
When the Tail Wags the Dog: Environmental Considerations and Strategies in Business Acquisitions, Sales and Merger Transactions

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A. INTRODUCTION

Business acquisitions and merger transactions involve a number of obvious considerations: asset valuation, financing issues, accounting problems, and tax consequences. As a result of the enactment of expansive environmental legislation commencing in the late 1970's and early 1980's, environmental risks have also become a critical consideration in deciding whether and how to purchase, sell, or merge businesses.

Environmental representations, warranties, indemnities, and related provisions frequently occupy a seemingly disproportionate number of pages in transaction documents. Indeed, it is not uncommon for the negotiations to essentially be turned over to the "environmental lawyers" once basic decisions regarding the structure of the transaction, price, and timing are made. As discomfiting as that may be to clients, the fact remains that environmental considerations and risk allocation strategies will play a major role in many business acquisition or merger transactions. There are several reasons for this emphasis on environmental risks and due diligence. First, there is the fear of the unknown. Unlike other risks, such as title defects, which can be ascertained at a relatively low cost prior to the closing of the transaction and which can be effectively managed through the agreements of the parties, environmental defects associated with a business often cannot be identified prior to closing; even after spending significant sums for environmental due diligence. Second, the complex, and sometimes counter intuitive, nature of the legal framework of environmental risks makes it especially difficult to identify environmental concerns and effectively represent a client in the risk allocation process. Finally, the potential economic impact of environmental problems and risks goes far beyond the possibil-

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ity of losing some portion of the benefit of the bargain. Environmental laws which impose upon business owners strict, retroactive, and joint and several liability to the government for a wide-range of environmental problems creates a situation where the economic “stakes” are much higher should due diligence be ignored or handled inappropriately.

The purpose of this article is to provide the reader with a general understanding of the environmental risks and liabilities inherent in business sales, acquisitions, and mergers. Further, this article will discuss the tools and strategies available to render such risks and liabilities “manageable;” as opposed to such risks becoming insurmountable “deal breakers.”

B. THE LEGAL FRAMEWORK: WHY ENVIRONMENTAL DUE DILLIGENCE IS NECESSARY¹

1. *The “Superfund” Law*

Perhaps no other single law defines and dictates the environmental risks and strategies of business acquisitions and mergers as the federal “Superfund” law. The purpose of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA),² otherwise known as the federal “Superfund” law, is to identify and clean up the nation’s hazardous waste sites.³ This goal is achieved through legislation enabling the federal government to undertake clean up action and/or to cause other parties, both private and public, to participate in or pay for clean up activity.⁴ This participation is made possible through the imposition of legal liability on broad categories of persons with a connection to the site and by imposing severe penalties on those who do not voluntarily cooperate.⁵

CERCLA’s provisions address the release into the environment of a wide variety of “hazardous substances”—including most of the chemicals, raw materials, and wastes associated with common industrial activities.⁶ It is the known or potential release⁷ of such hazardous substances

1. It is beyond the scope of this article to discuss in detail the liability provisions of environmental laws potentially applicable to sale, acquisition, and merger transactions, nor is it possible to provide an exhaustive list of all such laws and regulations. This section, generally describing the legal framework of environmental due diligence, is intended merely to put in context the risks, liabilities, and strategies discussed below.

2. 42 U.S.C. §§ 9601-9675 (1994 & Supp. III 1997).

3. 42 U.S.C. § 9604(a) (1994).

4. *See* 42 U.S.C. §§ 9601-9675.

5. *See* 42 U.S.C. §§ 9606, 9607 (1994 & Supp. III 1997).

6. 42 U.S.C. §§ 9601(14), 9602(a) (1994). The list of hazardous substances presently includes over 700 entries. 40 C.F.R. § 302.4 (1994). Significantly, petroleum and derived products are specifically excluded. 42 U.S.C. § 9601(14) (1994).

7. *See* 42 U.S.C. § 9604 (1994).

at, on, under, or from business property which creates the significant "Superfund" liability risks in acquisition or merger transactions.

a. Scope of Liability

CERCLA imposes liability on certain categories of persons for response costs associated with the investigation, removal, and remediation of hazardous substance contamination.⁸ Damages for injury to natural resources and the environment are also recoverable.⁹ Under CERCLA, the United States Environmental Protection Agency (EPA) may undertake to directly investigate and clean up a contaminated site,¹⁰ issue abatement orders, or commence litigation to compel responsible parties to undertake remedial action.¹¹ It is a rare site where the necessary costs of response do not amount to millions of dollars.¹²

Private party liability under CERCLA is joint and several, meaning that any one of several responsible parties can be made legally accountable for paying all response costs when each party's contribution to the contamination cannot be "separated" from that of the other parties.¹³ Parties held liable to the government under a joint and several theory, however, may have a right of contribution against other responsible parties.¹⁴ Liability under CERCLA has also been held to be retroactive; that is, it extends to releases of hazardous substances which occurred before the enactment of the statute in 1980.¹⁵ Finally, CERCLA liability is strict. Thus, liability does not depend upon whether a business was in any way at fault with respect to the contamination at issue.¹⁶ Historic business operations which, at the time, may have been in complete con-

8. 42 U.S.C. § 9601(20) (1994 & Supp. III 1997).

9. 42 U.S.C. § 9607(a)(4)(C) (1994).

10. 42 U.S.C. § 9604. The President, through the EPA, has discretion to respond to hazardous substance releases. CERCLA enables the EPA to respond to "releases" or threatened releases of hazardous substances from a "facility" into the "environment." 42 U.S.C. § 9604. "Environment," "facility," and "release" are broadly defined. See 42 U.S.C. §§ 9601(8), 9601(9), 9601(22) (1994 & Supp. III 1997).

11. 42 U.S.C. § 9606(a) (1994). A person who, without sufficient cause, violates or fails to comply with an abatement order may, in an enforcement action, be fined up to \$25,000 for each day of violation. 42 U.S.C. § 9606(b)(1) (1994).

12. See, e.g., *United States v. Bestfoods*, 524 U.S. 51 (1998) (detailing CERCLA liability exceeding ten million dollars).

13. *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 810 (S.D. Ohio 1983).

14. 42 U.S.C. § 9613(f) (1994). The interrelationship between a person's right to sue an alleged responsible party to recover costs under a joint and several liability theory pursuant to 42 U.S.C. § 9607(a) and the right to sue for equitable contribution under 42 U.S.C. § 9613(f) has been the subject of substantial judicial interpretation over the past several years. It appears to be settled in the Tenth Circuit (and most other jurisdictions) that, regardless of how it is characterized, a claim by one potentially responsible party (PRP) (as defined by 42 U.S.C. § 9607(a)) against another PRP is properly a contribution claim under 42 U.S.C. § 9607(a), and not a cost recovery claim under 42 U.S.C. § 9613(f). *United States v. Colorado & E. R.R. Co.*, 50 F.3d 1530 (10th Cir. 1995).

15. See *United States v. Northeastern Pharm. & Chem. Co.*, 810 F.2d 726, 732-37 (8th Cir. 1986), cert. denied, 484 U.S. 848 (1987).

16. See *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985). See also 42 U.S.C. § 9601 (1994 & Supp. III 1997).

formance with industry and governmental standards may nevertheless lead to strict, retroactive, and joint CERCLA liability.¹⁷

b. Persons Liable

Subject to only a few, very limited defenses, the following categories of “persons” are liable for response costs incurred as a result of a release of hazardous substances at a facility:

- The current owner or operator of a facility from which there has been a release/disposal of hazardous substances at any time;¹⁸
- Former owners or operators of a facility who owned or operated the facility at a time a disposal of hazardous substances occurred;¹⁹
- Persons who, at any time, arranged for the disposal or treatment of hazardous substances owned by such person at a facility owned by another party or entity (“generators”);²⁰ and
- Persons who transport hazardous substances for treatment or disposal, where the transporter selects the disposal site.²¹

Parties who are liable or potentially liable under CERCLA,²² are commonly referred to as “Potentially Responsible Parties” (PRPs). In the context of business sales, acquisitions, and mergers, the buyer, seller, and merging companies most commonly face potential CERCLA liability as present or former “owner/operator” and/or “generator” PRPs. In addition, employees, officers, and directors of both the buying and selling entities may be at risk personally if they have directly participated in conduct resulting in the disposal of hazardous substances or had responsibility or authority with respect to such disposal.²³ Shareholders may be liable if the shareholder and the corporation are not distinct entities; that is, if the requirements for piercing the corporate veil

17. See, e.g., *United States v. Shell Oil Co.*, 841 F. Supp. 962, 968 (C.D. Cal. 1993).

18. 42 U.S.C. § 9607(a)(1) (1994). The broad definitions of “release” and “disposal” arguably make the innocent owner of property which lies in the path of a migrating plume of contaminated groundwater liable under 42 U.S.C. § 9607. In other words, the mere movement of contaminated groundwater through the soil underlying a property could be deemed to be a “release” for purposes of CERCLA owner liability. At least with respect to EPA enforcement actions, that risk has been mitigated by a relatively recent EPA policy toward owners of property containing contaminated aquifers. 60 Fed. Reg. 34,790 (1995). This policy is designed to protect landowners who have not caused or contributed to contamination, but who own property to which hazardous substances have migrated in the aquifer from a source outside the property. In those circumstances, the EPA has indicated it will not pursue the property owner for response costs and will consider *de minimis* settlements with such persons to protect them from private third-party contribution actions.

19. 42 U.S.C. § 9607(a)(2) (1994). *But see United States v. CDMG Realty Co.*, 875 F. Supp. 1077 (D.N.J. 1995), *vacated on other grounds*, 96 F.3d 706 (3d Cir. 1996) (indicating that the prior owners of contaminated property are not liable under CERCLA if they did not actively dispose of hazardous substances; that is, no liability exists for hazardous substances that merely leaked or migrated during prior ownership).

20. 42 U.S.C. § 9607(a)(3) (1994).

21. 42 U.S.C. § 9607(a)(4) (1994).

22. 42 U.S.C. § 9607(a) (1994).

23. See *United States v. Northeastern Pharm. & Chem. Co.*, 810 F.2d 726 (8th Cir. 1986); *United States v. Mottolo*, 605 F. Supp. 898, 913-14 (D.N.H. 1985).

are met. A shareholder may also be liable if directly involved in the corporate activity resulting in or related to a disposal of hazardous substances.²⁴

2. Hazardous Waste Management

a. Resource Conservation and Recovery Act

The Federal Resource Conservation and Recovery Act (RCRA),²⁵ regulates a business' generation, transportation, treatment, storage, and disposal of solid and hazardous wastes.²⁶ Just as CERCLA is primarily "remedial" in nature, RCRA is a prospective program designed to prevent the releases of solid and hazardous wastes into the environment.²⁷ "Hazardous wastes" regulated under RCRA include a large number of specifically "listed" wastes as well as an equally large number of unlisted wastes which exhibit certain hazardous "characteristics" such as ignitability, toxicity, corrosivity, and reactivity.²⁸ It is a rare industrial business which does not generate one or more regulated hazardous wastes. If so, the business is subject to RCRA's exceedingly complex and pervasive regulatory scheme. A business' ongoing compliance with RCRA's operational requirements is primarily of concern in stock sale or merger transactions which involve the assumption of the "sellers" environmental liabilities by the purchaser.²⁹

b. Storage Tank Laws

Many businesses use underground and aboveground storage tanks to store petroleum products, solvents, and other chemicals. Underground storage tanks (USTs) are of particular concern in business sales and mergers for the obvious reason that their existence at the seller's facility may not be known or even discovered in the course of a typical site inspection or assessment. Prior to the enactment of federal and state storage tank laws,³⁰ such tanks and their associated piping often

24. The United States Supreme Court has recently provided significant guidance on parent-sub subsidiary and shareholder liability under CERCLA in *United States v. Bestfoods*, 524 U.S. 51 (1998).

25. 42 U.S.C. §§ 6901-6992k (1994 & Supp. III 1997).

26. 42 U.S.C. §§ 6901, 6902 (1994 & Supp. III 1997).

27. RCRA and CERCLA do have areas of overlap. For example, the spill or disposal of a waste at an industrial facility might result in a hazardous substance release falling within the purview of CERCLA, as well as within RCRA's "corrective action" program. See, e.g., 42 U.S.C. § 6928(h) (1994). Generally, the scope of the RCRA corrective action program is narrower than CERCLA because RCRA has applicability only to RCRA-regulated facilities whereas CERCLA applies to all facilities and responsible parties as broadly defined.

28. 42 U.S.C. § 6903(5) (1994). See also 40 C.F.R. § 261.3 (1998).

29. For a more specific discussion on how the nature of the business transaction may impact environmental risks, liabilities, and due diligence see *infra* Part C.

30. 42 U.S.C. §§ 6991-6991i (1994 & Supp. III 1997) (providing the EPA with authority to establish a comprehensive regulatory program for underground storage tanks). Included within this

leaked or were improperly closed or abandoned.

State laws, including the Kansas Storage Tank Act,³¹ typically impose liability for leaking storage tanks on both current and former owners and operators of such tanks.³² As is the case with other hazardous material spills, investigation and clean up of releases from storage tanks are usually expensive. The establishment of State trust funds,³³ such as the Kansas underground and aboveground storage tank trust funds, has helped to mitigate potential liability. However, an owner or operator who is ineligible for trust fund reimbursement faces significant economic loss and substantial transactional costs.

3. Other Federal and State Laws

a. Clean Air Act—Asbestos

Issues of liability under the federal Clean Air Act³⁴ commonly arise in business transactions in two situations. First, the Act's statutory and regulatory provisions impose complex and costly permitting obligations on facilities which emit certain air contaminants.³⁵ A business' ongoing compliance (or non-compliance) with these laws and regulations creates risks and liabilities for both the buyer and seller in acquisition transactions.

Another Clean Air Act issue commonly encountered during environmental due diligence activities associated with business acquisitions is the regulation of asbestos-containing materials. The Clean Air Act regulations establish national emission standards for certain hazardous air pollutants (NESHAPs), including asbestos.³⁶ Asbestos regulations

federal program are requirements that owners and operators of tanks be able to demonstrate evidence of financial responsibility for corrective action and other damages should spills or leaks occur. 42 U.S.C. § 6991b(c)(6) (1994). It is this "financial responsibility" requirement that led, in part, to the enactment of storage tank "trust funds" in most states, including Kansas.

31. KAN. STAT. ANN. §§ 65-34,100 to 65-34,130 (1992 & Supp. 1998).

32. KAN. STAT. ANN. §§ 65-34,102(i)-(k) (1992 & Supp. 1998). The Kansas Storage Tank Act was passed to address the requirements of 42 U.S.C. §§ 6901-6901i. By enacting a RCRA-compliant Storage Tank Act, the State essentially assumed the role of the "lead" agency in the enforcement of tank laws and regulations. These laws and regulations include "operational" as well as corrective action requirements.

33. KAN. STAT. ANN. § 65-34,114 (1992 & Supp. 1998) (Underground Petroleum Storage Tank Release Trust Fund); KAN. STAT. ANN. § 65-34,129 (1992 & Supp. 1998) (Aboveground Petroleum Storage Tank Release Trust Fund).

34. 42 U.S.C. §§ 7401-7671q (1994 & Supp. III 1997).

35. The Clean Air Act operating permit program and its requirements are generally set forth in Subchapter V of the Act, which is codified at 42 U.S.C. §§ 7661-7661f, and the regulations promulgated thereunder.

36. 42 U.S.C. §§ 7412(b), (d) (1994). *See also* 40 C.F.R. §§ 61.140-156 (1999) (establishing national emission standards for asbestos). The State of Kansas has also enacted a comprehensive asbestos control act which relates primarily to the licensing of asbestos contractors, the certification of asbestos workers, and training programs for employees of building owners who perform in-house asbestos management programs. Similar to the federal asbestos emission standards, the state law also includes regulations pertaining to the removal of asbestos-containing building materials and

specify, among other things, detailed and expensive work practice procedures for the demolition and renovation of facilities which contain regulated asbestos-containing materials. Where an acquisition may involve buildings which require demolition or renovation, the purchaser in particular must be alert to the risks of liability for the removal and disposal of asbestos.³⁷

b. Toxic Substances Control Act—PCBs

Polychlorinated biphenyls (PCBs) are commonly found in oils used in electrical transformers and capacitors. Spills and leaks of PCBs have been determined to present an unreasonable risk of injury to human health and the environment. Generally, the manufacturing, processing, and sale of PCBs is now prohibited.³⁸ Under the Toxic Substances Control Act (TSCA),³⁹ regulations have been implemented which require the phasing-out of electrical transformers and capacitors containing PCB contaminated oil. Moreover, detailed regulations govern the clean up and disposal of PCBs which have spilled or leaked from their containers.⁴⁰ Such extensive regulation, of course, can translate into significant cost liability for the purchaser of a business where such problems exist.

c. Federal Clean Water Act—Waste Water Discharges

The federal Water Pollution Control Act, commonly known as the Clean Water Act,⁴¹ generally regulates two types of discharges into the “navigable waters of the United States”⁴²—a phrase very broadly construed to include waters that are, in fact, not even “navigable.”⁴³ First, any direct discharge of a pollutant into the waters of the United States is prohibited absent compliance with detailed regulatory and permitting

disposal of asbestos-containing waste. KAN. STAT. ANN. §§ 65-5301 to 65-5315 (1992 & Supp. 1998).

37. In 1994, extensive Occupational Safety and Health Act (OSHA) regulations were also promulgated imposing a new regulatory scheme for occupational exposures to asbestos-containing materials. The new rules impose significant obligations on owners of facilities with asbestos-containing materials including the notification to workers of potential asbestos hazards and the documentation of the presence, location, and quantity of asbestos. 29 C.F.R. § 1926.1101 (1999). Such requirements may be of concern to purchasers in acquisition transactions.

38. 15 U.S.C. § 2605(e)(2)(A) (1994).

39. 15 U.S.C. §§ 2601-2692 (1994 & Supp. III 1997). TSCA was enacted to identify and control chemicals that pose an unreasonable risk of injury to health or the environment through their manufacture, processing, distribution, use, or disposal. Under the Act, the EPA is generally authorized to require industry to test chemicals for toxic effects. PCBs are a primary focus of TSCA. 15 U.S.C. § 2605(e) (1994).

40. See 40 C.F.R. § 761.125 (1998).

41. 33 U.S.C. §§ 1251-1387 (1994 & Supp. III 1997).

42. 33 U.S.C. § 1362(7) (1994).

43. See, e.g., *United States v. Byrd*, 609 F.2d 1204 (7th Cir. 1979) (including wetlands in the definition of “navigable”); *United States v. Oxford Royal Mushroom Prod.*, 487 F. Supp. 852 (E.D. Pa. 1980) (including streams in the definition of “navigable”).

requirements.⁴⁴ Second, indirect discharges of contaminants through publicly owned treatment works (POTWs) are also subject to complex regulations.⁴⁵ As with RCRA, it is a business' ongoing compliance with the permitting and regulatory requirements of the Clean Water Act which give rise to environmental considerations and risks in business transactions.

d. Community Right-to-Know Law

Largely as a result of the deaths of thousands of persons following the escape of toxic chemical gas at a facility in Bhopal, India in 1984, Congress enacted the Emergency Planning and Community Right-to-Know Act (EPCRA),⁴⁶ as part of the Superfund Amendments and Reauthorization Act of 1986 (SARA).⁴⁷ EPCRA's primary purpose is the accumulation and public distribution of information related to a business' storage and use of covered chemicals, as well as information concerning releases of those chemicals. The Act includes three significant reporting obligations: (1) one-time reporting of chemicals used by covered facilities (generally through the submission of material safety data sheets (MSDSs));⁴⁸ (2) the submission of annual chemical inventory reports;⁴⁹ and (3) annual toxic chemical release inventory reporting.⁵⁰ Reporting is generally made to Local Emergency Planning Committees (LEPCs) and State Emergency Response Commissions (SERCs).

Unlike laws such as the Clean Water Act and Clean Air Act which regulate activities which may pollute the environment, EPCRA is essentially a "paperwork" law; that is, it focuses on certain public reporting requirements. This distinction, however, does not lessen the risks to a purchaser in an acquisition transaction, particularly mergers and stock purchases where the seller's environmental liabilities are assumed. The Act provides for civil and administrative penalties (as well as criminal fines and imprisonment) of up to \$25,000 for each day of violation.⁵¹ The unwary purchaser of a business which failed for several years to comply with the "paperwork" requirements of the Act could thus face very significant liability.

44. 33 U.S.C. § 1311(a) (1994). The Clean Water Act permit program is referred to as the National Pollutant Discharge Elimination System (NPDES). The NPDES program generally regulates "point source" discharges into the waters of the United States. 33 U.S.C. § 1362(14) (1994).

45. 33 U.S.C. § 1317(b) (1994). See also 40 C.F.R. pt. 403 (1998).

46. 42 U.S.C. §§ 11001-11050 (1994 & Supp. III 1997).

47. 42 U.S.C. §§ 9601-9675 (1994). See generally Timothy B. Atkeson et al., *An Annotated Legislative History of the Superfund Amendments and Reauthorization Act of 1986 (SARA)*, 16 ENVTL. L. REP. (Envtl. L. Inst.) 10,360 (1986).

48. 42 U.S.C. § 11021 (1994).

49. 42 U.S.C. § 11022 (1994).

50. 42 U.S.C. § 11023 (1994 & Supp. III 1997).

51. 42 U.S.C. § 11045 (1994).

4. Common Law Environmental Liabilities

In addition to federal and state statutes and regulations, common law liabilities are an element of the legal framework of environmental risks associated with business acquisition transactions. Property damage liability typically involves claims by adjoining or nearby property owners or other third parties for injury to property resulting from the release, and subsequent off-site migration, of a hazardous substance from the business being acquired, sold, or merged. Property damage liability may be apparent at the time of the transaction, or may not arise until well after closing due to the slow movement of contaminants through the subsurface. These claims may involve significant damages for property restoration, loss of use, permanent diminution in the value of property, and “emotional distress.”⁵² Such claims are often based upon theories of strict liability, trespass, and nuisance.

Another common law liability risk is personal injury resulting from exposure to hazardous substances released at the subject business. Such “toxic tort” claims present difficult questions of causation. Furthermore, these claims present novel risk allocation issues—past releases and exposures versus ongoing releases and exposures. In addition to actual physical injury, these claims may also involve emotional distress for “fear of contracting a disease” by virtue of an exposure.

C. NATURE OF THE TRANSACTION AS DEFINING ENVIRONMENTAL RISKS AND LIABILITIES

The environmental risks and liabilities discussed in this article should generally be considered by all prudent buyers and sellers regardless of the nature of the transaction; that is, whether the transaction is structured as an asset purchase, stock purchase, or merger. Although the author is unaware of any strategy which completely avoids potential environmental liabilities, the extent of the risks being assumed, particularly with respect to historic environmental releases and regulatory compliance problems, may vary depending upon how the transaction is structured.

1. Asset Purchases

A business acquisition may be structured as an asset purchase, in part, to minimize potential environmental liabilities. A company which purchases another business’ assets generally does not assume the seller’s environmental (or other) liabilities.⁵³ Thus, if a business is acquired

52. For a good discussion of whether and under what circumstances a plaintiff may recover emotional distress damages in the context of an environmental property damage case, see *Maddy v. Vulcan Materials Co.*, 737 F. Supp. 1528 (D. Kan. 1990).

53. *City Env'tl. Inc. v. United States Chem. Co.*, 814 F. Supp. 624, 634 (E.D. Mich. 1993), *aff'd*

through a properly structured asset purchase agreement, the focus of the purchaser's environmental due diligence may very well be narrower in scope than that which would likely be necessary in a stock purchase or merger transaction. There are, however, several important exceptions to the more limited liability generally associated with asset purchase transactions:⁵⁴

- The acquiring company expressly or implicitly agrees to assume the selling corporation's environmental liabilities;
- The transaction amounts to a consolidation or *de facto* merger;
- The acquiring corporation is a "mere continuation" of the seller corporation; or
- The transaction is entered into fraudulently to escape liability.

There exists a substantial body of case law interpreting and applying each of the foregoing exceptions to specific transactions. Suffice it to say, a purchaser who structures a transaction as an asset purchase primarily to minimize environmental risks must carefully consider whether the transaction constitutes a *de facto* merger or a mere continuation of the seller's business.⁵⁵ If so, the strategy will not likely achieve the desired objective.

Of course, even properly structuring a transaction as an asset purchase at best merely serves to lessen environmental risk. The purchaser of assets, particularly where the assets include real property, becomes the "owner or operator" of such property for purposes of potential CERCLA response cost liability the moment the transaction closes. If the business' real property is a source of contamination, the purchaser may assume all or some portion of that liability, regardless of who caused the contamination or when the release or spill occurred and regardless of any fault or negligence on the part of the purchaser.

2. *Stock Purchases and Mergers*

An entity which acquires a business through a stock purchase, merger, or consolidation generally assumes the obligations and liabilities of the predecessor corporation.⁵⁶ In the context of environmental liabilities, such an assumption of predecessor obligations can have far reaching and sometimes unforeseeable consequences. With respect to

sub nom. City Mgmt. Corp. v. United States Chem. Co., 43 F.3d 244 (6th Cir. 1994).

54. *In re Acushnet River and New Bedford Harbor*, 712 F. Supp. 1010 (D. Mass. 1989).

55. In evaluating an argument that a purchaser's business is a "mere continuation" of the seller's enterprise, such that the purchaser is deemed to have assumed the seller's liabilities, courts typically consider several factors, such as: (1) whether the purchaser retains the same employees and production facilities, (2) whether the purchaser continues the same business enterprise or operations, (3) whether the business name is retained, and (4) whether the purchaser holds itself out to the public as a continuation of the prior business. *United States v. Carolina Transformer Co.*, 978 F.2d 832, 838 (4th Cir. 1992).

56. *United States v. Hardage*, 750 F. Supp. 1460 (W.D. Okla. 1990).

CERCLA liability, for example, a predecessor corporation's environmental liabilities may extend back in time many years and may involve property and/or subsidiaries long since disposed of by the corporation.⁵⁷ Consider a hypothetical in which the "seller" corporation divested itself of a manufacturer subsidiary ten years prior to the presently contemplated stock purchase or merger transaction. Assume also that the company's former subsidiary owned and operated contaminated facilities (long since sold), arranged for the off-site disposal of hazardous substances (long since forgotten), and failed to submit community right-to-know reports required by EPCRA. Obviously, under such a scenario, the scope of environmental due diligence would need to be quite extensive to even discover these very significant historic environmental risks and liabilities which are soon to become the potential problem of the "innocent" acquiring company.

For these reasons, any acquisition by stock purchase, merger, or consolidation needs to include appropriately expanded environmental due diligence. In addition to a thorough investigation of the "selling" corporation's existing operations and assets, its historical operations, and property asset sales, environmental compliance must be carefully researched and considered. Such inquiry should include the property and operations of former subsidiaries of the company which may have been divested many years ago.

D. OBJECTIVES OF ENVIRONMENTAL DUE DILIGENCE

1. Attainment of "Innocent Landowner" Status

A common objective of environmental due diligence in asset purchase transactions is attainment of "innocent purchaser" status under CERCLA. The terms innocent purchaser or innocent landowner refer to a class of facility owners who are relieved from CERCLA's onerous, retroactive, strict, and joint and several liabilities. From a practical standpoint, persons who are successful in obtaining "innocent purchaser" status are a rare breed.

Somewhat deceptively, CERCLA proclaims that an "innocent purchaser" is an entity which can demonstrate that, at the time of the acquisition, it "did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release, was disposed on, in or at the facility."⁵⁸ To establish that the entity did not know and had no reason to know of any hazardous substance release, the purchaser must prove that it made "all appropriate inquiry

57. See *supra* note 24.

58. 42 U.S.C. § 9601(35)(A)(i) (1994).

into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability.”⁵⁹ Unfortunately, “all appropriate inquiry” is not specifically defined and has been strictly construed by the courts. Moreover, once any environmental “red flags” are identified as the result of an environmental site assessment, further investigation is not likely to result in attainment of innocent purchaser status under the foregoing statutory criteria. Given the nature of the assessment process, and the natural inclinations of environmental consultants performing those assessments, it is unusual indeed for the purchaser of industrial property, and many commercial properties, to satisfy the innocent landowner requirements through environmental due diligence.

The fact that innocent purchaser status is somewhat illusory does not, however, mean that environmental due diligence is a meaningless exercise. Regardless of any innocent landowner objective, properly planned due diligence is critical to the identification of specific environmental problems associated with the business or property, the allocation of environmental risks, and successful financing.⁶⁰ Understanding the real value and objectives of environmental due diligence in a particular transaction is necessary to properly determine a course of action, minimize due diligence costs, and obtain the information necessary to achieve the desired objective.

a. Innocent Purchaser Exception to CERCLA Liability

Although a defense to CERCLA liability is provided where contamination is caused by an act or omission of a third party, the Act excludes from the definition of “third party” persons in a direct or indirect contractual relationship with a liable property owner.⁶¹ Thus, if the contamination was caused by a party in the chain of title, the third party defense to liability may not exist. In most situations, therefore, what the Act giveth, it quickly taketh away.

One exception to the “contractual relationship” rule is where the buyer can establish that it is an “innocent purchaser” under CERCLA; that is, at the time the facility was acquired, the purchaser did not know and had no reason to know that any hazardous substance was released or disposed of thereon.⁶² As indicated above, to establish that it had no reason to know of any hazardous substance release, the buyer must

59. 42 U.S.C. § 9601(35)(B) (1994).

60. Lender liability issues are beyond the scope of this article. Suffice it to say, lender environmental due diligence requirements in a transaction may be more extensive, time consuming, and costly than those contemplated or reasonably needed by the parties themselves. Generally, however, lenders are afforded significant liability protection under CERCLA. 42 U.S.C. § 9601(20)(E) (1994 & Supp. III 1997).

61. 42 U.S.C. § 9607(b)(3) (1994).

62. 42 U.S.C. § 9601(35)(A)(i) (1994).

show that it undertook, at the time of acquisition, all appropriate inquiry into previous ownership and uses.⁶³

b. The Innocent Landowner Exception is Strictly Construed

Obviously, if environmental due diligence results in actual knowledge of the existence of a release or threatened release at a facility, such knowledge will defeat the innocent landowner defense. The innocent landowner defense will likewise not be successful if the purchaser "should have known" of the contamination. Under CERCLA, judicial determination of innocent landowner status is required "to take into account any specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property if uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the ability to detect such contamination by appropriate inspection."⁶⁴

c. Environmental Due Diligence Standards

Neither CERCLA nor the case law provide a road map of the nature and extent of environmental due diligence which must be undertaken to satisfy the requirement of the innocent landowner defense.⁶⁵ Several public and private entities have developed due diligence standards which are now widely used and accepted. Commonly used environmental due diligence standards include the following:

- *Standards Developed By Financial Institutions*—Many financial institutions, particularly large national banking institutions, have adopted environmental site assessment procedures which must be followed in connection with the making of loans on commercial and industrial property. These procedures are detailed and compliance should provide a fair degree of comfort that the "all appropriate inquiry" requirement has been satisfied.
- *Regulatory Agency Standards*—Similarly, federal regulatory agencies such as, the Federal Home Loan Bank Board and Federal National Mortgage Association have published environmental assessment procedures.
- *American Society For Testing And Materials (ASTM) Standards*—A subcommittee of the ASTM has developed protocols for environmental site assessments intended to assist in complying with the

63. 42 U.S.C. § 9601(35)(B) (1994).

64. 42 U.S.C. § 9601(35)(B).

65. For a general interpretation of CERCLA's innocent purchaser requirements, see EPA, Guidance on Landowner Liability Under Section 107(a)(1) of CERCLA, De Minimis Settlements Under Section 122(G)(1)(B) of CERCLA, and Settlements with Prospective Purchasers of Contaminated Property, OSWER Directive No. 9835.9, 54 Fed. Reg. 34,235 (1989).

innocent purchaser obligations of CERCLA.⁶⁶ Those protocols, which are typically followed by most environmental consultants, include the well known procedures for “Phase I and II” inquiries into the environmental condition of property.

- *Insurance Standards*—Several insurance companies have also promulgated standards for environmental site assessments which are required to be followed in order to obtain coverage against the future discovery of contamination.

2. *Environmental Due Diligence to Ascertain and Allocate Risks*

As previously noted, an equally important objective of environmental due diligence in acquisition and merger transactions is to accumulate the information necessary to undertake an appropriate allocation of risk between “buyer” and “seller.” When used to accomplish such an objective, the acquiring and/or selling business must take care to plan an appropriately defined, cost effective environmental investigation. Environmental consulting companies may attempt to “sell” both Phase I and Phase II⁶⁷ site assessments for environmental due diligence regardless of the site or the circumstances of the particular transaction. For example, if the property to be acquired is industrial with known or suspected releases or is located in an area of documented soil or groundwater contamination, the significant cost of a complete Phase I site assessment may sometimes be avoided as unnecessary.⁶⁸ In such situations, a carefully planned limited site intrusive investigation of the soil and/or groundwater quality (Phase II environmental site assessment) is often more appropriate, and may result in an overall lower environmental due diligence cost.

The nature of the information obtained from environmental due diligence, planned with this objective in mind, provides the factual basis upon which purchasers and sellers in acquisitions and mergers can:

- Identify specific environmental problems associated with the business being acquired or merged;
- Establish a “baseline” environmental condition of business property at the time of the transaction; and
- Intelligently allocate environmental risks and liabilities (known and unknown) in the transaction documents.

66. See, e.g., ASTM Standard E 1527-97. This standard provides typical practices for performing environmental site assessments. These materials are copyrighted and may be purchased directly from ATSM at 100 Barr Harbor Drive, West Conshohockery, PA 19428, 610-832-9585.

67. See *infra* Section E.

68. See *infra* Section E (discussing the elements of a Phase I environmental site assessment. As indicated by that discussion, much of the information sought by a Phase I assessment may already be known with respect to this type of business property).

E. THE ENVIRONMENTAL SITE ASSESSMENT

An environmental site assessment performed in accordance with established protocols is the accepted method of accomplishing environmental due diligence in a business transaction. More often than not, the “phased” site assessment procedures incorporated in the ASTM standards are utilized. Some understanding of the scope, benefits, and limitations of such procedures is important for the business engaged in an acquisition, consolidation, or merger transaction.

1. Phase I, II, and III Environmental Site Assessments

The Phase I environmental site assessment process incorporates protocols by which a purchaser may satisfy the “all appropriate inquiry” requirement of CERCLA (unless the results indicate further investigation is warranted) and/or obtain information critical to the allocation of environmental risks between or among the parties to the transaction. The Phase I assessment obviously should be performed by a qualified environmental professional and will generally include the following elements:

- *Review of records*—This aspect of the Phase I assessment typically involves a review of historical facility records;⁶⁹ pertinent EPA and state environmental agency documents and electronic databases;⁷⁰ local fire department records;⁷¹ title records;⁷² United States Geological Society (USGS) topographic maps; zoning/land use records; and aerial photographs.⁷³ This document and database review includes not only the property or facility which is the subject of the transaction, but also other properties within a defined radius whose operations may have adversely impacted the property being acquired.⁷⁴

69. In “hostile” acquisition transactions, records and information of the target company may not be readily available. Thus, limiting the document review to public information.

70. Key sources of this type of information include the Comprehensive Environmental Response, Compensation, and Liability Information System (CERCLIS) which identifies potential hazardous substance sites which must be investigated; the National Priority List (NPL) which includes the highest priority CERCLA sites; the Resource Conservation and Recovery Information System (RCRIS) which identifies sites with RCRA compliance requirements and problems; and the Emergency Response Notification System (ERNS) which constitutes a list of reported releases and spills of hazardous substances exceeding certain reportable quantities maintained by the National Response Center (NRC). The State of Kansas also maintains similar databases which contain important information typically reviewed as part of the due diligence process.

71. Fire department records occasionally include historic information and diagrams showing the location of USTs and the location of hazardous material storage areas which are not found in other sources of publicly available information.

72. Land title documents may provide insight concerning how property has historically been used and thus whether prior business activities on the property may be associated with the generation and disposal of hazardous waste or other environmental issues.

73. Aerial photographs often cover an extensive time period. They are an excellent source of information concerning prior property usage not otherwise readily available.

74. This information is usually obtained using electronic databases which “plot” the location of other businesses with potential environmental problems and which include detailed environ-

- *Interviews*—Generally, the person or persons with the greatest knowledge about current and past operations of the facility or property at issue are interviewed with respect to pertinent environmental issues.⁷⁵ If possible, interviews with adjoining property owners or operators are also conducted.
- *Site inspection*—The site inspection is a planned visual inspection of the business property and facilities, as well as nearby properties. Experienced professionals are able to discern substantial environmental information simply by viewing the condition of the vegetation, soils, facility equipment, facility drains and floors, and chemical storage areas.

Because the term “Phase I assessment” is often used loosely to describe any preliminary environmental assessment procedure, a company involved in a business acquisition or merger should carefully evaluate the scope of the proposed work to ensure that it will accomplish all desired objectives in the context of the business being acquired or merged. For example, typical Phase I site assessments do not include an assessment of several significant environmental risks such as asbestos, lead paint, radon, indoor air pollution, and the business’ compliance with environmental regulatory requirements. In addition, depending on the circumstances, the proposed Phase I assessment may be unnecessary or may not produce sufficient relevant information to justify its cost.

The results of the Phase I site assessment are set forth in a written report. The report typically consists of several “narrative” sections describing and interpreting the scope and results of the site assessment and one or more appendices which contain site diagrams, chain of title information, aerial photographs, and the results of document and database searches. The conclusions of most consultants tend to be conservative in terms of identifying environmental “red flags.”⁷⁶ More often than not, therefore, the result of this process is that any hope of obtaining innocent purchaser status evaporates after a Phase I investigation of most industrial property.

If the Phase I assessment identifies recognized environmental conditions, the performance of a Phase II assessment may be appropriate to eliminate or, more likely, confirm and define those environmental concerns. A Phase II assessment normally involves the sampling and labo-

mental information pertaining to such other businesses. It is the job of the retained environmental consultant to interpret this information in the context of distance to the subject property, regional groundwater flow directions, etc.

75. Topics discussed during these interviews include: the type of environmental permits and licenses held by the business, any history of agency enforcement actions against the business, and facts related to the business’ compliance with applicable federal and state environmental “compliance” laws and regulations.

76. The technical term for what I have been calling an environmental “red flag” is a “recognized environmental condition” (REC) which, again, has its genesis in the ASTM standards.

ratory testing of soil and/or surface or groundwater at or near the facility. It may also involve locating and testing underground storage tanks for purposes of identifying their contents and integrity. Soil and groundwater "background" information is commonly obtained as is information related to the direction of groundwater movement or "flow" in the area of the subject property.

No specific protocols govern a Phase II site assessment. The scope and cost of a Phase II assessment depends to a large extent upon the information revealed by the Phase I activities and by general knowledge of the business' operations at the facility. Because a Phase II investigation produces actual data, it is normally of more benefit to both purchaser and seller than the Phase I assessment in terms of being able to identify and allocate environmental risks in an acquisition or merger transaction.

A Phase III environmental site assessment is merely a continuation of the Phase II site investigation process; that is, its objective is to fill in any gaps in the information which may be needed to attain innocent landowner status or to allocate environmental risks and liabilities.

2. Preliminary Considerations

Before embarking on the environmental site assessment process, it is important to carefully consider the client's objectives in undertaking environmental due diligence. A "front end" analysis by environmental legal counsel and retained consultants usually helps to define those objectives, streamline the assessment process, and ensure that assessment money is well spent. It is the author's experience that, more often than not, "cross-examination" of the environmental consultant as to the reasons for and benefits of proposed Phase II activities results in the scaling-back of those activities and associated cost savings.

It is also important to select the appropriate consultant to perform the desired scope of work. Virtually all environmental consultants perform Phase I site assessments and prices vary significantly. The selection of a qualified "Phase II" consultant is more difficult, but the importance of this exercise should not be minimized. Cost should not be the sole consideration. Depending on the objectives, factors such as the consultant's prior relationship with the business, its legal counsel and/or the regulatory agencies, the consultant's ability to promptly complete the work and timely produce a report, and the consultant's capabilities should follow-up work be required may very well take precedence over cost. A consultant's reputation in the industry and with the regulatory agencies can pay dividends in many transactions.

F. THE ENVIRONMENTAL COMPLIANCE AUDIT

1. *The Role of the Compliance Audit*

The primary purpose of the environmental site assessment is to determine the potential for, or existence of, environmental contamination on, under, or near the property or facility which is the subject of the transaction. On the other hand, the environmental compliance audit⁷⁷ focuses on different issues, such as whether the business has all proper permits and whether its on-going operations are being conducted in compliance with applicable federal, state, and local environmental laws and regulations. In an asset purchase transaction, an environmental compliance audit may be only marginally beneficial, assuming that the purchaser will not expressly, or as a matter of law, be assuming its predecessor's environmental liabilities. Conversely, an environmental compliance audit is often of critical importance in stock purchase, consolidation, and merger transactions where the purchaser or surviving entity will likely be assuming the environmental liabilities of the predecessor.

2. *Scope of the Audit*

The business being sold, consolidated, or merged may have previously engaged in internal environmental compliance auditing. Such information should obviously be obtained and evaluated if possible. As both federal and state governments continue to provide incentives for companies to perform periodic, systematic compliance auditing, such information is likely to be more available as time goes on.⁷⁸

Whether or not the business has a history of compliance auditing, a formal due diligence compliance audit may need to be performed as part of the acquisition or merger transaction. The precise scope of the audit will depend upon the size of the facility, the products it produces, the raw materials and inventory it uses, the nature of identified waste streams, its involvement in hazardous waste treatment and/or storage, and its disposal practices.

Perhaps the most common objective of a compliance audit in most industrial transactions is to determine the facility's compliance with federal and state hazardous waste, air, and water regulations. Such audits focus on whether required permits have been obtained and whether the

77. ASTM Standard PS11-9S for Environmental Regulatory Compliance Audits provides specific guidance for the performance of an acceptable environmental compliance audit.

78. See Voluntary Environmental Self-Policing and Self-Disclosure Interim Policy Statement, 60 Fed. Reg. 16,875 (1995); KAN. STAT. ANN. §§ 60-3332 to 60-3339 (Supp. 1998) (the Kansas Environmental Audit, Privilege, and Immunity Act). The nature and scope of these policies and privileges is complicated and beyond the scope of this article.

business' current and historic operations are otherwise in compliance with applicable regulations. In addition, the company's compliance with federal and state "record keeping" laws and regulations is also important because of the significant statutory non-compliance penalties. As discussed above, the community right-to-know requirements enacted as part of the amendments to CERCLA impose extensive record keeping and disclosure requirements on businesses which use hazardous chemicals and generate hazardous waste. While such requirements are not directly related to preventing or remediating environmental contamination, failure to comply may have cost ramifications as significant as those associated with other laws and regulations.

G. CONFIDENTIALITY AND DISCLOSURE ISSUES

The information and data provided by environmental site assessments may present both purchasers and sellers with difficult confidentiality and disclosure issues. A full understanding of the environmental condition of a facility is clearly essential to achieving the objectives of environmental due diligence. Parties to an acquisition or merger, however, should be aware that obtaining such knowledge may have ramifications beyond the transaction at issue.

From the purchaser's perspective, obtaining information related to environmental problems at the property may create governmental disclosure obligations even before the transaction is closed depending on state law and accompanying regulations.⁷⁹ The seller faces even greater concerns when confronted with the prospect of an environmental site assessment by or for the purchaser. To achieve the goal of selling the property or business as close as possible to its "as is, where-is" condition, sellers should expect that a detailed environmental site assessment will be performed. However, if a site assessment discloses serious environmental concerns, concerns which may even "kill the deal," the seller may still be confronted with problems and questions related to disclosing such adverse environmental information to governmental agencies and prospective future buyers.

Various strategies have been used, with more or less success, to insulate sellers, buyers, and third parties from information obtained as a result of an environmental site assessment. For example, arrangements can be structured under which a buyer is allowed to conduct an environmental assessment, but is instructed not to provide the results to the

79. See KAN. ADMIN. REGS. 28-48-1 to 28-48-2 (1997). These so-called "spill reporting" obligations are broad and, to some extent, vague. In Kansas, "owners" and "persons responsible" for actual or threatened environmental pollution have disclosure obligations. *Id.* Arguably, the Kansas regulation would exclude an entity engaged in due diligence in contemplation of acquiring a business. Nevertheless, the discovery of information revealing significant environmental problems at a facility presents moral as well as legal issues for prospective purchasers.

seller. There are, however, obvious problems with such a strategy. If recognized environmental conditions or reportable releases are identified and the purchaser decides to proceed with the negotiations, it is virtually impossible to intelligently allocate risks without the seller knowing the nature of the problems. Moreover, if the adverse information kills the deal, even without the seller becoming aware of the results of the assessment, the seller may be confronted with serious common law disclosure issues with respect to potential future buyers. That is, to what extent is the mere fact that prior negotiations failed due to unknown environmental considerations a material fact which must be disclosed in future transactions?

Such a strategy also has downsides for the buyer. Many environmental statutes limit reporting or disclosure obligations to the "owner or operator" or the "person in charge" of specific property. Thus, a prospective buyer may not be within the class of persons legally required to report or disclose to a governmental agency. Nevertheless, given the draconian civil and criminal penalties for violating reporting and disclosure laws, any person with knowledge of a serious release or spill may not wish to gamble on a "technical" interpretation of such a statute.

Setting aside the difficult issues of disclosure of environmental conditions to governmental agencies, the confidentiality of such information, with respect to third parties, may be protected by authorizing a lawyer for a party to arrange for and direct the environmental site assessment activities. Under this approach, the attorney orders the environmental assessment, arguably in anticipation of potential litigation. Additionally, the attorney should require the environmental consultant to execute a confidentiality agreement to protect the results from disclosure to third parties. Typically, the environmental assessment report is designated "confidential;" not to be disclosed to third parties. Although this procedure is commonly used and offers some degree of protection, it does not solve the statutory disclosure problem and is otherwise subject to possible attack on various legal grounds.⁸⁰ From a practical standpoint, before embarking upon an environmental site assessment, the seller in particular would be well-advised to assume that the results may be subject to discovery or disclosure.

80. The environmental site assessment may be determined to be discoverable notwithstanding allegations of the attorney work product privilege, the attorney-client privilege, and any self-critical analysis privilege. Also, even if the attorney's "work product" is protected, the facts contained in the assessment are likely discoverable. One or more of these "privileges" may also be lost by disclosure to third-parties, such as the other party to the transaction.

H. STRUCTURING THE TRANSACTION: GENERAL STRATEGIES OF BUYERS AND SELLERS

After environmental due diligence activities have been undertaken, any recognized environmental conditions impacting the business and its assets have, hopefully, been revealed. Both sides of the transaction are armed with substantial information relevant to the environmental legal liabilities discussed in this article. Environmental risks can now be better identified and quantified. To a great extent, the baton now passes from the environmental consultants to the parties' environmental legal counsel. The task shifts from information gathering to negotiating liabilities and risks, known and unknown, through the use of a number of tools including: warranties, indemnities, purchase price adjustments, and pre- and post-closing clean-up commitments. Obviously, the environmental concerns and strategies of buyers and sellers differ fundamentally as the transaction proceeds toward final contract drafting and closing. Careful planning of an appropriate negotiating strategy, and an ability to develop and be receptive to creative solutions to the inevitable problems that arise, are of critical importance to representing a client who expects the "deal" to be finalized with manageable environmental risks.

1. General Strategies of the Seller

Sellers of business property strive to end up as close as possible to an "as-is, where-is" sale. With a properly drafted "as-is" provision, the buyer agrees to take the property subject to all known and unknown environmental problems and impairments. At least with respect to the buyer, the seller retains no liability for environmental contamination on the property, regardless of when it may have occurred and how it may have been caused. For obvious reasons, it is often not possible to negotiate the agreement with such an extreme risk-allocation scheme, particularly if there is any significant possibility that the property is environmentally impaired.⁸¹

Even if the buyer is receptive, proposing such an arrangement typically invites a very detailed environmental investigation of the property by the buyer prior to closing. If environmental conditions are revealed, the deal may fail or a resolution of at least the known risks and conditions will need to be negotiated. The seller must, therefore, weigh the potential benefits of seeking an "as-is" provision against the heightened scrutiny such a provision invites. Also to be considered is the increased

81. Depending on the circumstances, and the buyer's assessment of the "remoteness" of environment risk, transactions incorporating "as-is" provisions can sometimes be negotiated where the seller is willing to make a purchase price adjustment in return for an increased level of environmental peace of mind.

likelihood that an environmental condition, which might otherwise have passed unnoticed, will be revealed and require resolution. Finally, even if an "as is" provision is successfully negotiated, such a provision does not relieve the seller from liability to governmental agencies under statutes such as CERCLA.⁸²

Given the foregoing, most transactions involve a more complicated allocation of environmental risk between buyer and seller with respect to both known and unknown liabilities. Where an "as-is" provision cannot be negotiated, sellers often attempt to structure the warranties and indemnities such that they remain liable only for environmental problems which can be directly related to their operations. With respect to environmental conditions unknown at the time of the acquisition transaction, such a strategy obviously invites future disputes over "who caused what." Suffice it to say, tracing a soil or groundwater contamination problem to a specific property owner or time period is extremely difficult and costly. More often than not, the "acquiring" entity will be carrying on a similar business at the facility, using similar equipment, chemicals, etc. Although the capabilities of environmental technology are continually expanding, it remains very difficult to attribute common contaminants, such as degreasing solvents and petroleum products, to one user or another.⁸³ Such problems may be partially mitigated by designing an appropriate Phase II environmental site assessment to establish a "baseline" of the property's condition at the time of closing. Although a useful tool to minimize future risk, the value of the "baseline" site assessment is limited by considerations of cost and time in the typical transaction.

2. General Strategies of the Buyer

Buyers obviously wish to avoid purchasing environmental liabilities. Accordingly, the optimal strategy of a buyer is to place the risk of all environmental liabilities associated with the business or property on the seller; except for those which may be directly and scientifically attributed to the operations of the buyer after closing. If possible, the buyer will seek to allocate to the seller the risk of all historic environmental liabilities associated with the property; regardless of whether such liabilities were caused by the operations of the seller or by an earlier owner or operator of the facility. The success of this strategy often

82. CERCLA imposes no limitations on the rights of private parties to allocate between themselves environmental risks and liabilities. However, such freedom of contract does not limit the statutory authority of the United States to seek response costs from any person potentially liable under the Act.

83. It should also be noted that even if it is possible to distinguish between two sources of contamination, if these sources have "commingled" and each party's contribution cannot be separated, CERCLA imposes joint and several liability on each PRP for all response costs associated with the site. *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 810 (S.D. Ohio 1983).

depends on the buyer's intended use of the property. If the buyer's activities clearly pose little or no environmental risk, the "equity" of such an allocation is more difficult for the seller to reject.

The extent to which it is in the buyer's interest to undertake, or require the seller to perform, a detailed environmental site assessment depends, in part, upon its success in allocating unknown risks to the seller. It is also important to factor into this decision whether the seller will continue to exist, and if its financial resources will be available to address problems discovered in the future. If the seller agrees to assume such risks and liabilities, and has sufficient financial resources, a buyer may not require (or even want) an extensive environmental site assessment.

Of course, some reasonable investigation of the property's environmental condition is necessary if an objective of the buyer is innocent purchaser status under CERCLA. Also, a more detailed site assessment may be important to determine whether the price being negotiated approximates the property's fair value in light of any environmental conditions. A "site-intrusive" assessment of the property's soil, surface water and/or groundwater is usually also necessary to expose existing environmental problems which presumably will either be remedied by the seller as a condition of closing the transaction or result in an appropriate reduction of the purchase price.

On the other hand, undertaking or requiring a detailed site assessment, simply to establish a "baseline" condition of the property or to identify environmental impairments, may actually be counterproductive to a transaction which could be successful in shifting most of the environmental risk to a viable seller. In other words, to the extent that a thorough assessment is performed, but does not reveal any recognized environmental conditions, it is much easier for the seller to later argue that a subsequently discovered problem must have been caused by the activities of the buyer. Even the most thorough of site assessments is limited by time and cost, making it virtually impossible to know with certainty that all potential environmental conditions have been detected. The buyer's general due diligence strategy in acquisition transactions thus depends to a great extent on whether the buyer plans to continue the same business activities as the seller and the strength of the seller's warranties and indemnities.

Buyers typically attempt to negotiate several broad categories of representations, covenants, and warranties from sellers:

- a. If the seller is already engaged in the investigation or remediation of a known environmental condition, the seller should be requested to provide a warranty that such work has been and will continue to be performed in a good and workman-like

manner, in accordance with all applicable laws and regulations, and the remediation will remain the responsibility of the seller until “satisfactorily” completed.⁸⁴ Unless the buyer is willing to assume responsibility for completing the work after closing (presumably at the seller’s “cost”), the parties will also need to negotiate language providing the seller with reasonable post-closing access to the property for specified purposes;

- b. Representations by the seller that it has no knowledge of any environmental impairment or condition existing on the property other than that expressly disclosed by the seller in an exhibit attached to the agreement or which may be revealed by an environmental site assessment;⁸⁵
- c. Representations that the seller has provided to the buyer any and all documents related to the identification, investigation, and remediation of any existing or historic environmental problems associated with the business and related to the seller’s prior compliance with all applicable environmental laws and regulations;⁸⁶
- d. Representations that, as of the date of closing, the facility is in full compliance with all applicable environmental laws and regulations;⁸⁷
- e. Representations that, to the best of the seller’s knowledge, no underground storage tanks are present on the property;
- f. Representations by the seller concerning the presence of asbestos and PCBs at the facility;⁸⁸

84. Issues sometimes arise as to the standard against which “satisfactory” resolution of known environmental conditions is to be measured. Often, the standard is defined in terms of a final approval or a “no further action” determination by the governmental agency responsible for overseeing the work. Concerns over excessive and unreasonable requirements of such agencies have led some parties to fashion standards based on the opinions of a qualified environmental professional, leaving the risk of further governmental requirements on the buyer. In either case, this issue should be carefully considered in drafting the environmental provisions of transaction documents.

85. Defining what is meant by the seller’s “knowledge” should also be considered. In many agreements, representations concerning the seller’s knowledge is limited to that knowledge which an identified group of officers and/or corporate managers possesses or with the exercise of reasonable inquiry, should possess. Leaving the term undefined invites future disputes as to how deep into the corporate organizational chart such representations extend.

86. Terms such as “environmental laws and regulations” and “hazardous substances” should be defined in transaction documents. Many agreements, in fact, incorporate an environmental definitions section to avoid future disputes over potentially ambiguous language. These definitions must be reviewed carefully as they may contain traps for the unwary. For example, a representation that the facility contains no “hazardous substances” may be a problem if that term is defined to include asbestos, and in fact the property being sold consists in part of older buildings which were likely built with one or more asbestos-containing materials.

87. Such broad warranties and representations justifiably make many sellers nervous given the reach of modern environmental laws. Sellers may, therefore, wish to negotiate for a materiality standard that triggers the warranty only after an alleged breach reaches a certain monetary amount.

88. The scope of a “standard” Phase I Environmental Site Assessment may not include any investigation or inquiry into the presence of asbestos or PCBs at a facility. Absent contracting for such matters to be addressed in the Phase I, the buyer should attempt to obtain as much information as possible from the seller concerning these hazardous substances and obtain appropriate war-

- g. Representations that the property contains no regulated wetlands;⁸⁹ and
- h. Representations regarding the existence and status of any pending or threatened governmental or private party claims or litigation which in any way relate to violations of environmental laws.

I. TIMING CONSIDERATIONS

A significant consideration and challenge related to the performance of environmental due diligence and negotiating environmental risk allocation is timing. Often, negotiation of the non-environmental terms of a merger or acquisition transaction proceed along a much faster track than reaching an agreement on the environmental issues. Once the basic terms of the deal are determined, such as price, financing, asset/liability identification and allocation, and title, the parties are usually motivated to have the transaction closed as quickly as possible. A quick closing, however, may be undesirable or impossible due to various environmental considerations.

If time allows, the most desirable way to proceed from an environmental risk standpoint is for the parties to fully perform all necessary environmental due diligence prior to finalizing the contract evidencing the terms of the transaction. In that situation, environmental problems and issues can be specifically identified and addressed in the transaction documents; risk allocation can be negotiated based on more complete information and with more certainty. A closing date can then be scheduled shortly after the finalization of the agreement. For obvious reasons, such a strategy may benefit both buyers and sellers and minimize the possibility of pre- and post-closing contractual disputes.

At the other end of the spectrum, some buyers may deem it advantageous or necessary to execute a contract prior to the completion of any environmental due diligence. Such a strategy is usually motivated by non-environmental issues and timing considerations. Such agreements obviously need to be carefully drafted to insure that adequate and well-defined contingencies are incorporated into the agreement to allow the buyer to "walk-away" from the transaction under specified conditions. These provisions pose significant challenges to both the buyer's and seller's legal counsel. Any agreement must afford the buyer

rancies and indemnities, if possible.

89. Like asbestos and PCBs, wetland delineation is not normally within the scope of a Phase I Environmental Site Assessment. The regulation of wetlands under the Clean Water Act is complex and beyond the scope of this article. It should be noted, however, that the presence of regulated wetlands at a facility may adversely impact a seller's plans to renovate or develop the property being acquired.

sufficient time and opportunity to identify environmental problems and must include carefully drafted walk-away provisions and/or provisions clearly allocating the risk associated with any problems which might later be revealed. The difficulty in “selling” extremely broad walk-away provisions, anticipating and allocating the risks of then unknown problems, and the motivation of all parties to move quickly to closing all give rise to negotiating and drafting challenges.

From the seller’s perspective, sufficient certainty and specificity with regard to the walk-away conditions must be negotiated in order that the seller may have some confidence that the transaction will be consummated. Events or conditions triggering the buyer’s walk-away right must be defined as narrowly as possible. Also, consideration should be given to addressing problems revealed by due diligence through risk or cost allocation as opposed to allowing such problems to become “deal breakers.”

An extended period of time between contract execution and closing creates other potential problems as well. During the interim period the seller’s business operations will likely be continuing. The agreement between the parties, therefore, needs to address how and when the buyer’s environmental due diligence activities may be performed, so as to minimize any disruption to the seller’s operations. Additionally, the negotiated allocation of environmental risks may use the date of the transaction agreement as a dividing line between seller’s and buyer’s responsibilities. That is, the seller’s obligation is limited to environmental conditions existing on or before the date the sale or merger agreement is executed. Such an allocation of risk was likely based on an environmental assessment or other environmental due diligence occurring prior to contract execution. In these situations, provisions need to be negotiated which address problems which might be created by the seller as a result of its operation of the business during the interim period. This problem frequently arises where a lengthy period between contract execution and closing is established for reasons unrelated to environmental due diligence; that is, where environmental due diligence was performed prior to contract execution but where the seller continues to operate the property for a number of months prior to closing.

Depending on the circumstances of the transaction and the requirements of the parties, other strategies which may be employed to address specific timing problems include: (1) entering into an option contract; followed by a specific purchase agreement detailing environmental due diligence and negotiations regarding environmental risks; (2) phased acquisition transactions where the purchaser acquires portions of the seller’s business or assets in a step-by-step procedure, generally leaving the environmentally controversial portions of the business

for further investigation and negotiation; and (3) transactions in which the purchaser attempts to “carve out” property or assets with environmental problems that the purchaser is reluctant to include in the transaction regardless of the allocation of risks.

Some purchasers believe that leasing a facility or property is a solution to the environmental concerns associated with these transactions. It is usually not a viable strategy, however, to lease rather than buy business assets and real property simply to avoid environmental risks. CERCLA’s expansive strict, joint, and retroactive liability applies to both “owners” and “operators” of a facility from which a release has occurred.⁹⁰ Lessees of property may therefore be responsible parties under CERCLA and may retroactively assume environmental liabilities associated with the property or business. From a practical standpoint, lessees (particularly those whose own operations are such that they did not likely cause or contribute to the environmental condition) are usually on the second or third tier of PRPs typically targeted by the governmental agencies in enforcement actions. The comfort afforded by that status depends to a large extent on the ability of the government to identify “first tier” PRPs, the financial condition of those PRPs, and the total anticipated response costs at the site. Nevertheless, all other factors being equal, a non-culpable tenant PRP is probably less likely to be targeted in an enforcement proceeding than a non-culpable owner PRP. One reason for this distinction is the agency’s view that the “owner PRP” will ultimately reap the benefits of an environmental cleanup regardless of culpability. Accordingly, although clearly not a “safe harbor,” structuring a transaction in whole or in part as a lease may lessen environmental risks.

J. ALLOCATION OF RISKS IN TRANSACTIONS INVOLVING KNOWN OR SUSPECTED ENVIRONMENTAL PROBLEMS

1. Traditional Allocation Mechanisms

As indicated, a primary purpose of environmental due diligence in most acquisition and merger transactions is to facilitate an informed and equitable allocation of known or suspected environmental risks between the seller and purchaser. The most common environmental risk allocation mechanisms used in transactions agreements are as follows:

a. Indemnifications

Indemnifications for claims and damages resulting from known or unknown environmental conditions are the most frequently negotiated

90. See *supra* Section B.

allocation mechanism. Such “hold harmless” agreements are normally of more critical importance to the purchaser than to the seller, although they typically run both ways. Because the effect of an indemnity is to place continuing obligations on the indemnifying party, the negotiation of indemnities is often the most difficult and time-consuming.⁹¹ Indemnifications typically cover (i) the indemnifying party’s breach of the environmental representations and warranties provided in the contract and (ii) damages incurred by the indemnified party which relate to environmental liabilities contractually assumed by the indemnifying party.⁹²

As with any indemnity, environmental hold-harmless provisions are only as good as the financial ability of the indemnifying party to perform. This issue is particularly complicated in those situations where the seller ceases to exist upon closing of the transaction. In such cases, individual shareholder indemnities or phased payment schemes may need to be considered. It is important to keep in mind that contractual indemnifications do not immunize a purchaser or seller from a governmental enforcement action. The seller or buyer who mistakenly believes that contractual indemnity protection guarantees a good night’s sleep in the future may be in store for a rude awakening. Nevertheless, although not guaranteeing future avoidance of an agency enforcement action, a properly drafted indemnity may provide at least financial relief in the event the indemnified party becomes involved in such actions.

b. Promises To Take Specific Action

This allocation mechanism is typically used when the seller has previously identified and is in the process of remedying a known environmental problem at the time of the transaction. Such provisions clarify the seller’s obligations to continue to perform all required actions⁹³ and to fully share with the buyer all data, reports, and other documents previously generated or to be generated in the future concerning the response action being performed. These provisions generally indemnify

91. An alternative to the continuing obligations imposed by an indemnity is for the seller, in particular, to accept a reduced purchase price in return for the elimination of on-going indemnity liability. Indeed, depending on the circumstances, a significant purchase price reduction may result in a shift of the indemnification obligations from the seller to the purchaser. The desirability of this purchase price-indemnification trade-off is, of course, dependent on many factors such as the amount of the price reduction and the priority placed by the seller on avoidance of future risks and obligations.

92. It is important that the transaction agreement specifically provides that environmental warranties and indemnities “survive closing.” Absent such provisions, the protection being sought may terminate at closing under the doctrine of merger.

93. The parties’ expectations as to what response actions are “required” at a given site often differ and are the subject of contract negotiations. Obviously, a seller committing to the performance of a response action would like to terminate its warranty and indemnity obligation based on objective and existing standards or regulations. On the other hand, given the dynamic nature of many environmental laws and the length of time required for most environmental cleanups, purchasers may attempt to negotiate a “floating” standard. In any event, future disputes may be avoided if this issue is specifically addressed in the contract.

the buyer should it sustain loss as a result of the identified problem. Of course, the quid pro quo for obtaining such commitments is the purchaser's agreement to afford the seller with reasonable access to the facility in order that the obligations may be performed.

Such "access agreements" may themselves be the subject of difficult and contentious negotiations. The purchaser is justifiably concerned that its planned operations not be adversely impacted by the seller's rights of access. Another concern of the purchaser is how existing remediation equipment may effect proposed activities at the facility and whether the seller's right or need to modify remediation systems in the future will create operational problems. The seller in this situation is usually under an obligation to a governmental agency to continue to perform certain activities until a "no further action" determination is obtained. In view of the significant penalties for non-compliance with such obligations, the seller must ensure that its continued access rights are adequate and that it has the ability to respond in the future to changes imposed by the regulatory authority.

These access requirements also give rise to issues such as the possibility of employees or agents of both seller and purchaser being injured by on-going response actions; property damage concerns; insurance needs; timing and advance notification of needed access; and indemnities for violation of access provisions. In fact, it is the author's experience that issues related to the continued access required to address existing environmental problems are substantial enough to warrant the negotiation of a separate environmental access and indemnity agreement.

c. Specific Assumption of Suspected, Potential, or Unknown Risks

No amount of environmental due diligence is usually sufficient to identify and allocate all potential environmental liabilities and risks associated with many businesses. Accordingly, virtually all transaction agreements include provisions whereby one side or the other assumes potential for unknown risks and releases the other party from liability for the same.

d. Allocation Deductibles

Unknown or suspected risks are sometimes allocated by cost. Thus, in appropriate circumstances, the seller will agree to assume potential environmental liabilities subject to a specified "deductible." In that situation, the purchaser agrees to assume response costs up to a specified dollar amount, with the seller taking responsibility for all costs above that amount. Such an allocation strategy is frequently used where the liability is unknown, but possible, and where either the

seller's or the buyer's operations could create the liability. In those circumstances, the seller may be unwilling to assume broad responsibility for pre-closing environmental conditions given the scientific difficulty of relating a future problem specifically to the buyer or seller. The amount of the deductible can roughly be determined based on the nature of the potential risk and the nature of each party's operations at the facility.

e. Thresholds

This allocation mechanism, closely related to deductibles, provides that the cost of a future environmental problem must reach a specified amount before the seller's indemnification obligation is triggered. Generally, when this type of allocation mechanism is negotiated, the seller's obligation extends back to the first dollar of costs or damages incurred once the trigger amount is exceeded.

f. Liability Caps

Although willing to assume a relatively broad allocation of environmental risks, a seller may insist that such risks be capped at a specified amount. The amount of the cap must be negotiated in the context of the businesses of the buyer and seller—the seller's financial situation and other non-environmental factors which typically define each party's bargaining leverage in a particular transaction.

g. Time and Geographical Limits

Time limit allocation mechanisms are commonly used where environmental liabilities potentially created by the seller are likely to manifest themselves within a relatively short period of time. Time limits on the risk allocation to the seller may also be appropriate when the buyer plans to continue essentially the same business activities of the seller; thereby increasing the possibility of the "who caused what" problem. In such circumstances, the seller may reasonably insist that any representation and/or indemnification obligations cease after the expiration of a specified number of years post-closing.⁹⁴

h. Environmental Insurance

Until recently, meaningful and affordable environmental insurance was not readily available. Today, reasonably priced environmental insurance policies are another allocation-related option. Either or both the buyer and seller may afford themselves of environmental insurance

94. Five years is a time limit often negotiated in this type of agreement. The appropriate length of time depends on the nature of the potential environmental condition given the historic activities at the facility.

in order to be willing to accept a proposed allocation of environmental risk. The types and coverages of such insurance products are myriad. Closely related to the concept of obtaining insurance to protect against presently unknown environmental risks are the companies which offer to "buy" or assume environmental liabilities after they are identified. The idea behind this increasingly available product is that a company with expertise in quantifying environmental problems contracts with a liable party to assume all future monetary obligations associated with such problems for a negotiated fee. These companies rely on their expertise to negotiate appropriate fees, with their profits often being dependent on their ability to promptly address such problems in creative ways. Insurance is also used to minimize their risks.

Obviously, these allocation mechanisms may be "mixed and matched" depending on the business at issue, the negotiating skills of the parties, and how highly motivated a party is to either buy or sell for other reasons. Normally, the inclusion or exclusion of the foregoing allocation provisions in any particular agreement is the result of the normal give and take which accompanies the negotiation of complex business transactions. It is important to remember that the objective is to minimize and manage environmental risks in the context of negotiating the other important issues associated with acquisition or merger transactions. The party who expects to eliminate environmental risks altogether will likely not close many deals.

2. Dealing with Environmental Problems Arising After Closing

As referenced elsewhere, applying the traditional, "bare bones," warranty and indemnification provisions to environmental problems which arise after closing is often a very difficult and costly process. Releases which occurred many years prior to closing may not manifest themselves until well after the transaction is consummated. In addition, such releases may commingle with the same or similar contaminants released by the purchaser (or its successors) after closing. Thus, in certain circumstances, simply providing that the seller shall be responsible for all environmental conditions existing prior to the date of closing invites further controversy. Although there are no "surefire" ways to avoid this particular problem, creative drafting of the transaction agreement may help. The following contractual provisions may help to resolve, or at least minimize the costs of dealing with, the "who did what" controversy:

a. Establish Guidelines Around an Environmental "Baseline"

As indicated, environmental site assessments are frequently used to establish a "baseline" for the environmental condition of the business

at the time of acquisition or merger. The shortcomings of the assessment for such a purpose have already been discussed. Nevertheless, a carefully thought out and designed Phase II environmental site assessment can establish baseline data upon which certain allocation agreements can be based. The most obvious example is a provision that contamination or other environmental problems not identified by the Phase II assessment are presumed to be the result of post-closing operations. Given the limitations of Phase II assessments, such provisions obviously tend to favor the seller rather than the buyer. A hybrid of this provision is to focus the Phase II assessment on a particular operation or potential contaminant. With respect to those operations or contaminants, the baseline data creates presumptions of liability. As to all other environmental risks, the agreement provides that no such presumptions exist.

b. Establish Other Liability Presumptions

Other liability presumptions may be established based upon the nature of the contamination or environmental problem most likely to arise in the future. Such an allocation mechanism is particularly useful if the buyer's business operations can be distinguished from the seller's. Thus, identifying chemicals or other substances that were or will not be used, generated, or stored by one party or the other can be the basis of liability presumptions. Similarly, presumptions can be established in the contract which are based upon where at the facility the contamination might be detected, particularly if the buyer plans a post-closing expansion or development. As such liability allocations are generally phrased in terms of presumptions, it may be desirable to state in the agreement whether such presumptions are "rebuttable" and, if so, what type and quantum of facts or data overcomes the presumption.

c. Pre-Closing Conditions Made Worse By the Buyer

Circumstances may arise where contamination which originated at the facility prior to closing has been exacerbated by some activity, expansion, or development of the purchaser or entity surviving a merger. Depending upon whether the purchaser's actions create or simply aggravate the pre-closing condition, the parties can negotiate an appropriate allocation of the costs. Again, such an allocation provision requires a relatively extensive Phase II site assessment to establish baseline conditions at or near the date of closing.

d. Phased-In Allocation

Where the buyer's business operations are virtually identical to the seller's, a phased-in allocation provision is sometimes appropriate. In allocating risks under such a provision, the parties basically agree to

forego the cost and “proof” problems often associated with an attempt to scientifically “fingerprint” the cause of the problem in favor of a more arbitrary allocation based on the time the problem arises. For example, a seller’s percentage liability for a future environmental liability may contractually vary depending upon how many years after closing the problem is discovered.

e. Mediation/Arbitration

When other, more specific, cost allocation mechanisms are either undesirable or inappropriate, the parties may simply agree to a less formal and costly procedure for resolving any disputes which may arise. Typically, such procedures include mediation and/or binding arbitration. The parties can provide as much detail as desirable with regard to how such mediation or arbitration is to be conducted and how the costs of such procedures are to be shared. Other alternative dispute resolution procedures, such as “fact-finding” by persons with environmental expertise, should also be considered.

In addition to the foregoing, there are other issues related to the post-closing discovery of environmental problems which might be addressed within the transaction agreement. For example, the parties may choose to specify the conditions under which a “remediation” of the problem needs to be undertaken, at least from the standpoint of contractual allocation of liabilities between the parties.⁹⁵ Conditions which may not require remediation from a regulatory standpoint may nevertheless cause damage to the buyer, such as diminution in property value. Conversely, the parties may, for purposes of privately allocating liabilities, establish conditions which impose responsibility on a particular party that may be more severe than those which would trigger an administrative enforcement proceeding. In either case, it is necessary to address these issues up-front in the transaction agreement.

Related to the foregoing, many of these agreements deal with the issue of a buyer’s voluntary versus involuntary initiation of environmental response actions after a problem arises. The contract might thus provide that a seller’s obligations will not be triggered unless and until an environmental condition results in an order by a regulatory agency to perform an investigation and clean up and/or a situation where entering into a voluntary consent order is reasonably necessary to avoid unilateral action by the agency.

The parties may also wish to address what clean up standard will apply to the remediation of an environmental problem discovered after

95. It is important to keep in mind throughout the process of contractually allocating risks and liabilities that such provisions do not in any way limit the enforcement authority of governmental regulatory authorities.

closing. To a great extent, clean up standards dictate the cost of a remediation. While neither the buyer nor the seller may have any control over what standard is actually imposed by a regulatory agency, they can agree, between themselves, to allocate costs based upon that regulatory standard or some lesser standard which is more site-specific and risk-based. For example, a regulatory agency might require clean up of groundwater contamination to "background" or "safe drinking water" standards. As between themselves, the parties might agree that the cost obligation of the buyer or seller is to be based on the standard which would be required to achieve an acceptable level of health risk using the facility-standards; which typically, are more liberal and less costly than the stringent agency standards.

Similarly, the parties may agree in advance as to the nature of the remedial action which would reasonably address specific environmental problems, at least from the standpoint of cost allocation. Again, such agreements and assumptions are not binding on the government and may, in fact, have little to do with the "reality" of a site clean up. Nevertheless, such agreements can be used between the parties as a basis for cost allocation where, to get a deal finalized, one party requires a degree of certainty as to the cost exposure associated with a specific potential environmental problem.

It may also be desirable for the parties to agree in advance as to which takes the lead in addressing future environmental problems. Such issues are potentially important in that the party taking the lead has control over project consultants and the negotiations with the regulatory authorities and, thus, is in a better position to influence the ultimate allocation of costs between the parties.

K. CONCLUSION

Because of the very significant economic consequences associated with environmental liabilities, environmental due diligence, and risk allocation these activities often "drive" the timing and sometimes the cost of business acquisition transactions. The legal framework which defines the potential environmental risk associated with the purchase and sale of a business is complex. In addition, federal and state environmental laws and regulations are broadly construed to impose the substantial cost of this country's environmental policy on existing businesses, often without regard to notions of fault or culpability. The reality of these risks explains why the environmental "tail" frequently wags the transactional "dog."

If planned carefully by knowledgeable professionals, environmental due diligence may significantly lessen environmental risks. Likewise, skilled contract negotiation and drafting can mitigate the

“fear of the unknown” aspect of these transactions. The elimination of environmental risk as an objective of due diligence and contract negotiations, although sometimes pursued, is typically unrealistic and unattainable. Environmental risks, however, like other economic risks inherent in business acquisitions and mergers, can be managed provided the appropriate tools, knowledge, and skills are employed by the parties to the transaction.