INSIDE THE MINDS

The Impact of Environmental Issues on Business Transactions

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Staying in Compliance with Today's Environmental Law Regulations

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Introduction

The top environmental concerns for companies doing business in the United States are much the same as they have been for many years: pollution-related issues involving air, water, and waste products. The importance of these issues is usually determined by where your business is located, or what industry you are operating in.

Increasingly, when you are involved in a business transaction you need to be concerned about the potential environmental risks you are either acquiring or retaining, depending on whether you are buying or selling a business. Most commonly, people tend to focus on waste issues in terms of contamination of the soil, groundwater, or surface water on a property. Depending on the type of business transaction, you can also acquire ongoing liabilities related to environmental compliance and permitting requirements, as well as for waste materials that were sent to offsite disposal sites. Consequently, it is important to understand the environmental risks in relation to the specific type of business transaction that is being undertaken.

Properly Assigning Environmental Risks

A common problem for many companies that are engaged in business transactions is that they do not have all of the facts and have not done a proper assessment of the environmental risks involved in the transaction. All too often, a company acquires another company or some of its assets and later discovers unknown environmental conditions that impose liability on them. For example, under state and federal environmental laws, the current owner of the property is generally liable for contamination that is present on that property. You can assign those responsibilities by contract, but if you do not know what those issues are, your contractual terms will probably not have assigned those risks properly. The risks and concerns will be different if only certain assets of a company are being acquired as opposed to an entire company being acquired.

Environmental laws with respect to contamination and transfer of liability are generally similar across the country, but some differences exist from state to state. It is important to know what those differences are, because

they can affect the liability involved in a transaction. For instance, some states may have a lien law that gives environmental claims priority over certain other claims on property.[1] In addition, some states may have a voluntary cleanup program, and some states may make records freely available that can help you discover what types of environmental issues exist in relation to a transaction.

The core legal basis for responsibility for contamination does not differ by industry, but some other environmental law issues do. For example, air quality permitting practices and air pollution regulatory requirements vary greatly from industry to industry. A company that is operating in the energy industry, such as a coal-powered plant, will need to pay more attention to air quality control laws than an owner and operator of retail shopping facilities. It is important to understand the client's industry and business model, as environmental compliance and risks are intertwined with the specifics of each client's specific situation.

Staying on Top of Key Environmental Issues and Trends

Perhaps the biggest trend in this area concerns the resources devoted to environmental issues within companies and state environmental agencies. In the wake of the economic downturn, there has been a lot of belt-tightening in both the private world and the public sector, and as a result, companies and regulators have been trying to do more with less. We are seeing fewer environmental professionals within companies, which may increase the risk of there being undiscovered environmental liabilities. There has also been a stretching of resources within state environmental agencies, which means environmental issues may take more time and money to resolve. Consequently, it is more important than ever to make sure you are devoting enough time and effort to environmental issues. Unfortunately, environmental issues are sometimes raised late in a deal, and they are not given much attention until many other issues have been worked out. When that happens, there is a bigger chance that environmental risks will become a key issue. This may, in some cases, kill a deal. If environmental concerns are brought up earlier with sufficient time to examine them, there are often solutions that will allow a deal to take into

[1] *See* N.J. STAT. ANN. §58:10-23.11(f) (West 2012); MICH. COMP. LAWS ANN. §324.20138(2) (West 2012); LA. REV. STAT. ANN. §30:2281 (2012).

account an allocation of the risks in a way that is acceptable to both sides. Another trend in this area relates to the tendencies of agencies to focus on the *contaminant de jour*. The Toxic Substance Control Act is intended to provide a regulatory framework for new substances that are used in US industry, but there are many instances where companies are dealing with substances where the potential impacts are not completely known.[2] For instance, you may think you have a handle on the potential costs and issues associated with a particular contamination site, and then suddenly wind up dealing with issues relating to a new contaminant. This happens simply because scientists have gained more knowledge about what a previously non-concerning substance can do. Good examples of this type of situation would be the impacts of mold or estrogen that is released into the environment. Another contaminant that has recently become an agency focus is 1.4 dioxane. This substance was added as a preservative to industrial solvents for many years and has now come under scrutiny at sites where the solvents themselves were at issue. Responsible parties have now found that they have to do different testing to find out where this type of contamination exists, and to come up with an entirely different cleanup approach to address the contaminant. Essentially, you are dealing with a moving target in terms of trying to keep up with the contaminants you are going to have to be concerned about in relation to your business.

Understanding Environmental Regulations

The Clean Air Act

The Clean Air Act is probably the one area of environmental law where there has been the greatest level of activity and where many regulatory changes are underway.[3] Again, much depends on the industry in which a company is operating, as many businesses have relatively little impact from the Clean Air Act. However, if a company is a manufacturer that produces airborne emissions, it is important to be aware that there are air toxin requirements, new source review requirements, cross-state implications, and greenhouse gas implications that are the subject of ongoing rule-making or are expected to be addressed in the near future. Changes in air regulations are not only subject to

[2] Toxic Substances Control Act, 15 U.S.C. §§2601-92 (1976).
[3] Clean Air Act, Pub. L. No. 88-206, 77 Stat. 392 (amended 1990) (codified as amended beginning at 42 U.S.C. § 7401).

many regulatory changes, but many of these changes are the subject of litigation by interested parties. Therefore, keeping up with the changes in this area can be critical for those industries that are heavily regulated under the Clean Air Act.

The Clean Water Act

The Clean Water Act has also had recent regulatory changes and litigation.[4] One of these areas is the total maximum daily load (TMDL) requirements. Instead of analyzing what can be discharged into a river or a stream from the end of one pipe on an industry-by-industry basis, under TMDL agencies consider the entire watershed and all of the sources within a region that contribute to one particular system of water bodies. Agencies conduct an analysis of the condition of those water bodies and how much additional loading of contamination can occur without impairing them, and then come up with a case-by-case set of processes, procedures, and actions that will guarantee that you are going to meet that basin-wide standard. This TMDL analysis approach is being utilized across the country, and it can have major impacts depending on the specific conditions in a certain area, and what kinds of discharges are entering the surface waters.

Likewise, there has been a switch from what is called descriptive order or result-oriented standards to specific numeric standards for the amount of nutrients and other substances that are found in water. In the past, narrative standards required that a substance such as phosphorous or nitrogen could not significantly impair a water body, but there were no specific numerical standards for such pollutants. Recently, however, there has been some very controversial rule-making—some of it stemming from litigation—that proposes to impose numerical standards for such pollutants in Florida. For example, a specific numerical amount will be allowed for nutrient discharges, including very common types of discharges from agricultural operations and various municipalities, as well as other types of industries. There has been a great deal of interest in the outcome of the adoption of specific numerical standards with regard to nutrients in particular, because the final decision-making could have a big impact on what a company/industry can discharge into water bodies.[5]

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[4] Clean Water Act, 33 U.S.C. §§1257-387 (1972)(amended 1987).

[5] *See Florida Wildlife Federation v. Johnson*, No. 4.08-cv-00324 (N.D. Fla. Feb. 18, 2012).

The Safe Drinking Water Act

The Safe Drinking Water Act has been around for many years, and while some issues are still a concern, it is a relatively known quantity.[6] That said, some regulators have proposed a new process for measuring the levels of certain substances in drinking water, including the solvent TCE. Any new developments in this area could affect ongoing cleanups as Safe Drinking Water Act standards often impact remediation standards. Lower cleanup levels could be acquired at sites impacted with substances subject to the new process, driving up remediation costs.

The Resource Conservation and Recovery Act

The Resource Conservation and Recovery Act is part of a complicated regulatory system for how companies should handle the waste they generate in the course of doing business.[7] The act creates a "cradle to grave" program for determining which wastes are hazardous and how such wastes are managed, stored, transported, treated, and disposed. Consequently, it is important for companies to pay attention to detail in relation to the existing regulations, and make sure they follow them. There are certain enforcement actions associated with the act. Therefore, companies need to stay on top of their compliance program and keep doing what they have been required to do for many years in this area.

The Emergency Planning and Community Right to Know Act

The Emergency Planning and Community Right to Know Act, is a reporting requirement for the amount of hazardous materials a company stores.[8] Simply put, every business that stores hazardous materials must report the quantities of such materials stored and used. For certain quantities of some substances, plans for how the materials will be managed and how the company will respond to an emergency are required. These reports and plans need to be kept up to date.

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[6] Safe Drinking Water Act, 42 U.S.C. §§ 300f-j (1974).
[7] Resource Conservation and Recovery Act of 1976, 42 U.S.C. §§ 6901-700.
[8] Emergency Planning and Community Right to Know Act of 1986, 42 U.S.C. §§ 11001-49.

The Toxic Substances Control Act

It often seems as if there is an annual call to change the Toxic Substances Control Act, the regulatory framework for reviewing and approving the use of new chemicals in the United States, because there are a number of issues with respect to how effective and fair that law is.[9] A tremendous number of new chemicals have come online in recent years, and the amount of science in relation to many of them can be sparse. For example, there have been some issues in relation to the field of nanotechnology. The science concerning what impacts nanotechnology may have on public health and safety is not completely developed. Consequently, regulators in this area have, in some instances, required companies to enter into consent decrees to the effect that they are allowed to do experimentation and begin some use of nanotechnology on a limited basis, prior to a review being conducted under the Toxic Substances Control Act.

Although there have not been any major changes in this area as of yet, there has been a lot of discussion about the fact that changes need to happen. Changes that have been proposed include increasing the amount and type of data that must be reported to the Environmental Protection Agency (EPA), the submission of additional data for chemicals already in use, establishment of priorities for which chemicals will be evaluated first, and development of standards as to what poses an unreasonable risk for a particular chemical. Therefore, if a company is involved in creating new chemicals, it should take part in discussions about what is coming down the road in this area.

Helping Clients Comply with Environmental Laws

Having a lawyer on your team who knows how to deal with environmental issues is essential. Such a lawyer can help you put together a compliance program to make sure you follow applicable law, and put procedures in place so you know how to deal with any errors or deficiencies.

A skilled environmental lawyer can also play an important role with respect

[9] 15 U.S.C. §§2601-92.

to confidentiality issues. For instance, a company may have trade secrets it wants to protect, or may want to ensure that when it conducts internal investigations it has some control over when and how certain information gets released. An environmental lawyer can help manage disclosure issues to best serve these goals.

An environmental lawyer also plays a leading role in environmental due diligence. Environmental professionals and consultants do a great deal of the work in this area, but you also need a lawyer on your team who understands the business issues in relation to a transaction, can assess what the client is trying to do, and can advise a company regarding their risks. This enables the client to take the environmental assessments that are done by the non-lawyer professionals, put them into context, and decide how best to use them. For example, an environmental report prepared by a seller will not be written in the same way as one written by a buyer, even when the underlying data is the same. An environmental lawyer can help a client assess both what is said and what may have been overlooked. Simply put, although a lot of the work in relation to environmental due diligence can be done by non-lawyers, it is not useable unless there are lawyers involved in the process who understand the data and how to apply it.

Recent Environmental Law Cases: *Sackett v. EPA*

One case that has received a lot of attention in the past year and may affect regulations in this area down the road is *Sackett v. EPA*.[10] This is a case brought under the Clean Water Act that involved the issue of whether you can challenge an order from the EPA prior to it actually being complied with. In this particular case, a company had illegally filled in some wetlands. The EPA then ordered the company to restore the wetlands, and told the company it could only challenge the order after it had complied with it. The judge in the *Sackett* case ruled against the EPA in saying the company had the right to challenge that order at the outset. This case was brought under the Clean Water Act, but the ruling may be more broadly applicable and there are similar provisions to the Resource Conservation and Recovery Act and many other environmental statutes. Prior to this decision, the EPA had

[10] *Sackett v. EPA*, 132 S.Ct. 1367 (2012).

been accustomed to issuing an order and taking the position that you have a very limited ability to challenge that order until you have complied with it. However, in the wake of *Sackett*, there may be a more level playing field in this area.

Developing an Effective Environmental Compliance Program

With respect to developing an effective environmental law compliance program, the Boy Scout motto is applicable: be prepared. For most businesses, it is a very good idea to have a written environmental compliance plan that spells out what your goals are and who is individually responsible for achieving which one—in other words, where does the buck stop in the area of environmental compliance? It is important to define the role of each of the professionals involved in an environmental law compliance program, including the company's lawyers and technical people. You should also keep in mind that even if you have the best possible plan, problems can arise—some sort of spill, release, or equipment malfunction may occur, due to a human error or natural event, such as a hurricane. Therefore, a good environmental law compliance program needs to spell out what you should do to get back into compliance in such a situation, including how and when to report to the environmental regulatory agencies, and how to respond to any enforcement action stemming from those agencies.

The components of an environmental law compliance program will vary from business to business—there is no such thing as catch-all best practices. Basically, you have to look at the particular set of regulations that apply to the client's industry, and come up with a case-by-case set of best practices. Again, it is essential to assemble the proper team of environmental professionals and legal counsel who can put together the proper compliance plan—there is no cookie-cutter approach.

As previously noted, in tight economic times, fewer resources tend to be devoted to environmental law compliance. However, while cutting back on those resources can save you money in the short term, it can cost you money in the long term. Simply put, if you do not have an adequate staff to make sure you stay in compliance, you will probably wind up paying a lot

more money in fines than you saved by not employing compliance staff. A well thought out compliance plan can also make sure you are in fact using your resources in the most efficient and effective manner.

Phase I and II Environmental Assessments

As an advisor in the area of buying and selling companies, it is important to keep in mind that your clients will have various levels of sophistication. Some companies have done many deals and therefore are very familiar with environmental risks and how to evaluate them. Conversely, some companies are relatively unsophisticated in this area, and there are some basic issues they do not understand. For example, it is important to be aware of what is involved in a Phase I environmental assessment, which is a set of standards under the American Society for Testing and Materials and EPA regulations. Clients often have some misconceptions about what a Phase I assessment consists of. A standard Phase I environmental assessment examines the narrow issue of whether there is contamination present at a particular facility. The assessors will look at existing records; conduct interviews of people who have knowledge about the site; look at databases at different types of facilities, including lists of storage tanks or waste generators; and conduct a site visit/walk-through of a facility.

There is no testing in a Phase I assessment; assessors are simply conducting an analysis as to whether readily accessible information indicates there might be a contamination problem. In addition, a standard Phase I assessment does not include assessment as to whether there are lead paint, asbestos, or wetlands issues in relation to a property. For example, if a company is planning to buy and expand a property and there are wetlands that might interfere with those plans, a Phase I assessor does not do a compliance check to see if you are in compliance with your permit, and they do not consider whether Clean Water Act compliance could prohibit a proposed development. Unfortunately, some companies still think a Phase I environmental assessment means you have looked at all possible environmental issues, but that is not the case.

If a Phase I assessment does uncover some issues of concern, such as what are called recognized environmental conditions, it is often

recommended that a Phase II assessment be performed. A Phase II assessment samples the soil, groundwater, and sometimes the surface water around a facility to see if there are contaminations from the items that were identified in the Phase I assessment. Again, this check is limited to whether there is a contamination problem; there is no complete assessment of the extent of the contamination. Very often in the deal-making process, the parties will want to put a price tag on the potential costs of the environmental impacts at a site, but even after a Phase II assessment you do not really know the extent of the contamination—you only know whether you have contamination. Therefore, it is very hard to make any kind of accurate prediction as to the cost of a particular contamination risk. Ultimately, there are many technical issues involved in this area, which is why it is helpful to have environmental professionals and attorneys on-board during a transaction.

Penalties for Noncompliance

The penalties for noncompliance in the area of environmental law can be severe, depending on the particular environmental program involved. In the case of criminal violations, the noncompliant party could actually go to jail—and most environmental law violations could be considered criminal violations. If the government chose to make a criminal case out of many of these violations, the law would allow it to do so.

The monetary penalties in this area can also be very large—i.e., $25,000 per day, per violation. For example, if you are subject to the Resource Conservation and Recovery Act compliance program and you did not label a storage drum properly, perform the proper inspections, or log the information correctly, these seemingly minor violations could result in hefty penalties. The EPA and most of the states have well-established penalty policies that cover the different types of violations in this area and what penalties are appropriate for each violation. Basically, they have set up a penalty matrix with degrees of deviation from requirements and potential for harm. There are typically major/moderate/minor categories for both potential for harm and for extent of deviation of from the requirements resulting in the monetary amounts. A specific penalty is assessed from this matrix for each violation. Consequently, there is a well-established process for determining what the penalties should be in this area and how to assess them, and they can be quite large, depending on the type of violation.

However, ensuring that the penalty matrix is correctly applied in a particular circumstance may require negotiations with the enforcing agency. Engaging an environmental lawyer who has particular experience in this area can make a big difference in the level of penalty ultimately imposed.

Conclusion

Again, paying attention to detail and staying in compliance with the basic programs regulating air, water, and waste product contamination are the primary compliance challenges, particularly in an era of belt-tightening inside many companies and regulatory agencies. In terms of business transactions, it is important to pay attention to environmental issues early on and have all of the facts so you can properly evaluate environmental risks, and not have those risks come as a surprise late in the deal-making process.

Fortunately, a wide variety of helpful resources for lawyers and clients are available over the Internet, including many relevant publications and daily web-based seminars and conferences that can help you stay current on topics of environmental law. The primary challenge is to weed through all of those resources and focus on those that are best suited for your particular industry.

In addition to having a thorough understanding of the law and regulations in this area, it is important for lawyers who practice environmental law to understand the people involved. The way environmental laws get implemented, as in any other field of human endeavor, is through the actions of people. There are a lot of gray areas in environmental law that are subject to interpretation by various decision makers, which is why it is helpful to know the regulators at the state and federal agencies. You need to know what they consider important and how they view these issues, apart from what is written on the page. That knowledge is what makes a good environmental lawyer stand out from the average attorney in this field.

Key Takeaways

- Obtain all of the facts in relation to the company that is being acquired, and make sure that both the buyer and the seller

understand what the environmental risks are in relation to the transaction, how those risks are to be assigned between the parties, and how known environmental risks are going to be paid for.

- Understand the business terms of the transaction and how those terms impact environmental risks.
- Assist the client with confidentiality issues. A company may have trade secrets it wants to protect, or may want control over internal investigations.
- Help the client create a written environmental compliance plan that spells out what their goals are and who is individually responsible for achieving which ones. Make sure the client knows how and when to report to the environmental regulatory agencies, and how to respond to any enforcement action.
- Take advantage of the wide variety of helpful resources for lawyers and clients available over the Internet, including various publications and daily web-based seminars and conferences that can help you stay current in this area.
- Know the regulators at the state and federal agencies, as well as the individuals responsible for environmental compliance inside your client's company.
- Understand the client's industry and business plan. Environmental compliance and risks do not occur in a vacuum.

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Before joining Foley, Mr. Maurer was deputy general counsel for the Florida Department

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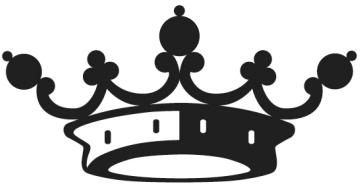

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