Chapter 24
ENVIRONMENTAL DUE DILIGENCE IN MINERAL PROPERTY TRANSACTIONS: EMERGING RISKS, REQUIREMENTS, AND STRATEGIES

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§ 24.01 Introduction

Environmental liability is a common concern in mineral property transactions, for good reason. Mining operations can release toxic substances into the air, water, and soil. The exposure of certain metals to atmospheric oxygen and water can cause acid drainage, i.e., the discharge of water polluted with high acidity, sulfates, and metals, at the time of extraction and long after mining operations have been completed. Mining can also alter the landscape and cause slope instability, soil erosion, and subsidence. Oil and gas operations typically involve the use of materials such as drilling mud, pipe dope, heavy metals, biocides, Ph control additives, and corrosion inhibitors, and can cause the production of brine and naturally occurring radioactive materials (NORM), all of which may be regulated under various environmental laws. Contamination may be present in disposal pits, gas processing facilities, compressor stations, repair facilities, saltwater disposal wells, and other facilities that are commonly included in sales of oil and gas properties. As a result, a buyer of

mineral properties can face significant exposure to environmental liability.

This article reviews several of the legal grounds for environmental liability in mineral property transactions, examines the guidelines and considerations for pre-acquisition environmental due diligence, and suggests strategies for managing environmental liability when buying or taking over the operation of mineral properties.

§ 24.02 Legal Bases of Environmental Liability

A complex set of federal and state environmental laws and regulations applies to mineral properties. "Mineral properties" itself is a broad term. It can include properties where "hard-rock" metals (such as copper, gold, iron, lead, magnesium, silver, uranium, and zinc), non-fuel minerals (such as asbestos, gypsum, phosphate rock, and sulfur), or fuel minerals (such as coal, oil, and natural gas) are mined or produced. A comprehensive survey of the environmental laws applicable to such properties is beyond the scope of this paper. Instead, the following is a general review of some of the more important legal grounds upon which a buyer or operator of mineral properties may face environmental liability.

[1] The Comprehensive Environmental Response, Compensation, and Liability Act

One of the most significant sources of liability for cleanup of contaminated sites, including mineral properties, is the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA),[1] commonly known as the federal Superfund statute. CERCLA was created primarily to provide funding and enforcement authority for cleaning up thousands of existing contaminated sites.

CERCLA liability is retroactive in that it may result from past activities that were entirely legal when performed. It is strict, i.e., it is imposed without proof of negligence or fault.[2] It is also joint and several; one potentially responsible party (PRP) out of many may be liable for the entire cost of the cleanup unless it

[1] 42 U.S.C. §§ 9601 - 9675 (elec. 2005).

[2] United States v. R.W. Meyer, Inc., 889 F.2d 1497 (6th Cir. 1989).

can prove that the harm is divisible.[3] PRPs may be liable for, among other things, cleanup and other "response costs," damages for injury to or loss of natural resources, and the costs of health assessment or health effects studies.[4]

CERCLA authorizes the Environmental Protection Agency (EPA) to issue administrative orders requiring PRPs to clean up property or pay the costs of doing so,[5] or sue to recover its past and future cleanup and other response costs.[6] In addition, PRPs that are sued by or settle with the government can bring contribution actions against other PRPs to recover part of their cleanup costs, and innocent parties that voluntarily clean up sites may sue PRPs for indemnification.[7]

PRPs under CERCLA include: (1) the current owners or operators of the facility; (2) persons who owned or operated the facility at the time the disposal of hazardous substances occurred on the property; (3) "arrangers," i.e., persons who arranged for disposal, treatment, or transport of hazardous substances they owned or possessed at or to the facility; and (4) transporters, i.e., persons who accepted hazardous substances for transport to a disposal or treatment facility selected by them.[8] Thus, significantly, the current owner or operator of a contaminated mineral property may be liable for cleanup costs even if the contamination was caused by another party and occurred prior to its purchase or operation of the property, unless it can establish one of the limited CERCLA defenses.

The terms "owner" and "operator" are not separately defined under CERCLA, and the statute defines "owner or operator" simply as "any person owning or operating" any onshore or offshore facility.[9] Thus, the job of determining the meaning of

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[3] United States v. Bell Petroleum Services, Inc., 64 F.3d 202 (5th Cir. 1995).

[4] 42 U.S.C. § 9607(a) (elec. 2005).

[5] 42 U.S.C. § 9606 (elec. 2005).

[6] 42 U.S.C. § 9607(a) (elec. 2005).

[7] Cooper Industries, Inc. v. Aviall Services, Inc., 125 S. Ct. 577 (2004); 42 U.S.C. § 9613(f)(1) & (3)(B) (elec. 2005) (contribution); and 42 U.S.C. § 9607(a) (elec. 2005) (indemnification).

[8] 42 U.S.C. § 9607(a) (elec. 2005).

[9] 42 U.S.C. § 9601(20) (elec. 2005).

these terms essentially has been left to the courts. Unfortunately, it is not always clear whether a party is an "owner" or "operator" of a mineral property. There is little or no case law interpreting the terms "owner" or "operator" in relation to oil and gas properties. In light of the cases decided in other contexts, however, the term "owner" could include all owners of an interest in a producing property, such as surface owners, working interest owners, royalty interest owners, and other mineral interest owners, and the term "operator" could include all operators of the producing property, including contract operators and service companies that perform work at the site.

Under certain circumstances, parent corporations and individuals such as shareholders, officers, directors, and managers may be personally liable for cleanup costs under CERCLA even if the "corporate veil" cannot be pierced. These persons may be liable as "operators" if they manage, direct, or conduct operations at the facility related to pollution, i.e., operations having to do with the leakage or disposal of hazardous waste or decisions about compliance with environmental regulations.[10] They may also face liability as "arrangers."[11]

Many types of contamination commonly found at mineral properties are "hazardous substances" under CERCLA and, therefore, are subject to CERCLA enforcement actions. Notwithstanding the exemption of mining wastes and certain oil and gas exploration and production (E&P) wastes from regulation as "hazardous waste" under the Resource Conservation and Recovery Act (RCRA),[12] such wastes may be considered "hazardous substances" under CERCLA.[13] NORM, which can precipitate in the form of scale or mineral deposits onto tubing, pipe, or other oilfield equipment and may be an issue at the

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[10] United States v. Bestfoods, 524 U.S. 51, 66-67 (1998); Browning-Ferris Indus. of Illinois, Inc. v. Ter Maat, 195 F.3d 953 (7th Cir. 1999), *on remand*, 2000 WL 1716330 (N.D. Ill. 2000) (president and principal shareholder of corporations that operated landfill held personally and jointly liable with corporations as an "operator" of landfill).

[11] *Cf.* Gen Corp, Inc. v. Olin Corp, 390 F.3d 433 (6th Cir. 2004).

[12] 42 U.S.C. § 6921(b)(3)(A)(i) & (ii) (elec. 2005) and 40 C.F.R. § 261.4(b)(7) (elec. 2005) (mining wastes); 40 C.F.R. § 261.4(b)(5) (elec. 2005) (E&P wastes).

[13] Eagle-Picher Indus., Inc. v. U.S. Envtl. Protection Agency, 759 F.2d 922 (D.C. Cir. 1985).

well site, pipe yards, production pits, treater/disposal facilities, land farms, landfills, and related locations, is likely a hazardous substance under CERCLA.[14] Also, under EPA's interpretation, the CERCLA petroleum exclusion excludes from the definition of hazardous substances crude oil and fractions thereof even if they naturally contain substances (such as benzene, toluene, and xylene) or contain additives (such as lead) that are otherwise specifically listed as hazardous substances under CERCLA, but does not exclude petroleum that has been mixed with or contaminated by hazardous wastes that are not indigenous to petroleum or hazardous substances in petroleum that increase in concentration as a result of contamination during use.[15] The courts have generally upheld this interpretation.[16]

EPA has reported that as of January 2003, 87 abandoned hardrock mine sites were listed as Superfund sites.[17] Although, to the author's knowledge, EPA has not brought CERCLA actions as to any oil and gas production sites, several facilities that handled E&P wastes have been designated as Superfund sites.[18] Thus, potential CERCLA liability should be carefully considered in mineral property transactions.

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[14] Radionuclides such as radium-226 and radon are typical daughter products of NORM, and radionuclides are hazardous substances that give rise to liability under CERCLA. *See* Amoco Oil Co. v. Borden, Inc., 889 F.2d 664, 668-69 (5th Cir. 1989).

[15] Memorandum on "Scope of the CERCLA Petroleum Exclusion Under Section 101(14) and 104(a)(2)," by Francis S. Blake, (then) General Counsel of EPA (July 31, 1987).

[16] *See* Tosco Corp. v. Koch Industries, Inc., 216 F.3d 886 (10th Cir. 2000) (petroleum exclusion inapplicable where hazardous wastes have commingled with petroleum products in the soil and are floating on the groundwater beneath a refinery; court noted that the petroleum exclusion was added to address oil spills, not releases of oil that has become infused with other hazardous substances); Cose v. Getty Oil Co., 4 F.3d 700 (9th Cir. 1993) (crude oil tank bottoms, which are comprised of water and sedimentary solids that settle out of the crude oil and create a layer of waste at the bottom of the crude oil storage tanks, do not fall within the petroleum exclusion); United States v. Western Processing Co., 761 F. Supp. 713, 722 (W.D. Wash. 1991) (petroleum exclusion inapplicable to waste oil resulting from rinsing and cleaning oil tanks when hazardous substances from the tank's interiors were added to the waste oil during cleaning).

[17] Off. Inspector General, EPA, "Implementation, Information, and Statutory Obstacles Impede Achievement of Environmental Results from EPA's National Hardrock Mining Framework" (EPA Report No. 2003-P-00010 Aug. 7, 2003). A copy of this report is available at www.epa.gov/superfund/programs/aml/MiningFramework.pdf.

[18] *E.g.*, the D.L. Mud, Inc. Superfund Site (drilling mud facility), the Gulf Coast Vacuum Services Superfund Site (facility that primarily handled waste from oil and gas activities), and the PAB Oil & Chemical Service, Inc. Superfund Site (disposal

[2] The Resource Conservation and Recovery Act

The Resource Conservation and Recovery Act (RCRA)[19] is the primary federal statute regulating the management of hazardous and nonhazardous wastes "from cradle to grave," i.e., from generation to collection, transportation, and disposal. It authorizes EPA actions and citizen suits against "any past or present generator, past or present transporter, or past or present owner or operator of a treatment, storage, or disposal facility, who has contributed or who is contributing to the past or present handling, storage, treatment, transportation, or disposal of any solid or hazardous waste [at the facility] which may present an imminent and substantial endangerment to health or the environment."[20]

As stated, the RCRA regulations exempt certain mining and E&P wastes from regulation as hazardous waste. As a result, such wastes typically are not subject to the storage, manifesting, transportation, permitting, disposal, and other requirements that are applicable to RCRA hazardous wastes. For several reasons, however, buyers of mineral properties may incur liability under RCRA notwithstanding the mining and E&P waste exemptions.

First, many wastes commonly associated with E&P activities are not exempt from regulation under the RCRA Subtitle C (hazardous waste) regulations.[21] Second, to the extent non-exempt wastes become mixed with exempt mining or E&P wastes, the property may be subject to RCRA Subtitle C requirements by virtue of the "mixture rule."[22] Third, under the "imminent hazard" authority, EPA (and state agencies) may have the authority to issue mandatory cleanup orders to owners and operators of facilities contaminated with mining or E&P wastes on grounds that the materials are "solid wastes" under the statute and, in the case

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facility for oil field waste), all located in Vermilion Parish, Louisiana. Information on these sites is available at www.epa.gov/superfund/sites/npl/la.htm.

[19] 42 U.S.C. §§ 6901 - 6981 (elec. 2005).

[20] 42 U.S.C. § 6972(a)(1)(B) (elec. 2005). *See also id*. § 6973(a).

[21] *See* Regulatory Determination for Oil and Gas and Geothermal Exploration, Development, and Production Wastes, 53 Fed. Reg. 25,446 (July 6, 1988); Clarification of the Regulatory Determination for Wastes From the Exploration, Development and Production of Crude Oil, Natural Gas and Geothermal Development, 58 Fed. Reg. 15,284 (Mar. 22, 1993).

[22] 40 C.F.R. § 270.1(c) (elec. 2005).

of E&P wastes, also because they are only excluded from the regulatory, but not the statutory, definition of "hazardous waste."[23]

To recap, buyers of oil and gas properties should gain little comfort from either the petroleum exclusion under CERCLA or the mining and E&P waste exemptions under RCRA. Although "petroleum" is excluded from CERCLA regulation, petroleum releases may give rise to enforcement actions, "imminent hazard" actions, or citizen suits under RCRA.[24] There is no petroleum exclusion under RCRA. Similarly, although certain mining and E&P wastes are exempted from RCRA's hazardous waste requirements, they are arguably subject to enforcement and "imminent hazard" actions under the RCRA statute and are likely subject to cleanup actions under CERCLA.

[3] The Surface Mining Control and Reclamation Act

Underground and surface coal mining is regulated under the Surface Mining Control and Reclamation Act (SMCRA).[25] To ensure that the land is returned to productive use, SMCRA requires operators of coal mines to submit a "reclamation plan" as part of the permitting process.[26] If conditions, practices, or violations may cause an imminent danger to the health or safety of the public or significant, imminent environmental harm to land, air, or water resources, the government may order cessation of coal mining, reclamation operations, and abatement actions.[27]

[4] Regulation of Hardrock Mining

Hardrock mining is regulated by a patchwork of federal and state environmental laws. State laws apply on federally owned, state owned, and privately owned lands, and vary from state to state. States commonly impose permitting and reclamation requirements.[28]

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[23] Adam Babich, "RCRA Imminent Hazard Authority: A Powerful Tool for Businesses, Governments, and Citizen Enforcers," 24 *Envtl. L. Rep.* 10122 (Mar. 1994).

[24] *See* Kara Holding Corp. v. Getty Petroleum Mktg, Inc., 67 F. Supp. 2d 302 (S.D.N.Y. 1999).

[25] 30 U.S.C. §§ 1201 - 1328 (elec. 2005).

[26] 30 U.S.C. § 1257(d) (elec. 2005).

[27] 30 U.S.C. § 1271(a)(2) (elec. 2005).

[28] *E.g.*, Nev. Rev. Stat. Ann. §§ 519A.010 - 519A.290 (elec. 2005) (Nevada).

[5] Wetlands and Coastal Zone Issues

Mining operations that involve dredging or filling in wetlands require a permit from the U.S. Army Corps of Engineers under section 404 of the Clean Water Act (CWA).[29] The Corps's jurisdiction, however, may not extend to "isolated wetlands" that are not adjacent to navigable waters.[30] Stormwater runoff from mining operations requires a permit if it contacts overburden, raw materials, intermediate products, finished products, by-products, or waste products.[31] Permitting and other requirements may also be imposed under state law on mining activities in coastal zone areas.[32]

[6] The Oil Pollution Act

The Oil Pollution Act of 1990[33] imposes liability for the discharge or substantial threat of discharge of oil into navigable waters and adjoining shorelines from any vessel or offshore or on-shore facility. Owners and operators of such facilities, which include any equipment used to explore for, drill for, produce, store, handle, transfer, process, or transport oil, are potentially liable for removal (cleanup) costs, property damage, natural resource damage, and other damages.

[7] State Regulation of Oil and Gas Operations

Oil and gas operations are regulated primarily under state law. Typically, the requirements apply to, and penalties for mismanagement of E&P wastes and closure of production sites are assessed against, the current owner or operator.[34] State law may also impose restoration obligations in the absence of a contractual obligation to restore.[35]

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[29] 33 U.S.C. § 1344 (elec. 2005).

[30] Solid Waste Agency of N. Cook County v. United States, 531 U.S. 159 (2001) (ponds on abandoned sand and gravel mining site not subject to Corps's CWA jurisdiction).

[31] 60 Fed. Reg. 50,804, 50,888-902 (Sept. 29, 1995).

[32] *E.g.*, La. Rev. Stat. §§ 49:214.21 - .42 (elec. 2005) (Louisiana).

[33] 33 U.S.C. §§ 2701 - 1656 (elec. 2005).

[34] *E.g.*, La. Admin. Code tit. 43, pt. XIX, subpt. 1 (elec. 2005) (Louisiana).

[35] *E.g.*, Terrebonne Parish School Bd. v. Castex Energy, Inc., 893 So. 2d 789 (La. 2005) (in absence of a contractual obligation to restore, oil and gas lessee may be obligated to restore the leased premises to its pre-lease condition if it exercised its rights under the lease unreasonably or excessively). *See also* Boyd Bryan, "From Corbello to

[8] Contractual Liability

Acquisitions of mineral properties commonly include an assignment of mineral leases or other agreements that may impose obligations to restore or reclaim the property. The effect of such contractual obligations can lead to significant and perhaps unexpected liability. For example, in Louisiana, a mineral lessee may be required to fulfill a contractual obligation to restore even if the restoration costs far exceed the fair market value of the property.[36]

[9] Tort Liability

Environmental contamination can give rise to tort liability for property damage, restoration costs, personal injury (e.g., toxic tort damages), and other damages under various theories including negligence, nuisance, and trespass. Likely plaintiffs in these types of claims are neighboring landowners or occupants of the contaminated property.

§ 24.03 Pre-Closing Environmental Due Diligence

[1] The Environmental Assessment

An acquisition commonly involves three steps: (1) the execution of a purchase agreement that, among other things, allows the buyer time to conduct its environmental and other due diligence; (2) the buyer's pre-closing due diligence investigation; and (3) the sale. Steps can be taken at each stage to address potential environmental liability.

The due diligence investigation should almost always include an environmental assessment of the property. The environmental assessment typically involves a records review, a site reconnaissance (i.e., a walk through of the site), interviews with current owners and occupants, and interviews with government officials (the Phase I); depending on the results of the

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Castex: The Mineral Lessee's Obligation to Restore in Louisiana," 50/2 *Landman* 47-54 (Am. Ass'n of Prof. Landmen Mar./Apr. 2005).

[36] *E.g.*, Corbello v. Iowa Production, 850 So. 2d 686 (La. 2003) (surface lessee ordered to pay $33 million to restore property, more than 33 times the fair market value of property in uncontaminated condition); Hazelwood Farm, Inc. v. Liberty Oil & Gas Corp., 844 So. 2d 380 (La. Ct. App. 2003), *writ denied,* 857 So. 2d 476 (La. 2003) (oil and gas lessee ordered to pay $2 million as damages on oil and gas property despite jury findings that the value of the property in an uncontaminated state was $304,000).

Phase I, the assessment may also involve intrusive sampling in areas of concern (the Phase II). The assessment can serve several purposes. First, it can help identify and quantify environmental risks before the closing which, as discussed below, can affect the purchase price and other contract terms and, in some cases, result in certain properties being excluded from the transaction. It can also memorialize the environmental conditions existing at the time of closing, thereby establishing a "baseline" against which future environmental problems and disputes over whether contamination occurred before or after the closing can be evaluated. Significantly, the assessment also can help establish certain defenses to or limitations on potential CERCLA liability.

[a] Defenses to CERCLA Liability

With the enactment of the Small Business Liability Relief and Brownfields Revitalization Act in January 2002 (the Brownfields Amendments),[37] CERCLA now provides protections from liability to at least three types of landowners.

The "innocent landowner" defense protects a buyer from CERCLA liability if, among other things, it can establish that it acquired the property without knowing, or having any reason to know, of the prior disposal of any hazardous substances on the property.[38] To establish that it "had no reason to know" of the contamination, the buyer must show that prior to the purchase it carried out "all appropriate inquiries" into the previous ownership and uses of the property.[39] The landowner also must satisfy additional requirements after contamination is discovered including taking "reasonable steps" to stop continuing releases, preventing any threatened future release, and preventing or limiting human, environmental, or natural resources exposure to any previously released hazardous substance.

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[37] Pub. L. No. 107-118, 115 Stat. 2356 (2002) (codified at 42 U.S.C. § 9628).

[38] The "innocent landowner" defense arises from the definition of "contractual relationship" contained in 42 U.S.C. § 9601(35) (elec. 2005) for purposes of the third party defense under 42 U.S.C. § 9607(b)(3) (elec. 2005).

[39] 42 U.S.C. § 9601(35)(B)(i)(I) (elec. 2005).

In addition, CERCLA provides liability protection to "bona fide prospective purchasers" (BFPPs).[40] A BFPP's CERCLA liability is limited to the amount of EPA's "windfall lien" on the property that covers the amount of any increase in the fair market value of the property attributable to a response (cleanup) action undertaken by EPA. The intent of these amendments is to remove a significant impediment—potential CERCLA liability—to the purchase of "brownfield" properties and thereby put them back into commerce. Significantly, a buyer may be considered a BFPP even if it acquires the property with knowledge of existing contamination, provided that, among other things, it made "all appropriate inquiries" into the previous ownership and uses of the property and takes "reasonable steps" similar to those required under the "innocent landowner" defense with respect to the contamination. EPA (or the appropriate state agency) may be willing to provide the buyer with a letter acknowledging that the buyer's pre-closing environmental assessment satisfies the "all appropriate inquiries" standard and specifying the "reasonable steps" that must taken by the buyer after the closing to maintain its status as a BFPP.[40.1]

CERCLA also protects "contiguous property owners," i.e., persons who own property that is contiguous (or otherwise similarly situated) to contaminated property owned by another. To qualify, the landowner, among other things, must conduct "all appropriate inquiry" with respect to the property, must not know or have reason to know that the property was or could be contaminated by a release or threatened release from the contiguous property, must not be potentially liable or affiliated with any potentially liable person, and must take "reasonable steps."[41]

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[40] 42 U.S.C. §§ 9601(40) & 9607(r) (elec. 2005).

[40.1] *See* Mem., Susan E. Bromm, Dir., EPA Off. of Site Remediation Enforcement, "Interim Guidance Regarding Criteria Landowners Must Meet in Order to Qualify for Bona Fide Prospective Purchase, Contiguous Property Owner, or Innocent Landowner Limitations on CERCLA Liability," 12 (Mar. 6, 2003), *available at* www.epa.gov/brownfields/liab.htm#ap.

[41] 42 U.S.C. § 9607(q) (elec. 2005).

[b] Satisfying the "All Appropriate Inquiries" Test

[i] The Current ASTM Standards

To qualify for any of the foregoing CERCLA defenses or limitations on liability, the landowner must conduct "all appropriate inquiries" into the previous ownership and use of the property. The Brownfields Amendments and subsequent EPA regulations[42] establish that a buyer may satisfy the "all appropriate inquiries" requirement by having an environmental assessment conducted in accordance with either American Society for Testing and Materials (ASTM) Standard E 1527-97 (the 1997 standard) or ASTM Standard E 1527-00 (the 2000 standard).

Significantly, on August 26, 2004, EPA proposed new "all appropriate inquiries" regulations to replace the ASTM standards.[43] Until EPA promulgates the final regulations, however, the ASTM standards continue to define the requirements for "all appropriate inquiries" under CERCLA.[44]

[ii] EPA's Proposed "All Appropriate Inquiries" Regulations

A complete analysis of EPA's newly-proposed "all appropriate inquiries" regulations is beyond the scope of this paper and may be premature because the regulations may not be finalized exactly as proposed. That said, the following provisions of the proposed regulations warrant mention:

Applicability. The proposed regulations confirm that they are applicable to, among other things, persons seeking to qualify for the innocent landowner defense, the bona fide prospective purchaser liability protection, and the contiguous property owner liability protection under CERCLA.[45]

Qualifications of "Environmental Professionals." The proposed regulations require that "all appropriate inquiries" under CERCLA be conducted by, or under the supervision or responsible charge of, an "environmental professional."[46] Paraphrasing,

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[42] 68 Fed. Reg. 24,888 (May 9, 2003) (codified at 40 C.F.R. pt. 312).

[43] 69 Fed. Reg. 52,542 (Aug. 26, 2004) (proposing amendments to 40 C.F.R. pt. 312).

[44] *Id.* at 52,545.

[45] Proposed 40 C.F.R. § 312.1(b).

[46] Proposed 40 C.F.R. §§ 312.20(a)(1) & 312.21(a).

the proposed regulations require that an "environmental professional": (1) hold a current Professional Engineer's or Professional Geologist's license and have the equivalent of three years full-time relevant experience; (2) be licensed by the federal government or a state and have the equivalent of three years full-time relevant experience; (3) have a Baccalaureate or higher degree in a relevant discipline of engineering, environmental science, or earth science and the equivalent of five years full-time relevant experience; or (4) as of the date of promulgation of the final regulations, have a Baccalaureate or higher degree and the equivalent of ten years full-time relevant experience.[47]

Data Gaps. "Data gaps" are defined as "a lack of or inability to obtain information required by the [proposed regulations] despite good faith efforts by the environmental professional . . . to gather such information. . . ."[48] To the extent there are data gaps, the persons conducting the inquiry must identify the sources of information consulted to address the data gaps and comment on the significance of the data gaps with regard to the ability to identify releases or threatened releases of hazardous substances at the property.[49] The proposed regulations suggest, but do not require, sampling to address data gaps.

Interviews. Interviews of past and present owners, operators, and occupants of the subject property and, for inquiries conducted at "abandoned properties," interviews of owners or occupants of neighboring or nearby properties, are required.[50]

Records Review. The proposed regulations require review of historical records (such as aerial photographs, fire insurance maps, building department records, title documents, and land use records) from the time the property was first used for residential, agricultural, commercial, industrial, or government purposes;[51] a search for environmental cleanup liens filed against the property;[52] a review of federal, tribal, state, and local records on the

[47] Proposed 40 C.F.R. § 312.10(b).

[48] Proposed 40 C.F.R. § 312.10(b).

[49] Proposed 40 C.F.R. § 312.20(f).

[50] Proposed 40 C.F.R. § 312.23.

[51] Proposed 40 C.F.R. § 312.24.

[52] Proposed 40 C.F.R. § 312.25.

subject property and adjoining properties; and a review of public health records regarding the subject property.[53]

Visual Inspection of the Property and Adjoining Properties. An on-site visual inspection of the property is required. Physical limitations to the inspection (such as snow, overgrowth, high water, etc.) must be noted, and an on-site inspection is not required in those circumstances provided good faith efforts have been taken to gain access. Visual inspection of adjoining properties must be conducted from the subject property line, public rights-of-way, or other vantage points (such as aerial photography). An on-site visual inspection of adjoining properties is not required, but is recommended where practicable. Physical limitations to the visual inspection of adjoining properties should be noted.[54]

Specialized Knowledge. The buyer must take into account its specialized knowledge of the subject property and adjoining properties and any other experience relevant to the inquiry.[55]

Property Value. The proposed regulations require the buyer to consider whether the purchase price reasonably reflects the fair market value of the property if it were not contaminated, and whether any differential between the two is due to contamination. A real estate appraisal of the property, however, is not required.[56]

Commonly Known or Reasonably Ascertainable Information. The buyer and the environmental professional must also take into account, throughout the inquiry, commonly known or reasonably ascertainable information within the local community about the subject property, and the environmental professional must gather information about commonly known or reasonably ascertainable information.[57]

Sampling. Although the preamble states that sampling and analysis is not required in all cases, the lack of such a require-

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[53] Proposed 40 C.F.R. § 312.26.

[54] Proposed 40 C.F.R. § 312.27; 69 Fed. Reg. at 52,564-65.

[55] Proposed 40 C.F.R. § 312.28.

[56] Proposed 40 C.F.R. § 312.29; 69 Fed. Reg. at 52,567.

[57] Proposed 40 C.F.R. § 312.30.

ment may not prevent a court from concluding that, under the circumstances, sampling and analysis should have been conducted to satisfy the "all appropriate inquiries" test and obtain protection from CERCLA liability.[58]

Written, Signed Report with Opinion. The results of the inquiry must be documented in a written report signed by the environmental professional, with statements that the signer is an "environmental professional" and has performed the inquiry in conformance with the regulations. The report should include, among other things, opinions as to whether conditions indicative of contamination were identified, and regarding additional appropriate investigation, if any.[59]

To summarize, it appears that "all appropriate inquiries" will expand in scope, and increase in cost, when the proposed regulations are finalized and replace the interim ASTM standards.

[c] Other Assessment Considerations

A few additional points concerning the environmental assessment are worth noting. First, assessments performed in accordance with the ASTM standards are designed primarily to preserve the CERCLA defenses, and normally do not address contaminants or issues that are not within the purview of CERCLA. For example, the typical environmental assessment will not address NORM contamination nor will it delineate wetlands on the property. When appropriate, separate evaluations should be requested to address NORM, wetlands issues, and other "non-scope" matters.

Also, the environmental assessment should be performed not more than 180 days prior to the sale in order for it to be presumed valid for purposes of the CERCLA defenses.[60] Generally, an updated assessment should be obtained if more than 180 days has passed since the previous environmental assessment.

Further, in selecting the environmental professional, the buyer should place particular emphasis on the consultant's education, experience, and expertise in dealing with mineral

[58] 69 Fed. Reg. at 52,568.

[59] Proposed 40 C.F.R. §§ 312.21 & 312.31.

[60] ASTM Standard E 1527-00, § 4.6.

properties, as well as his or her credibility and reputation in the industry and with the governmental authorities. The buyer should also be certain that the consultant is appropriately insured. Moreover, even though EPA's recently proposed regulations addressing the "all appropriate inquiries" assessment are not yet final, it is advisable that the consultant qualify as an "environmental professional" as that term is defined in the proposed regulations.

[2] The Compliance Audit

In addition to an environmental assessment of the property, the buyer may want to conduct a compliance audit of seller's facility and operations. The compliance audit involves an examination of all environmental and regulatory aspects of the seller's operations and a legal inquiry into what federal, state, and local laws and regulations apply and whether the seller is in compliance with them. It is commonly performed by a team of professionals, including environmental scientists, engineers, geologists, and lawyers, who bring their knowledge of environmental issues, as well as trained eyes and ears, to identify potential environmental problems.

Matters to be evaluated include the seller's licenses and permits, handling and storage of raw materials and finished products, record keeping, cleanup and notification procedures for accident releases, off-site transportation and disposal of waste materials, compliance history, and outstanding violations. The audit can involve not only an inspection of the seller's facility, but also gathering and review of corporate and agency records and interviews of the seller's employees and representatives. Records to be reviewed may include permit files, inspection reports, enforcement documents, litigation files, insurance files, repair records, correspondence with regulatory agencies, waste handling documents, documentation of water consumption, corporate environmental policies, employee training procedures, and contingency and spill response plans. Information can be obtained from the regulatory agencies through written requests under the Freedom of Information Act.[61] It also can be helpful to discuss matters informally with regulatory agencies.

[61] 5 U.S.C. § 552 (elec. 2005).

A compliance audit is often undertaken when successor liability is a particular concern, such as in a stock acquisition or merger. But it can also supplement the buyer's due diligence in an asset purchase by shedding more light on the environmental condition of the property, by addressing issues that may be outside the scope of the environmental assessment, and by providing information pertinent to the accuracy of the seller's representations and warranties.

§ 24.04 Strategies for Managing Environmental Liability

[1] The Purchase Agreement

[a] Representations and Warranties

The seller's representations and warranties in the purchase agreement can benefit the buyer in several ways. First, they require the seller to inform the buyer of actual or potential environmental problems prior to closing of the transaction. Second, the buyer's obligation to close can be conditioned on the representations and warranties being correct at the time of execution of the purchase agreement and also at the time of closing. Thus, if an environmental problem is disclosed by the seller or discovered during the buyer's due diligence investigation, the terms of the sale may be renegotiated or the buyer may be relieved of the obligation to close. Also, if the purchase agreement provides that the representations and warranties survive the closing, they can provide remedies to the buyer if they were incorrect when made by the seller.

Common environmental representations and warranties by the seller include the following: (1) the seller has complied with all environmental laws and regulations in connection with its ownership of and operations on the property; (2) hazardous materials have not been generated, used, treated, recycled, stored on, transported to or from, or released, deposited, or disposed of on the property, except in compliance with environmental laws; (3) there are no pending or threatened environmental claims or actions with respect to the property; (4) all necessary permits have been obtained and complied with by the seller, and are transferable to the buyer; (5) the assets are not subject to any state or federal environmental lien; (6) there are no impending changes or events that will affect the ability of the facility to

comply with environmental laws; (7) all books, records, environmental studies, and other documents provided by the seller are true, accurate, and complete; and (8) provisions addressing other miscellaneous environmental issues, e.g., there are no underground storage tanks, asbestos-containing materials, waste drums, PCBs, etc., located on the property.

[b] Indemnities

Indemnity provisions can be used to shift potential environmental liability from one party to the other. CERCLA recognizes the validity of indemnity agreements between private parties as to CERCLA liability,[62] although they will not bind the government or third parties.[63] Moreover, even as between private parties, it may be advisable for the indemnity as to CERCLA liability (or liability under other environmental statutes) to expressly identify the statutes at issue and include strict liability as well as negligence.[64]

The following are some of the most important issues to be considered when negotiating and drafting the indemnity:

Liabilities, Losses, and Damages Covered. Indemnity against "loss" may not be triggered until the indemnitee actually makes payment or sustains a loss, whereas indemnity against "liability" may be triggered when the liability of the indemnitee arises regardless of whether a payment has been made or actual loss has been suffered. Damages covered under the indemnity can include fines and penalties, diminution in the value of the property, loss of use of the property, inability to obtain financing collateralized by the property, and exemplary damages.

Substances and Conditions Covered. Frequently, a broadly worded definition of the substances covered by the indemnity is set out, followed by specific references to CERCLA, RCRA, and other environmental statutes. Also, the definition often specifi-

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[62] 42 U.S.C. § 9607(a)(1) (elec. 2005).

[63] Mardan Corp. v. C.G.C. Music, Ltd., 804 F.2d 1454, 1457 (9th Cir. 1986).

[64] *See* Fina, Inc. v. ARCO, 200 F.3d 266, 273 (5th Cir. 2000) (buyer's CERCLA claims against seller of refinery not barred by buyer's agreement to indemnify seller from "all claims . . . arising from the ownership or the operation of the Assets . . . and accruing from and after Closing . . . except to the extent that any such claim . . . shall arise from the gross negligence of [seller]").

cally names substances that may be excluded from regulation under particular statutes, such as petroleum, E&P wastes, and NORM.

Presence Versus Release. The parties may want to address whether indemnification is owed based on the presence, or only the actual or threatened release, of hazardous materials on the property. Hazardous materials are commonly used in mining and oil and gas operations, and the mere presence of such materials on site will not necessarily subject the buyer to environmental liability. Rather, liability is generally triggered by a release or threatened release of hazardous materials or handling of such materials in violation of environmental laws or permits.

Changes in the Law. Some conditions that may be lawful at the time of the purchase agreement or closing may thereafter become unlawful due to a change in the law. Thus, the parties may want to address whether indemnification is owed for conditions that become environmental liabilities after the closing as a result of a change in the law.

Floors, Caps, and Baskets. The seller may seek to impose a "cap" on its liability under the indemnity, or a "floor" providing that it will not owe indemnification for claims below a certain amount. If a floor is established, the buyer may want to include a "basket" provision providing that claims will be accumulated to meet the "floor," similar to a deductible under an insurance policy.

Materiality. Some agreements provide that indemnification is owed only if the matter is "material." Materiality can be defined quantitatively (i.e., by the dollar amount), qualitatively (e.g., where the ability to conduct operations is affected), or in other ways.

Voluntary Versus Mandatory Cleanup. For various reasons, the buyer may want to institute a cleanup of the property even if it has not been mandated by the governmental authorities, such as to mitigate the damage or when delay in cleanup may adversely affect operations at the site or present health hazards or exposure to toxic tort lawsuits. Thus, the parties may want to address whether indemnification is owed for a cleanup voluntarily undertaken by the buyer, or only cleanup that is required by the government.

The Cleanup Standard. The applicable cleanup standard may also be the subject of negotiation. Absent indemnity language to the contrary, the indemnity may not require the "best" cleanup for the buyer, but only one that satisfies applicable law or allows the property to be used as intended by the buyer, e.g., for industrial or commercial, as opposed to residential, uses.

Survivability and Term. Environmental risks are commonly allocated between the parties as of the closing date, i.e., the seller's indemnity covers pre-closing conditions or events. The seller, however, may want to specify that its indemnity is only owed for a limited time period after the closing. In other transactions, a reasonable rule of thumb may be to limit the indemnity period to the prescriptive period applicable to potential claims. However, in the environmental context, that logic may not suffice. Under CERCLA, the statute of limitations period generally does not accrue until the cleanup is either completed or initiated.[65]

Indemnity as the Sole Remedy. Absent contractual language to the contrary, the buyer may have many remedies in addition to those provided by the indemnity provision. For example, the buyer may have a claim against the seller in the event of a breach of any representation or warranty, and may also have the right to bring a cleanup cost recovery action or contribution claim against the seller if contamination resulting from pre-closing activities or conditions is discovered. The parties, therefore, might consider addressing whether the indemnity will be the buyer's sole remedy against the seller.

Defense Obligations and Attorneys' Fees. The parties may want to address whether, in addition to indemnification, the seller will be obligated to defend the buyer in suits by third parties. Indemnity provisions can require the seller to pay the attorneys' fees and expenses associated with the defense, and can grant the buyer the right to retain attorneys of its own choosing to defend the suit.

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[65] 42 U.S.C. § 9613(g)(2) (elec. 2005) (for removal actions, the statute of limitations is three years after completion of the removal action; and for remedial actions, the statute of limitations is six years after initiation of physical onsite construction of the remedial action, except under certain circumstances).

Notice. The parties might also address whether, and under what circumstances, notice must be provided by one party to the other of matters affecting the environmental condition of the property or potential environmental liability. The buyer may want immediate notice of any spill or release of hazardous substances on the property or adjacent property; any notice or demands from any governmental agency or third party regarding environmental matters; and any fact or change in circumstances that reasonably could be expected to cause any of the representations and warranties to cease to be true. Notice of these matters could affect the buyer's decision whether to go through with the closing, and notice after closing could allow it the opportunity to immediately demand a defense and indemnification from the seller or promptly address the issues itself and mitigate its damages. The seller may want similar notice from the buyer so that it can mitigate its potential legal and contractual liability.

Other Sources of Protection. The parties might consider whether other sources of protection from liability—such as insurance coverage or contractual indemnities from other parties—are primary and must be pursued by the buyer before the seller's indemnity obligation is triggered.

Indemnified Parties. In light of the potential personal liability of shareholders, officers, directors, employees, agents, and attorneys of the buyer, the parties may want to specify whether indemnification is also owed to these persons.

Financial Assurance for Performance of the Indemnity. The value of the indemnity to the buyer will be dependent upon the financial ability of the seller to perform if called upon to do so. As a result, the buyer may want to include provisions to help ensure that the seller will be able to meet its indemnity obligations, such as: escrow of a portion of the purchase price for some period of time after the closing pending resolution of outstanding environmental matters; a non-dissolution agreement and requirement that the seller maintain its financial status for some period of time after closing, including restrictions on dividends or other transfers of assets; guaranties provided by the shareholders, parent corporation, or other persons owning an interest in the seller, or other third parties; maintenance of financial

guaranties by letters of credit; insurance policies specifically insuring the indemnity agreement, and naming the buyer as an additional insured;[66] and perhaps other financial assurance mechanisms, such as those found in 40 C.F.R. § 264.143, including a trust fund, a security bond, or a financial assets test.

[c] "As Is" Sales

Sellers in a strong bargaining position often want to sell the property "as is," which means that the buyer accepts the property in its present condition and waives any warranties as to the condition of the property. Although some courts have limited the effectiveness of "as is" clauses as a bar to environmental liability,[67] such clauses, together with other provisions in the sale agreement, can effectively cause the buyer to assume almost all environmental risks.[68] Thus, if the property is to be sold "as is," the buyer's pre-closing due diligence takes on particular importance.

[2] The Sale

[a] Assignment of Claims

Several options may be available to the buyer at the closing stage to limit its potential environmental liability. For example, the buyer might request an assignment of all known and unknown claims the seller might have against prior owners, operators, and third parties for pre-closing contamination or property damage. Under state law, the buyer may not have the right to assert such claims absent an assignment from the seller.[69]

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[66] *See* William E. O'Neil, "Insuring Contractual Indemnity Agreements Under CGL, MGL, and P&I Policies," 21 *Tul. Mar. L.J.* 359, 370-75 (Summer 1997).

[67] *E.g.*, Bonnie Blue, Inc. v. Reichenstein, 127 S.W.3d 366 (Tex. Ct. App.—Dallas 2004) (buyer's acceptance of assets "in their present condition" did not bar its claim against seller under the Texas Solid Waste Disposal Act based on contamination discovered after closing); Southland Corp. v. Ashland Oil, Inc., 696 F. Supp. 994 (D.N.J. 1988) ("as is" clause in purchase agreement precludes only claims based on breach of warranty by seller, but does not defeat buyer's claim for contribution under CERCLA).

[68] *E.g.*, Niecko v. Emro Marketing Co., 973 F.2d 1296 (6th Cir. 1992); W. Ohio Pizza, Inc. v. Clark Oil & Refining Corp., 704 N.E.2d 1086 (Ind. Ct. App. 1999).

[69] *See* St. Jude Medical Office Bldg. Ltd. P'ship v. City Glass & Mirror, Inc., 619 So. 2d 529 (La. 1993); Exxon Corp. v. Pluff, 94 S.W.3d 22 (Tx. Ct. App.—Tyler 2002), pet. denied.

[b] The Seller's Insurance Coverage

Coverage for the seller's liability for pre-closing contamination may be provided under the seller's current or prior comprehensive general liability (CGL), property, or environmental liability insurance policies. Occurrence-based CGL policies historically have covered injury or damage that occurred during the policy period, even if the claim is not made until years after expiration of the policy. Also, the absolute pollution exclusion was not introduced until the mid-1980s and, as a result, old CGL policies—particularly those issued in the 1960s and 1970s—may cover present and future environmental claims. Thus, the buyer might consider requesting copies of all of the seller's old insurance policies, together with any "secondary evidence" of coverage (such as insurance certificates, partial policies, letters with policy numbers on them, financial ledger entries, umbrella and excess-policy schedules, correspondence to and from insurance agents, and other documents that refer to coverage for particular time periods) that might be used to establish coverage in the absence of the actual policy.[70]

[c] Designating the Generator

The parties often fail to consider who will be designated as the generator and sign the waste manifests and other documentation if a cleanup is required. Under RCRA and corresponding state law, the person whose act or process generates the waste (e.g., contaminated soils that are excavated or removed) is responsible for the proper management of the waste. This includes sample analysis, waste characterization, temporary storage, manifesting, reporting, transportation, and disposal of the waste. Manifests must be signed by the "generator" and, if there is a future release or contamination problem at the landfill or other disposal facility, the manifests can establish a paper trail identifying the person who signed as the "generator" as potentially liable for cleanup of the disposal facility. Notably, there is no "innocent generator" defense to CERCLA liability. Therefore, the buyer might request a written agreement from the seller providing that if any cleanup of contamination for which the seller is responsible becomes nec-

[70] *See* Todd S. Davis, *Brownfields: A Comprehensive Guide to Redeveloping Contaminated Property* ch. 13 (Am. Bar Ass'n 2d ed. 2002).

essary, the seller will sign all manifests and other documentation as the generator and the buyer's name will not appear on any such documentation.

[d] Addressing Known Contamination

The discovery of contamination during the due diligence stage does not necessarily doom the transaction. The following are a few possible strategies for addressing known contamination.

First, the seller could assume the obligation to clean up the property after closing. This may be the least desirable alternative, however, because the buyer normally will take on environmental liability to the government when it becomes the owner, it is difficult to ensure that the seller will have the funds to fulfill its cleanup obligation, and the remedies for breach of the obligation may be inadequate.

A better strategy may be to require the seller to clean up or otherwise resolve the contamination issues to the satisfaction of the buyer and the regulatory agencies prior to the closing. As explained, a party should not incur environmental liability unless it acquires an interest in, or participates in operation of, the contaminated property. Therefore, a prospective buyer should be able to avoid environmental liability by requiring the seller to clean up the property prior to closing. This strategy, however, may be unworkable in some circumstances because there may be significant delays before the cleanup is completed and approved by the regulatory agencies.

A third possibility is to exclude from the transaction the properties or portions thereof that are contaminated. In some cases, the contaminated properties may not be essential to the transaction. The buyer should be able to avoid environmental liability by "carving out" the contaminated areas or tracts from the sale.

Another strategy may be to reduce, or hold back a portion of, the purchase price to account for the estimated cost of the cleanup and related actions. This option is not without its risks. First, as explained, it involves the purchase of contaminated property which normally gives rise to environmental liability on the part of the buyer. Second, cleanup costs are very unpredictable and often underestimated. These problems, however, might be effectively managed in a number of ways. For example, the

seller could purchase a remediation stop-loss/cost-cap insurance policy naming the buyer as the insured. This type of policy indemnifies the insured against unanticipated cleanup cost overruns.[71] In addition, the seller could indemnify the buyer from environmental liability, including any liability for cleanup costs that exceed the amount of coverage provided to the buyer under a remediation stop-loss/cost-cap insurance policy, and provide some form of financial assurance for its performance of the indemnity. Further, in appropriate circumstances, the buyer might attempt to qualify as a BFPP under CERCLA and corresponding state law. This may provide protection from CERCLA liability despite the fact that the buyer will acquire the property with knowledge of the contamination.

Finally, it should be noted that several states have enacted voluntary cleanup or remediation programs (VRPs) that typically exempt the buyer and its successors, assigns, and lenders from liability to the state if, among other requirements, the cleanup is performed in accordance with an approved plan and completed to the satisfaction of the state agency.[72] Thus, if cleanup is required as part of the transaction, compliance with the VRP requirements might be considered by the parties. There may be a question, however, as to whether mining or oil and gas properties are eligible under the state's VRP.

§ 24.05 Conclusion

The purchase of mineral properties can expose the buyer to potentially significant environmental liability. That liability, however, can be effectively managed through careful planning, due diligence, and contracting.

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[71] *Id.* at 160.

[72] *Id.* pt. V, chs. 25-72. *See also* La. Rev. Stat. §§ 30:2285 - :2290 (elec. 2005) and La. Admin. Code tit. 33, pt. VI, ch. 9 (elec. 2005) (Louisiana).