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M&A ACADEMY
ENVIRONMENTAL CONSIDERATIONS
IN M&A TRANSACTIONS

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Introduction

- Mergers, acquisitions and divestitures commonly require the identification of potential environmental liabilities associated with the target company or business, assessment and quantification of the associated risk or liability, and allocation of that risk or liability among the parties to the transaction.
- Environmental liabilities can be expensive, long in duration, and not always readily apparent.
- This section of the M&A Academy focuses on understanding the environmental considerations in transactions and the tools available to identify and allocate environmental liability and risk.

Environmental Considerations in M&A Transactions

- Overview of CERCLA liability
- Successor Liability: Asset v. Stock Transactions
- Environmental Due Diligence Considerations
- Environmental Provisions in Transactional Documents
- Environmental Insurance Options

CERCLA/Superfund: Liability for Contamination

- The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund) is the primary federal law that imposes cleanup obligations on owners and operators of contaminated properties and certain other categories of parties.
- CERCLA imposes strict, joint and several liability on: (i) current owners and operators of contaminated sites; (ii) former owners and operators of contaminated sites if they owned or operated the site at the time of disposal of the hazardous substances; (iii) entities that arrange for disposal of hazardous substances; and (iv) transporters of hazardous substances.
- Liability under CERCLA is joint, strict and several meaning that any one responsible party can be liable for the entire cleanup regardless of fault.
- Liability is typically apportioned among potentially responsible parties (PRPs) based on an equitable allocation (assuming viable PRPs exist).
- Most states have state laws substantially equivalent to CERCLA.

Successor Liability: Asset v. Stock Transaction

- **Stock Acquisitions:** Environmental liabilities come with the stock, including with respect to: (i) currently owned or operated properties; (ii) formerly owned or operated properties; and (iii) sites to which hazardous substances were sent for disposal.
- **Asset Acquisitions:** When a company acquires the assets of another company, the acquiring company typically is not responsible for the liabilities of the selling company subject to certain exceptions: (i) when a purchaser agrees to assume the liabilities; (ii) when a transaction is a de facto merger or consolidation; (iii) when the purchaser is a mere continuation of the seller; (iv) when the transaction is fraudulent; or (v) if the “**substantial continuity**” theory of liability is imposed.

Substantial Continuity Exception

- Courts that recognize the “substantial continuity” exception typically consider all or some of the following factors: (i) retention of employees; (ii) retention of supervisory personnel; (iii) retention of production facilities in same location; (iv) manufacture of the same product(s); (v) retention of name; (vi) continuity of assets; (vii) continuity of general business operations, (viii) public representation as a continuation of the seller; and (ix) knowledge of seller’s environmental liabilities.
- If some or all of these factors are present, an asset purchaser may be held responsible for the asset seller’s environmental liabilities as if it were a stock deal, including with respect to former site and off-site disposal liability.
- Fulsome environmental due diligence is necessary even in the context of assets purchases because of the potential for successor liability.

CERCLA Bona Fide Prospective Purchaser Defense: Overview

- CERCLA Bona Fide Prospective Purchaser (BFPP) defense allows certain purchasers of real property and tenants to obtain liability protection from pre-existing contamination under certain circumstances.
- Applies only in asset acquisitions, not stock acquisitions or mergers.
- BFPP defense applies only to CERCLA liability and does not insulate purchasers from claims under common law, state law or other statutes.
- To qualify for BFPP defense, purchasers must conduct specified pre-Closing and post-Closing requirements and activities.
 - Key pre-Closing requirement is to conduct “all appropriate inquiries” into the previous ownership and uses of the facility to identify potential releases of hazardous substances at the property (essentially a Phase I Environmental Site Assessment).
 - Key post-Closing requirement is continuing obligation to “take reasonable steps” to (1) stop any continuing releases of hazardous substances, (2) prevent any threatened future releases, and (3) prevent or limit any human environmental or natural resource exposure to any previously released hazardous substances.
- Fact-specific inquiry as to whether requirements are met; EPA and private parties have significant opportunities to challenge availability of defense.

CERCLA Bona Fide Prospective Purchaser Defense: Specific Requirements

Requires parties to satisfy and conduct specified pre-Closing and post-Closing requirements and activities

- (i) All disposal of hazardous substances at the facility occurred before the person acquired the facility.
- (ii) The person made all appropriate inquiries into the previous ownership and uses of the facility in accordance with generally accepted good commercial and customary standards and practices before acquisition of the property. This “all appropriate inquiries” standard incorporates by reference the ASTM Phase I requirements (ASTM standard E2247-16 for forestland and rural property and ASTM standard E1527-13 for commercial property) at 40 C.F.R. § 312.11. The all appropriate inquiry (i.e., Phase I) must be conducted within one year of the acquisition of the property, with certain aspects of the inquiry conducted or updated within 180 days prior to the acquisition. 40 C.F.R. §312.20(a) & (b).
- (iii) The person provides all legally required notices under federal, state, and local laws with respect to the discovery or release of any hazardous substances at the facility.
- (iv) The person exercises appropriate care with respect to hazardous substances found at the facility by taking reasonable steps to stop any continuing release, prevent any threatened future release, and prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance.
- (v) The person provides full cooperation, assistance, and access to persons that are authorized to conduct response actions or natural resource restoration at the site.
- (vi) The person complies with any land use restrictions established or relied on in connection with the remediation of the site (e.g., zoning restrictions) and does not impede the effectiveness or integrity of any institutional control employed at the site in connection with the remediation (e.g., deed notices).
- (vii) The person complies with any request for information or administrative subpoena issued by EPA.
- (viii) The person is not potentially liable or affiliated with any other person that is potentially liable, for response costs at a site through any direct or indirect familial relationship or any contractual, corporate, or financial relationship (other than instruments that convey title or the leasehold interest) or the reorganization of a business that was potentially liable.
- (ix) a tenant must show that the leasehold interest is not designed to avoid liability.

Environmental Due Diligence Objectives

Important for both **buyers** and **sellers** to conduct environmental due diligence.

Seller Due Diligence Objectives:

- Provides Seller with critical information and a competitive advantage.
- Enables Seller to control the diligence process.
- Eliminates surprises and allows Seller to frame the issues and formulate positions.
- Minimizes transaction delays.
- Preserves credibility of Seller.
- Potentially reduces environmental indemnity obligations.

Buyer Due Diligence Objectives:

- Provides Buyer with critical information regarding whether to proceed with transaction, to negotiate appropriate protections in transaction documents, and/or negotiate purchase price reduction.
- Lack of due diligence typically puts Buyer at a competitive disadvantage.
- Allows Buyer to potentially qualify for CERCLA BFPP Defense (asset purchase only).

Pre-Environmental Due Diligence Inquiry

Prior to commencing the environmental due diligence, it is critical to understand the target company, the industry and the transaction to tailor the due diligence to the transaction, including:

- Nature of transaction: Asset or stock
- Timing of transaction
- Purchase price
- Public versus private company
- Identity and size of Seller
- Letter of intent terms regarding allocation of environmental liabilities/post-Closing indemnities
- Target company industry
- Number and location of facilities
- Owned, leased or shared facilities
- How long the Seller has owned the company/assets
- Corporate history, including acquisitions/divestitures
- Will representation and warranty insurance be purchased
- Exit strategy/plans to close facilities

Key Environmental Due Diligence Inquiry Areas for Buyers & Sellers

- Due diligence should be tailored to transaction and generally should include inquiry into the following:
 - On-site contamination at currently owned, leased and operated sites
 - Regulatory compliance matters (current and future)
 - Off-site liabilities associated with waste disposal activities
 - Legacy liabilities associated with formerly owned, leased and operated sites or divested operations/companies
 - Toxic tort and asbestos liabilities
 - Environmental Insurance
- Due Diligence Request List should be tailored to the transaction and include general and fact/transaction-specific questions/requests.
- Due Diligence Request List should not be a stagnant document – it should be updated, supplemented and revised as due diligence and negotiations progress.

Key Environmental Due Diligence Documents

Key information may be contained in environmental-specific documents or general corporate documents, including:

- Phase I's, Phase II's, internal EH&S audits, sampling data, underground storage tank closure reports, asbestos surveys, manifests, monitoring data, emissions data, PRP notices, settlement agreements, litigation documents.
- Environmental permits, NOV's, consent decrees, regulatory inspections, litigation documents, settlement agreements, compliance plans and other regulatory correspondence.
- Websites and on-line databases maintained by the US Environmental Protection Agency and state environmental agencies.
- Court docket searches to identify environmental/toxic tort/environmental insurance cases
- Environmental capex budgets and reserves.
- Environmental due diligence reports from previous transactions.
- Purchase and Sale Agreements and associated disclosure schedules and indemnity agreements from historic mergers, acquisitions, divestitures.
- Lease agreements.
- Credit agreement disclosure schedules.
- Attorney responses to auditor inquiries.
- Current and historic insurance policies (and associated claims).
- SEC filings.

Environmental Due Diligence: Beyond the Document Review

- Interview environmental managers, long-time employees, in-house/outside environmental counsel.
- Retain a consultant to conduct a Phase I Environmental Site Assessment.
- Conduct EHS compliance audit to identify material non-compliances with environmental laws and permits and future regulatory requirements.
- Develop reasonable case/worst case cost estimates.
- Consider conducting Phase II Investigation (invasive sampling, including soil, groundwater and soil vapor sampling).
- Contact regulators (subject to confidentiality considerations).
- Evaluate information on current and historic off-site disposal facilities.
- Conduct database searches, EPA/State agency websites, internet searches.
- Conduct docket searches to identify environmental/toxic tort/environmental insurance cases.

Other Environmental Due Diligence Considerations

- State environmental transfer laws (most notably, New Jersey and Connecticut)
- Permit transfers
- Financial assurance requirements
- Underground storage tank funds
- Existing environmental insurance policies (including transferability if asset deal)
- Environmental risk allocation in lease agreements
- Environmental indemnity rights or obligations

Purchase and Sale Agreements: Relevant Sections for Environmental Risk Allocation

Key Sections of Purchase and Sale Agreement from Environmental Perspective:

- Reps and Warranties
- Excluded/Assumed Liabilities
- Definitions
- Survival
- Indemnification/Indemnification Procedures and Limitations
- Access to Documents and Properties
- Conditions to Closing
- Covenants

Purchase and Sale Agreements: Environmental Reps

- Environmental Representations and Warranties can range from limited/narrow reps to very broad and sweeping, depending on the transaction and sophistication of parties.
- Purchasers typically seek very broad reps unqualified reps.
- Sellers typically seek to provide limited qualified environmental reps.
- Gap is typically closed by use of qualifiers to reach an acceptable middle-ground: "Knowledge," "Material Adverse Effect," material, disclosure schedule, limited look-back provisions, reps limited to seller's/target's actions, and ring-fencing language.

Purchase and Sale Agreements: Seller-Friendly Environmental Reps

- Sellers should consider limiting exposure from environmental reps as follows:
 - Qualify reps by Knowledge, Material Adverse Effect, and Disclosure Schedule.
 - Limit compliance to current compliance (or limited look-back periods).
 - Limit reps to actions taken by Seller.
 - Add ring-fence/exclusive rep language (i.e., no other reps in the agreement apply to environmental matters).
 - Limit survival period.
 - Limit scope of reps in initial draft to:
 - Seller is in compliance with Environmental Laws and Environmental Permits as of the Closing Date
 - Seller holds all Environmental Permits required for operations as of the Closing Date
 - There are no pending written environmental claims or enforcement proceedings as of the Closing Date
 - The environmental reps are the exclusive reps applicable to environmental health and safety matters (i.e. ring-fence language)
- Environmental representations for Sellers to **AVOID**:
 - Unqualified reps regarding the absence of environmental liabilities (liabilities often defined as contingent, known, unknown, asserted, unasserted, inchoate, etc.).

Example: *Seller has no Liabilities under Environmental Laws.*
 - Reps as to future compliance with Environmental Laws or Permits.

Example: *No costs are required to be incurred for the facility to remain in compliance with Environmental Laws or Environmental Permits after the Closing Date.*

Purchase and Sale Agreements: Purchaser-Friendly Environmental Reps

- Purchasers should try to limit Knowledge and Material Adverse Effect qualifiers, resist temporal limits on reps related to contamination and seek look-back periods of 5 years on compliance with environmental law reps and extended survival periods (minimum 3 to 5 years).
- Purchasers should consider seeking reps covering the following: (i) contamination at current and formerly owned, operated and leased sites, (ii) compliance with environmental laws and permits (current and past), (iii) possession of all environmental permits, (iv) consent orders/decrees, (v) predecessor activities/liabilities, (vi) off-site disposal liabilities, (vii) hazardous substance exposure, (viii) asbestos liabilities (premises and product liability), (ix) underground storage tanks, (x) PCBs and PFAS, (xi) contractual liabilities, (xii) disclosure of environmental documents, (xiii) transferability of permits, governmental consents, filings, and (iv) applicability/non-applicability of environmental transfer laws (i.e., ISRA and CT Transfer Act).

Purchase and Sale Agreements: Excluded/Assumed Liabilities

Retained/Excluded Environmental Liabilities:

- In an asset deal in particular, the retained/excluded liability section is a key risk allocation provision.
- Purchasers typically prefer Seller to retain all pre-closing environmental liabilities and Sellers typically prefer Buyer to assume all environmental liabilities.
- A Purchaser may achieve a competitive advantage in a bid by agreeing to assume all or some of the environmental liabilities.
- Some Sellers prefer to retain certain environmental liabilities if the alternative is a significant price reduction.
- A common compromise is that Seller retains liability for former/retained facilities, off-site waste disposal liabilities and/or certain known environmental liabilities and Purchaser assume all other environmental liabilities associated with the business and transferred assets.
- Another common risk allocation is the “our watch/your watch” construct.
- If pre-closing environmental liabilities are retained by Seller, typically detailed procedures are negotiated such that both parties have reasonable input into the process. It is important to understand from a practical perspective how a “my watch/your watch” structure will work.

Purchase and Sale Agreement: Other Important Risk Allocation Provisions

- **Survival:** Environmental reps typically survive longer than general reps (Typically 3-5 years).
- **Exclusive Remedy:** Contractual remedies are the exclusive remedy; all other rights/remedies waived.
- **Direct Environmental Indemnity:** Indemnities for certain environmental liabilities (usually known environmental liabilities) in addition to an indemnity for breaches of reps are often negotiated.
- **Indemnity Control Provisions:** Control procedures are typically negotiated to allow one party to control remediation and contacts with environmental regulators with reasonable participation and input from the other party.
- **Indemnity Trigger:** Indemnity triggers are often limited to remediation required by Environmental Law, governmental order or third party claim so as to avoid indemnities for voluntary remedial actions.
- **“No Dig”/ “No Look” Provisions:** Exclusion from environmental indemnity (direct indemnity or breaches of environmental reps) for voluntary invasive sampling or voluntary disclosures to the governmental authorities.
- **Exacerbation:** Exclusion from environmental indemnity for post-closing exacerbation of pre-closing contamination.
- **How Clean is Clean/Anti-Goldplating Standards:** Applicable remediation standards are typically negotiated to limit Seller’s indemnity obligation to the least stringent, most cost-effective standard acceptable under environmental laws consistent with industrial/commercial use of property including institutional and engineering controls.

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Insurance for Environmental Risk Allocation

Various insurance products are available for environmental risk allocation:

- Rep & Warranty Insurance
 - Insures Purchaser against Seller's breach of representations and warranties.
 - May exclude environmental liabilities if inadequate due diligence is conducted or reps are unreasonably broad/off-market.
 - No coverage for known or disclosed environmental liabilities.
- Pollution Legal Liability (PLL) Insurance
 - Provides insurance for claims for bodily injury/property damage/cleanup costs arising out of unknown conditions for on-site and off-site contamination at current and former sites and off-site disposal liabilities.
 - May contain exclusions and endorsements with respect to voluntary remediation, contaminants addressed through engineering controls, PFAS, etc.
 - PLL policies should be negotiated and tailored to address specific environmental risks.
- Cost-Cap: Protects against the cost of a remediation exceeding estimates.
- Tank Insurance: Typically required for the ownership/operation of underground storage tanks.

Key Takeaways

- Environmental liability flows with a stock purchase and may similarly come along with an asset purchase under successor liability theories. Environmental due diligence is important to identify and quantify liabilities to assist purchasers and sellers in allocating the risk through reps and warranties, indemnities and/or insurance policies.
- Phase I Environmental Site Assessments are an important part of due diligence, may provide a defense to liability in an asset purchase but not in a stock acquisition.
- Sellers providing environmental indemnities (either direct indemnities or for breaches of reps and warranties) should consider provisions to limit liability exposure, including indemnity exclusions for voluntary investigations, remedial actions and disclosures, anti-gold-plating provisions and control provisions that allow seller to control or have meaningful input into the process.
- Rep & Warranty Insurance and PLL policies may help to “close the gap” in negotiating liability apportionment, but they rarely are a complete liability transfer and always require environmental due diligence and negotiation with the insurers to maximize coverage.



QUESTIONS?

Biography



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Christopher McAuliffe counsels clients on obtaining environmental approvals for new development, climate change laws, and compliance with water pollution control and air pollution control requirements. He also advises clients on solid and hazardous waste, site remediation, brownfields, natural resource damages, and environmental cleanup cost recovery matters. Chris brings to his practice experience gained while working as vice president of environmental, litigation, and employment in the law department of a large energy company.

Chris advises clients on the environmental disclosures of publicly traded companies. He also assists in obtaining necessary approvals for projects within the Highlands region of New Jersey, including defending those approvals in administrative and New Jersey Superior Court Appellate Division proceedings. Chris has an extensive background in environmental due diligence for the acquisition and sale of assets and companies.

Highlights of Chris's experience include negotiating one of the first voluntary consent decrees in the utility industry to resolve allegations of noncompliance with new source review (NSR) and prevention of significant deterioration (PSD) requirements. He has represented clients in litigation and regulatory proceedings arising out of land, sediment and waterbody environmental cleanup sites including the Passaic River and Newark Bay complex.

Chris also obtained the environmental approvals needed for New Jersey's largest utility to divest its electric generation business into a new affiliated company without triggering site remediation obligations under New Jersey's Industrial Site Recovery Act (ISRA). Additionally, he obtained concurrence from the New Jersey Department of Environmental Protection that ISRA did not apply to the transfer of a petroleum refinery, terminal, tank farm, and pipeline to a newly created company.

Chris provides environmental compliance assistance for facilities located in multiple states. He has experience in advising clients with respect to permits under the Clean Water Act for cooling water intake structures at power plants, and compliance with the Clean Air Act's restrictions on engine manufacturing.

While in-house counsel, Chris provided legal advice and representation to the company's electric delivery, gas delivery, and electric-generating business. His job focused on matters arising under environmental, real estate, land use, and intellectual property law, and Occupational Safety and Health Administration (OSHA) regulations. He managed a group of lawyers and paralegals who provided environmental, litigation, and employment legal services to the corporation.

Chris is listed in *Chambers USA: America's Leading Lawyers for Business* (2011–2015); *The Best Lawyers in America* (2014); and in *New Jersey Super Lawyers* (2008–2014). He publishes and speaks on environmental compliance issues, and regularly moderates panel presentations on renewable energy and green technology innovations.

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Biography



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Judith Walkoff advises clients on environmental issues that arise during US and cross-border mergers and acquisitions (M&A), financing, and real estate and other business transactions. Her clients include private equity firms, public and privately held corporations, and financial institutions. Judy conducts and coordinates environmental due diligence assessments, counsels clients on transaction-related risks and risk allocation strategies, and drafts and negotiates risk allocation agreements. She also helps clients manage environmental liabilities after transactions are completed.

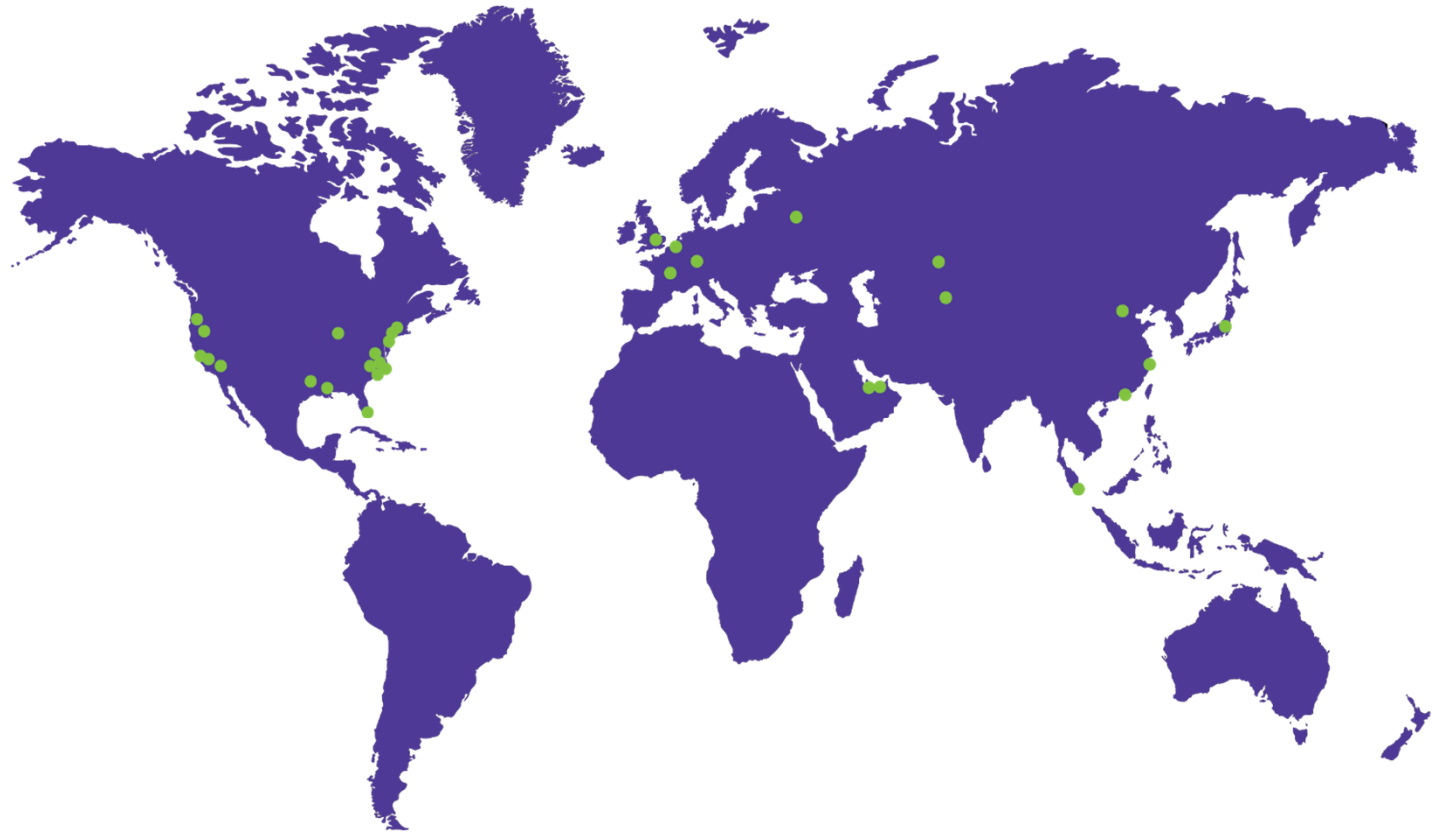
Judy also represents clients in federal and state Superfund actions and advises on compliance with all major US federal and state environmental laws.

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