Mass Spectrometry (GC/MS) (Dec. 1996), <https://www.epa.gov/sites/production/files/2015-12/documents/8260b.pdf>; Method 8270D, Semivolatile Organic Compounds by Gas Chromatography/Mass Spectrometry (July 2014), <https://www.epa.gov/sites/production/files/2015-12/documents/8270d.pdf>.

¹⁶ A "frac tank" is a holding tank used to store contaminated water during the excavation and remediation of a contaminated site.

or conduits are at risk. A search for hidden, abandoned, or unknown USTs performed by a GPR (ground penetrating radar) survey or magnetometer search prior to or in conjunction with the Phase II site work is standard operating procedure.

Finally, the Phase II report should summarize its findings, describing any contaminants found in the soil, groundwater, and soil vapor in excess of allowable governmental standards and, as appropriate, making recommendations as to pre-construction, construction-related, and post-construction remedial steps that should be taken, including soil disposal, groundwater monitoring and sampling, treatment of groundwater during dewatering, and installation of vapor mitigation barriers, vapor extraction systems, and SSDS systems.

Conclusions and Other Considerations

It is easy to see why gas stations can be attractive development sites, if handled properly, notwithstanding their unique environmental and non-environmental concerns. Below is a summary of the main issues to consider in connection with their development or redevelopment as well as some final points:

- A. **Title/Oil Company Indemnities, Restrictions, and Other Requirements:** You should review carefully each of the documents of record and all of the title objections to ensure that each restriction, oil company right, and purchaser obligation is fulfilled, waived, or complied with.
- B. **Land Use Restrictions:** Local zoning and use restrictions need to be carefully analyzed and an upfront determination made whether the proposed use is achievable. In some jurisdictions, environmental contamination is considered a “hardship” entitling the owner/developer to special zoning and use considerations. Allow for substantial lead time for dealing with the oil company counsel and personnel. Rome was not built in a day. Although there are no assurances that the restrictions will be waived or modified, if you are willing to negotiate and accept the conditions that go along with a modification, you have a reasonable chance of success.
- C. **Risk and Liability:** Gas station redevelopment presents obvious environmental risks. Conducting proper environmental due diligence will help identify those risks and will enable the purchaser or developer to negotiate or ameliorate those risks through careful planning, creative remedial strategies, and environmental insurance.
- D. **Environmental Insurance:** Environmental insurance is highly recommended and ordinarily covers unknown conditions, third-party personal injury and property damage claims, and, where no active spill exists, cleanup costs. It is not a substitute, however, for conducting adequate due diligence.
- E. **Financial Review and Cost Recovery:** A well-done Phase II ESA can be a valuable tool in estimating extra incremental and premium construction and development costs attributable to contamination, including the costs of further investigation, soil disposal, groundwater treatment, vapor

control, and other forms of remediation. Soil excavation and disposal generally eliminate much of the risk and contamination. While PRPs earlier in the chain of ownership or operations may be identified, you should review relevant state statutes and agreements to determine whether cost recovery claims for reimbursement are viable. Sometimes a cost-sharing arrangement may be reached with a responsible oil company in the right circumstances. Remember, however, that no responsible party will pay more than the incremental increase in costs for disposal of soil or groundwater above disposal costs for disposal of clean soil or water for a comparable “clean” site—ordinary construction costs are always borne by the developer. In some jurisdictions, a developer may be entitled to financial benefits under various state brownfield programs, oil spill fund programs, or tank funds. It pays to research.

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LEGAL DEVELOPMENTS

ENERGY

Second Circuit Upheld DEC Denial of Water Quality Certificate for Natural Gas Pipeline

The Second Circuit Court of Appeals upheld the New York State Department of Environmental Conservation’s (DEC’s) denial of an interstate natural gas pipeline developer’s application for a Water Quality Certificate under Section 401 of the Clean Water Act. The Second Circuit concluded that it lacked jurisdiction to consider the developer’s argument that DEC had waived its right to rule on the application because it failed to act on the application within the time period required by the Clean Water Act. The court noted that the record indicated that DEC had never received information it had “consistently and