

# Doing diligence

## Navigating environmental issues and liabilities in transactions

INTERVIEWED BY SUE OSTROWSKI

When conducting corporate or real estate transactions, prospective buyers need to be aware of the environmental risks of the proposed acquisition, or they could find themselves on the hook for millions of dollars in remediation and compliance liabilities.

“Buyers need to work closely with an experienced environmental transactional attorney, sometimes in tandem with an environmental consultant, to ensure they are not acquiring environmental liabilities they didn’t intend to acquire,” says Ben Clapp, shareholder in the Environmental, Corporate and Commercial, and Energy and Natural Resources groups at Babst Calland. “Sellers also need to ensure they do not remain saddled with liabilities they didn’t intend to retain after a sale.”

*Smart Business* spoke with Clapp about the environmental diligence process in a sale and how to address environmental risks in contractual provisions.

### WHAT SHOULD POTENTIAL BUYERS BE AWARE OF REGARDING ENVIRONMENTAL RISK?

Purchasing a property without proper safeguards could put a buyer at risk of substantial liability should environmental contamination or compliance issues be discovered after purchase. Property owners are generally responsible for contamination, regardless of whether they caused it, including contamination that existed prior to taking ownership. Acquiring a business with undiscovered compliance issues can result in significant capital outlays for corrective actions and raises the possibility of becoming subject to enforcement actions and fines.

Environmental diligence is key to assessing the scope of environmental risk associated with a given transaction. However, the

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extent of diligence a buyer is permitted to perform can differ based on transaction structure and relative leverage of the parties.

### HOW CAN BUYERS IDENTIFY POTENTIAL ENVIRONMENTAL ISSUES?

A Phase I Environmental Site Assessment, performed by an environmental consultant, is often a good place to start. A Phase I combines a noninvasive investigation with a review of publicly available records and interviews of key personnel to determine whether contamination is likely to exist.

If a Phase I identifies the presence or likely presence of hazardous substances, a Phase II investigation may be performed, which involves environmental sampling. Phase IIs can also provide some insight into the extent of contamination, whether it is migrating from the property, and the cost and timing of remediation that may be required. If a Phase II is recommended, the seller and their counsel must consider whether it is in its best interest to allow one.

When assessing environmental compliance, attorneys generally evaluate materials provided by the seller in response to a diligence request, review public records and conduct interviews of EHS personnel and management. This can be supplemented by a formal compliance review, usually performed by an environmental consultant.

### HOW CAN CONTRACTUAL PROVISIONS HELP ADDRESS RISKS?

It is critical that the purchase agreement allocates the responsibility for environmental risks clearly and with specificity so there is no confusion or ambiguity that could lead to litigation. Environmental representations and warranties can play an important role, as they require the seller to disclose known environmental issues. The scope of these provisions is often a key negotiation point. Depending on the transaction structure, other considerations include determining whether the seller will retain responsibility for pre-closing environmental issues, and whether, and to what extent, the seller will indemnify the buyer for environmental liabilities for events that occurred before closing. Because environmental laws establishing cleanup liability generally have no statute of limitations, sellers often want a sunset provision for the indemnity so they don’t remain on the hook in perpetuity for liabilities. Buyers, however, may seek an indemnity that survives as long as possible.

All it takes is one undiscovered environmental issue to significantly impact the economics of a transaction. Thorough diligence and thoughtful drafting and negotiation of contractual provisions can go a long way toward mitigating the risk of a party incurring unintended environmental liabilities. ●