Toxic Succession Planning

How Planning Ahead Mitigates Environmental Cleanup Liability Risk for Successors

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The Chemical Contamination Issue

Tens of thousands of businesses in the United States either use, store, or dispense chemicals that are hazardous if inhaled or ingested. It is commonplace for these chemicals to leak or spill at these facilities, which then end up contaminating the soil. Once in the soil, these chemicals and their hazardous vapors migrate downward – vertically – toward our "groundwater" and drinking water aquifers, and laterally – often beyond property boundaries. Because of the danger to communal health and the environment, state and federal laws require that these released chemicals be remediated once they are discovered in soil or groundwater.

The Underlying Ownership Problem

The mere act of owning a real estate parcel where chemicals have leaked into the soil or groundwater makes the owner liable for potentially the entire cost of cleaning up these contaminants, even if the owner had nothing to do with causing the chemical release. The investigation and remediation costs associated with this kind of environmental cleanup liability are often hundreds of thousands of dollars, and in many cases, in the multi-million dollar range.

Protocols for identifying and dealing with these soil and groundwater cleanup liability issues in the purchase/sale of potentially contaminated sites, including requirements for Phase I investigations by banks and other lenders, are well established. Decades of "Superfund" actions by the U.S. EPA, cleanup actions by other federal and state agencies, and tens of thousands of private party lawsuits to compel cleanup, have left their mark. It is truly a "buyer beware" landscape for those who consider purchasing real estate that is or might be contaminated.

What is "Toxic Succession"?

The passing of contaminated sites from one generation to another, or to one or more business partners, other heirs or beneficiaries, or charities, is referred to throughout this white paper as *toxic succession*. In the trusts and estate planning arena the concept will be referred to in this paper as "toxic *estate* succession," while succession in the corporate business arena will be known as "toxic *business* succession". To our knowledge, this issue has not previously been given a name, nor has much been written about the problems inherent in passing contaminated properties at death.

Toxic Succession Problems

The one area where very little emphasis has been placed, whether by red flagging the potential problems or working to prevent or otherwise resolve them, are situations where the party acquiring the contaminated real property asset is an heir, beneficiary or business partner of the owner of the property who has now passed away. These estate succession and business succession scenarios carry the same serious and potentially catastrophic potential for environmental cleanup cost liability for the *heirs, beneficiaries, and business partners* who now find themselves in the crosshairs of regulators and private parties, merely for succeeding to an "owner" status due to an estate plan or business buy-sell agreement.

WHO IS IMPACTED:
Any recipient or beneficiary of an estate, trust or business succession plan

POTENTIAL LIABILITY:
Ranges up to multiple $ millions

FEDERAL STATUTE:
Comprehensive Environmental, Response, Compensation & Liability Act

The environmental cleanup liability problems associated with a transfer of contaminated real estate to heirs and successors at death are just as serious as those associated with purchasing a contaminated site.

Example 1: Business Partners, Buy-Sell Agreement (George and Tony)

RELATIONSHIP:
50/50 business partners for 20 years in a successful California manufacturing business.

PERSONAL CHALLENGES:
Without warning George has a heart attack and passes away. Tony is prepared to buy out George's 50 percent share of the company, but has been advised that by doing so he might be inheriting George's share of any environmental cleanup liability associated with contaminated real property owned by the company.

LEGAL SITUATION:
The company owns two parcels of real estate where contamination may have occurred. One property contains the manufacturing equipment and production lines, and the other property is used for chemical storage. Prior to George's death, the company's environmental consultant advised both George and Tony that the soil and groundwater on these parcels was likely to contain chemical contamination from spills, leaks and other releases associated with the company's normal manufacturing operations.

The Buy-Sell Agreement: The terms and conditions for Tony's purchase of George's 50 percent interest in the company are set out in a buy-sell agreement drafted almost a decade earlier. The valuation formula is based on a standard industry multiple of the average gross revenue of the company for the previous five years. However, the formula does not account for the environmental cleanup liability Tony will be assuming by acquiring a 100 percent ownership interest in the company and its contaminated real property sites.

PROBLEM:
Tony realizes that if he purchases George's shares of stock using the formula set forth in their buy-sell agreement, he may well be significantly overpaying. He would then own 100 percent of the company but would also acquire 100 percent of the environmental cleanup liabilities associated with the contaminated sites owned by the company.

OUTCOME:
Tony is forced to sue the estate (the wife and children) of his long-time business partner, George. This delays the distribution of George's estate for several years, destroying the friendship between the families, and causes George's heirs and beneficiaries to sue each other. Both Tony and George's estate sue the accountant and lawyer who set up the buy-sell agreement (and the formula for valuing the company at death).

The maxim must be, "successor beware," because the draconian cleanup cost liabilities associated with ownership of contaminated properties pass at death to each new owner.

Example 2: Lori, Trustee of Family Trust

RELATIONSHIP:
Mary and Greg Donovan have been married for 53 years, and are both very successful. They have substantial investments, including family money passed down from prior generations – which include a large portfolio of commercial properties and two industrial parcels. The family's advisors created a sophisticated estate plan, employing cutting edge tax and succession strategies, involving a family charitable foundation, several trusts, and specifying large gifts upon death to two well-known charities. Lori, the Donovans' eldest daughter, has an Ivy League MBA and is chosen to be the trustee of the main family trust.

PERSONAL CHALLENGES:
Mary and Greg eventually pass, and Lori (as family trustee) begins the process of dividing up the estate according to their wishes. Although Lori soon learns that two real estate investment properties held in the family trust may be heavily contaminated, her Mom and Dad did not provide directions to her on how to deal with, or set aside earmarked monies to pay for, these contamination issues. They inadvertently left Lori "holding the bag".

LEGAL SITUATION:
Lori is advised that one of her family's commercial properties was occupied for several years by various dry cleaning operators, and also housed a gasoline service station. Though none of these businesses has been in operation at the site for at least a decade, significant gasoline and PCE contamination has been discovered. Lori discovers that one of the family's industrial properties is also severely contaminated, resulting from the operations of various industrial tenants over a 30-year time span.

PROBLEM:
While Lori is analyzing the estate and determining how best to deal with the contamination issues and distribute estate assets, she learns that the PCE contamination from the dry cleaning facility has migrated offsite and is part of a major regional groundwater contamination problem. She is very concerned because she has been advised that, in her role as trustee of the family trust, she can now be held personally liable for the cleanup of that contamination, potentially even above and beyond the assets and resources of the family trust.

OUTCOME:
Due largely to her potential personal liability for the significant offsite PCE plume, Lori decides to forego trust distributions to the other beneficiaries of the estate - her four siblings and two prominent charitable organizations. Two of the siblings sue Lori, demanding significant distributions from the estate. The ensuing litigation lasts eight years, and ends up tearing the family apart. The charities have yet to see a dime of the donations they had been expecting.

About the Environmental Cleanup Process

Ownership Liability Under CERCLA

According to the **Comprehensive Environmental Response, Compensation and Liability Act**, a current owner of a contaminated site is liable in any action by the federal government to clean up the chemicals that are on or migrating from that site. This liability is "joint and several," meaning that the government can require the present owner to pay 100% of the cleanup costs. Because of the stringency of this liability scheme even when the new owner had zero fault in causing the contamination, it is very risky to acquire commercial or industrial property that may be contaminated.

The legal backdrop for the liability scheme pertaining to chemically contaminated sites is the federal law known as the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA" or "Superfund").

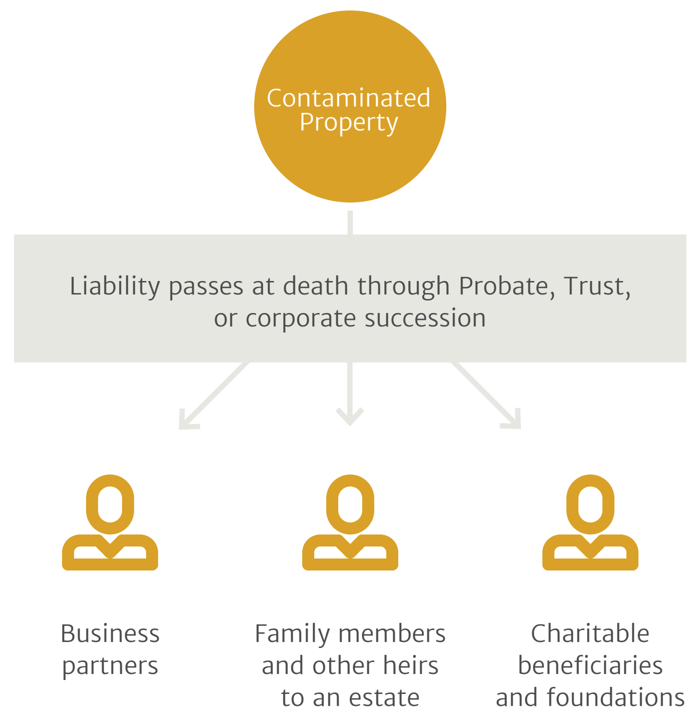
CERCLA provides liability for any party (collectively "Potentially Responsible Parties" or "PRPs")in the chain of ownership or operation of a facility, or transportation or disposal of hazardous substances from the facility, that generates or releases contamination to the soil or groundwater. However, since the existing owner is the easiest to locate, the owner is often the first and primary target brought into a federal Superfund action.

While the federal government is somewhat sparing in the number of CERCLA actions it initiates, there are similar laws in each state providing essentially identical environmental cleanup liability concerns for existing owners of contaminated property. Additionally, just like the federal government, state and local regulatory agencies have the authority to initiate actions compelling cleanup without the necessity of initiating a lawsuit.

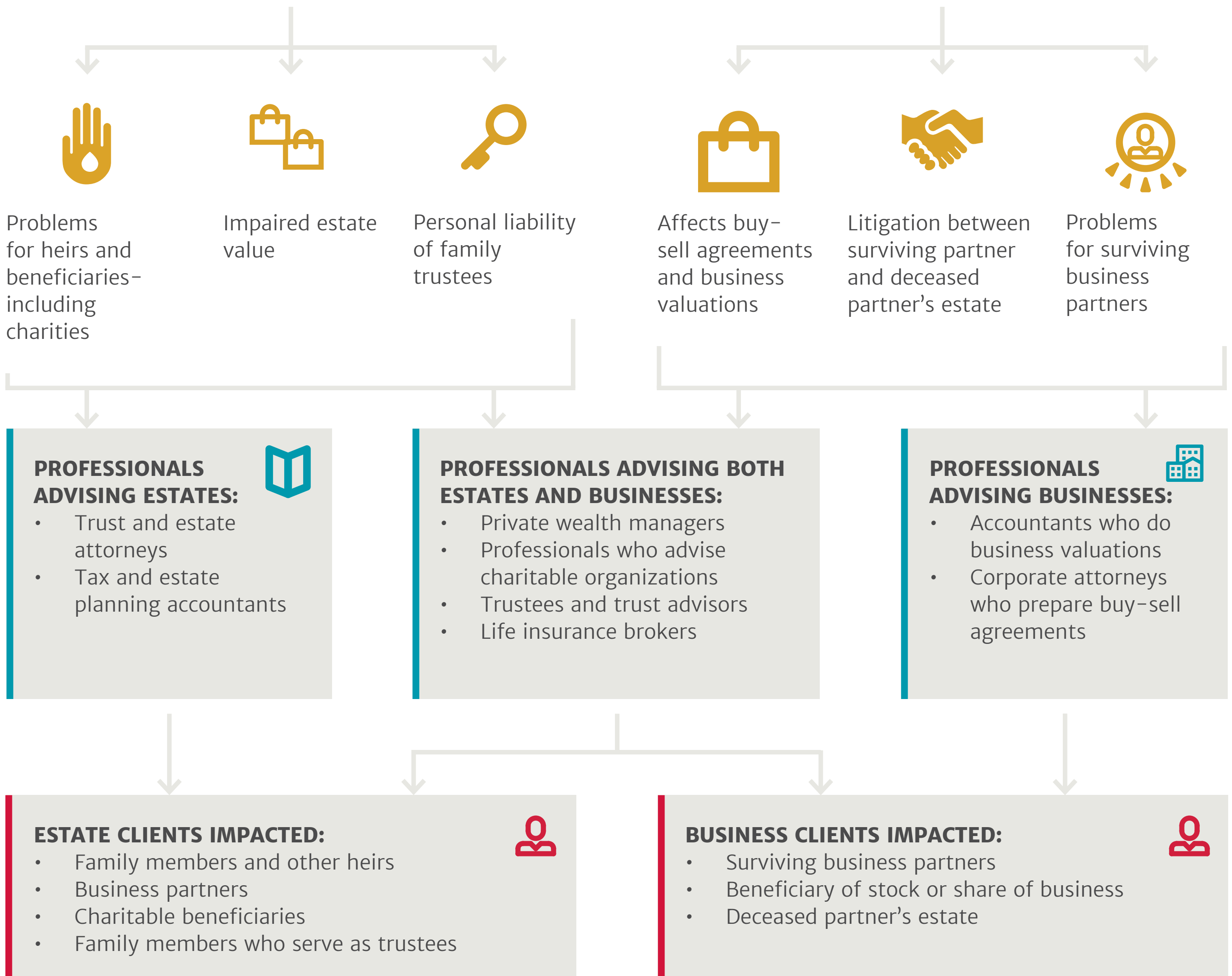
This liability scheme is often harsh and unfair. Because the parties that caused the contamination may be difficult to find or may not have the resources to pay for the cleanup, the government pursues the easiest to locate parties – the existing landowners, often requiring those parties to conduct and pay for 100% of the remediation work. These parties, "tagged" with the liability for clean- up, may file their own lawsuits against other parties who have PRP liability status, but this is often prohibitively expensive, and the private party filing such a lawsuit does not have the benefit of the joint and several aspects of CERCLA often available when the action is filed by a government entity. As such, private party litigation against other parties for contribution to help pay for cleanup costs is often protracted, difficult and very expensive.

Who Do Toxic Succession Problems Affect?

Toxic "estate" succession affects those heirs and beneficiaries who acquire title to contaminated real property, or who will otherwise benefit financially, because of the disposition at death of an estate or trust containing contaminated real property. Toxic "business" succession affects surviving business partners when contaminated real property is owned by the business at the time of the deceased partner's death.



Cleanup liabilities pass with title at death



TOXIC ESTATE SUCCESSION

Transfer of contaminated real property through estate succession, whether passed through a trust or by probate, can have severe financial consequences. Heirs or beneficiaries taking title to contaminated assets often become the target of environmental cleanup actions because of their new status as "owners," for CERCLA and state environmental law purposes. Additionally, contaminated properties held in family trusts may result in personal liability for the family trustee, and can significantly diminish the total value of the assets held in trust. Unplanned successor environmental liabilities often result in litigation between heirs and beneficiaries, and with third parties.

TOXIC BUSINESS SUCCESSION

At the death of one business owner, the deceased owner's share of the environmental cleanup liabilities can pass to the surviving owners either directly or through a stock ownership transfer, often through the use of a Buy-Sell Agreement. This can result in dire financial consequences for the surviving owners as they may well be stuck with significant additional environmental cleanup liability without any financial contribution from the deceased partner or the deceased partner's estate. Without planning for this eventuality, severe inequities can result, and litigation is often imminent.

The Value of Professionals in Toxic Succession Planning

Because of the potential for catastrophic consequences to heirs, beneficiaries, businesses and others involved as direct participants in the estate or business succession process, financial and legal professionals who advise such clients on succession planning issues need to be aware of, and be ready to address, the site contamination and toxic succession issues that may arise. This includes proper, up front toxic succession planning as well as being prepared to deal with the fall-out from not addressing these contamination issues in the succession planning stage.

It is important for a client to see that the professionals he or she employs are at the cutting edge of important issues and are proactively looking out for the client's best interests. Conversely, a failure to advise clients on the potentially dire consequences of ignoring these toxic succession issues up front during the succession planning process can lead to claims of misadvice, errors and omissions claims, and malpractice against the professionals.

The following professionals serve clients in situations where toxic succession planning could be important:

Attorneys – Trusts and Estate Planning

Attorneys who provide advice on trusts and estate planning, including the use of various trust interrelationships to minimize tax liabilities, should be prepared to include evaluations of potential toxic estate succession issues in their advice. As noted throughout this paper, liabilities for cleaning up contaminated real property assets follow the title to these properties.

A prudent trusts and estates lawyer should be able to provide clients with access to strategies which will maximize the value of the estate while minimizing environmental cleanup liabilities for heirs and beneficiaries, and for future generations. Such advice will also help prevent future disputes and the litigation which often follows inadequate toxic succession planning efforts.

Private Wealth Managers

Because of the scope and breadth of services private wealth managers provide as part of financial planning and portfolio building efforts, wealth managers often encounter clients with potential site contamination and toxic succession issues. These advisors typically provide client support in the areas of trusts and estate planning, business succession planning, and business valuation, all of which require an awareness of toxic succession issues.

Accountants Specializing in Tax and Estate Planning

Toxic succession issues are a potential estate planning concern for any estate containing real property assets that might be contaminated with gasoline or other chemicals. Passing the ownership of contaminated properties at death will often result in a transfer of the environmental cleanup liabilities to the new heirs, beneficiaries or charitable organizations receiving them. Accountants can provide a useful service to clients by being aware of these issues and providing clients with access to the tools necessary to address these toxic succession issues.

Accountants and Other Professionals Conducting Business "Valuations"

It is important to properly account for contamination issues when a business going through a succession process owns contaminated properties. This includes valuations of interests between owners or shareholders pursuant to a buy-sell agreement. Accountants must make sure the formulas in the succession process used to value the business and any other agreements the parties rely upon consider and account for all potential environmental liabilities associated with any contamination.

Corporate Attorneys and Buy-Sell Agreements

Business valuations often fail to account for potential environmental contamination of real estate owned by the business. This oversight can have serious consequences at the death of a business owner when that deceased owner's share of the company is transferred to surviving business partners or beneficiaries – along with the deceased owner's share of liability for the remediation of any contaminated real estate owned by the company. Corporate law attorneys, especially those that regularly draft buy-sell agreements, should be aware of the potentially serious business valuation issues involved in the passing of corporate environmental cleanup liabilities at death.

Moreover, in the business succession context, these concerns relate not just to the present ownership of contaminated properties. The company's prior ownership or operations at contaminated properties is also of concern, as is the acquisition of other companies that may have owned, operated, transported or disposed of hazardous substances previously, themselves carrying environmental liabilities. In order to properly determine the buy-out value of a deceased owner's interest in a company, the company's value must be reduced to account for the environmental liabilities the surviving owners will be assuming at the deceased owner's death. Planning for this concern by including an analysis of likely environmental liabilities is the best way for corporate attorneys to address these issues.

Life Insurance Brokers – Funding for Cleanup Costs

One partial solution for dealing with contaminated real property and toxic succession problems is to ensure the provision of one or more funding sources that can be used to pay for site investigation and cleanup at death. While various funding mechanisms are potentially available, one attractive option is the use of life insurance, including the increased funding of already funded estate or business obligations. Life insurance can be utilized as a partial funding mechanism for environmental cleanup liabilities in the context of an estate, the context of a buy-sell agreement, or for any other transfer of contaminated real property or business ownership at death. Knowledge of the potential role of life insurance in the estate succession context can be a useful business development tool for savvy life insurance brokers.

Trust Companies & Trustees

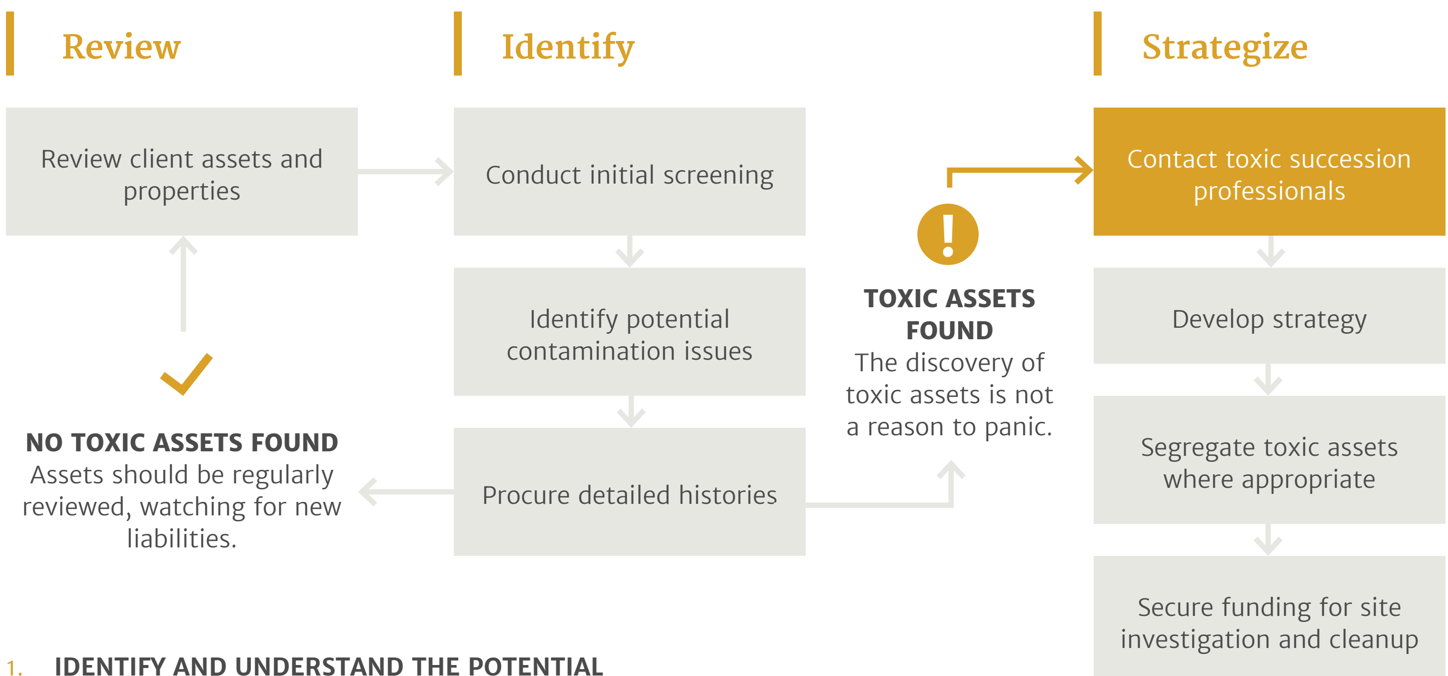
The problems of dealing with contaminated properties at death are not limited to heirs, beneficiaries and business interests. Those willing to serve in the role of trustee, or other fiduciary, have good reason to want toxic succession planning to be part of the estate succession planning and administration process. While truly independent trustees (those that do not have a personal financial interest in the assets being distributed) have protections from CERCLA-type liability under certain state and federal statutes, the property in the trust does not receive those protections. Moreover, trustees might be named personally in any litigation that ensues, including potential claims that contaminated assets have been mismanaged. Fiduciaries can also be liable if they run afoul of the strict requirements for statutory protections, and may additionally have to fight off litigation once an estate is distributed, the estate assets have been depleted, or the trust has otherwise been terminated.

Professionals Who Work with Charitable Organizations in Planned Giving Arena

Toxic succession issues arise on a regular basis in the planned giving context. Though many foundations and charitable organizations refuse to accept gifts of real property that may be contaminated, even this extremely conservative approach often won't eliminate the impact of toxic succession issues if the estate or business does not conduct adequate upfront toxic succession planning. When problems associated with contaminated properties are not properly addressed and are left to be handled without direction by the trustees or heirs of the estate, the potential for unintended estate liabilities and litigation becomes a very real concern. If an estate is embroiled in litigation because of real property contamination issues, the value of the estate may well be impacted and the timing of distributions to charitable organizations can be delayed by years or even decades. Because of this, it is in the best interest of foundations, charitable organizations and planned giving professionals to reach out to potential donors, advising them of the need to conduct up-front planning to avoid potential unintended toxic succession liability consequences.

Identifying and Mitigating Potential Problems

The main goal of reaching out to the identified professionals within the financial, legal, banking, accounting, planned giving and insurance industries is to put these professionals on notice that potential toxic succession problems should be considered during estate and business succession planning efforts. As with all complex issues, a proactive approach and planning strategy – in this case prior to death – will often be the key to a successful toxic succession process. A few key components of such a strategy follow.



1. **IDENTIFY AND UNDERSTAND THE POTENTIAL SCOPE OF A TOXIC SUCCESSION PROBLEM:** The evident first step in proactively planning for toxic succession issues is to determine whether contamination is a likely problem for a given estate or business. This at the very least entails a review of the real property parcels that are presently owned by the family or business undergoing succession planning, and should include analysis of the historical uses of such parcels and likelihood of potential contamination of those sites. If this survey identifies the existence of contamination and potential toxic succession issues, the histories of the subject properties should be analyzed to determine the potential magnitude of any concerns. In order to protect the investigations, while at that same time keeping them confidential and potentially privileged from disclosure in any future litigation, an environmental attorney should oversee the screening process.

2. **DEVELOP A STRATEGY WITH THE CLIENT'S EXISTING FINANCIAL AND LEGAL ADVISORS:** Once likely toxic succession issues have been identified, the properties in question should be evaluated by the professionals on the client's estate and business succession team. The client's accounting, financial, legal and insurance advisors should all be included in the decision-making process. An attorney specializing in environmental contamination and toxic succession issues should spearhead the team, if possible. It may be determined that certain contaminated properties should be segregated from other assets of the estate. Differing approaches to handling the environmental issues will be employed, depending on the circumstances.

3. **MINIMIZE LIABILITY AND INEQUITIES FOR HEIRS AND SUCCESSORS:**
   One primary goal of any toxic succession planning effort is to ensure that significant environmental cleanup liabilities do not pass inadvertently to heirs, beneficiaries or business partners. Therefore, once potentially contaminated sites have been identified and a toxic succession team has been assembled, that team should focus much of its efforts on how best to avoid or minimize personal liabilities for successors.

   Some approaches, like utilizing independent trustees instead of family members to deal with certain contaminated real property assets, are fairly straightforward. Identifying the likely scope of contamination is also critical, as is providing adequate direction to the trustee or other fiduciary so that she can effectively address contamination issues.

4. **MAXIMIZE OVERALL VALUE OF THE ESTATE:**
   Working with a team that understands how to maximize the value of contaminated real property, including how to utilize local government assistance and possible grant money, can make a big difference. Even significant contamination issues often do not need to be a devastating blow to the estate if they are handled appropriately. There are many local, state and federal programs that provide incentives and encourage development of contaminated properties. Having environmental specialists in the succession planning stage, to help navigate through these regulatory programs, is critical.

5. **SECURE FUNDING FOR SITE INVESTIGATION AND CLEANUP**
   In the majority of cases, site contamination will cost less to clean up than the property would sell for if it were not contaminated. However, if a property has not been adequately investigated and characterized – so that the likely cost of remediation can be determined – a buyer that otherwise might be willing to purchase the contaminated parcel won’t have enough information available to do so. By conducting a full investigation – and providing the estate and its fiduciaries with adequate authority and enough money to do so, it is often possible to turn contaminated properties that are otherwise unmarketable into valuable positive assets for the estate. On the other hand, if the estate and succession fiduciaries are not provided appropriate latitude and funding to properly investigate contaminated estate assets, the estate will often find itself embroiled in what may be needless infighting and litigation.

CONCLUSION

Now is the time to reach out to financial, legal, banking, accounting, planned giving and insurance professionals across the country, and to advise these professionals on addressing toxic succession issues up front in the succession planning process. The estate, trust and business succession nightmares that often result from failing to properly address toxic succession issues can and should become a thing of the past.

About the Campaign

Campaign 5000 is a multi-disciplinary effort to raise awareness and spark widespread discussion concerning the importance of toxic succession planning for businesses, trusts and estates. Spearheaded initially by a handful of professionals intimately connected with the issue, Campaign 5000 strives to rectify the lack of information and mindfulness on the topic of toxic succession by partnering with as many accountants, lawyers, trusts, wealth managers, and succession planning professionals as possible. The Campaign 5000 outreach seeks to ensure that identifying and addressing potential site contamination issues becomes a regular part of every thoughtful estate or business succession planning effort.

Contributors

Kevin Daehnke
Senior Partner
Daehnke Cruz Law Group, LLP
Newport Beach, California

Kevin Daehnke is an environmental law attorney, specializing for more than thirty years in issues relating to the contamination of soil and groundwater resulting from business operations. Mr. Daehnke is credited with creating and securing passage of legislation which established the Bona Fide Ground Tenant tool for dealing with contaminated "Brownfield" sites. He is also known for spearheading the Campaign 5000 effort to educate legal, accounting and financial professionals on the need for up front toxic succession planning during the business and estate succession process. Mr. Daehnke has been appointed to serve on the executive committees of numerous legal, professional and trade association panels and committees, is a regular author for legal and environmental trade publications, has testified on Brownfields legislation before the Assembly Toxics Committee, and has given numerous speeches and presentations at legal and trade association panels and conferences. Mr. Daehnke is a founding partner of Daehnke Cruz Law Goup, LLP.

Marshal Oldman
Senior Partner
Oldman, Cooley, Sallus, Birnberg, and Coleman, LLP
Encino, California

Marshal Oldman has practiced in the Trusts, Estates and Probate arena for four decades, establishing himself as one of the preeminent experts in the field. He has served as Chair of the Trusts and Estates sections of the Los Angeles County Bar Association and the California State Bar Association. He has helped draft legislation relating to probate, trusts and estate planning issues, and has testified on probate legislation before the Assembly Judiciary Committee. He is the author of numerous articles for various Bar journals, has given numerous speeches before the L.A. County Bar Probate Section and other organizations, and has served as an expert witness in probate, attorney fee, legal malpractice and federal estate tax matters. Mr. Oldman served as President of the State Board of Accountancy from 2011-2012. Mr. Oldman is a founding partner of Oldman, Cooley, Sallus, Birnberg and Coleman.