

*Environmental Due Diligence in
Mineral Property Transactions:
Emerging Risks, Requirements,
and Strategies*

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“MINERAL PROPERTIES”

- Hardrock Metals
- Non-Fuel Minerals
- Fuel Minerals

Mining Property Issues

- Release of Toxic Substances
- Acid Drainage
- Alteration of Landscape
- Slope Instability
- Soil Erosion
- Subsidence



**Acid Mine Drainage – Galax, VA
(EPA photo)**



**Acid Mine Drainage – Cement
Creek, CO (EPA photo)**

Oil and Gas Issues

- Use of Potentially Hazardous Materials
- NORM
- Potentially Contaminated Facilities – Disposal Pits, Gas Processing Facilities, Compressor Stations, Repair Facilities, Saltwater Disposal Wells



*Legal Bases for Environmental
Liability*

CERCLA

- Addresses Existing Contaminated Sites
- Liability: Retroactive, Strict, Joint and Several
- Liability for “Response Costs,” Natural Resource Damages, and Cost of Health Assessment and Effects Studies

CERCLA Plaintiffs

- EPA Or State Agency
- Private Parties
 - Contribution
 - Indemnification

CERCLA PRPs

- Current Owner and Operator
- Owner and Operator at Time of Disposal
- “Arrangers”
- Transporters
- Parent Corporations
- Individuals – Shareholders, Officers, Directors, Managers

CERCLA “Hazardous Substances”

- Mining Wastes
- E&P Wastes
- NORM
- Petroleum Exclusion

Eye Opener



- As of January 2003, 87 abandoned hardrock mine sites listed as Superfund sites
- At least three E&P waste disposal sites designated as Superfund sites

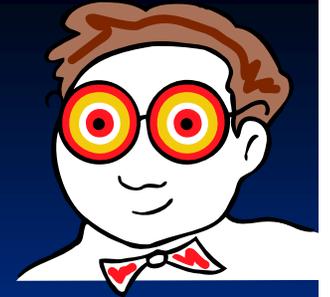
Resource Conservation and Recovery Act (RCRA)

- Regulates waste “from cradle to grave”
- Authorizes agency actions and citizen suits:
 - against any past or present generator, transporter, owner, or operator
 - who has contributed or is contributing to the handling, storage, treatment, transportation, or disposal of solid or hazardous waste at the facility
 - that may present an imminent and substantial endangerment to health of the environment

RCRA Exemptions From Hazardous Waste Regulation

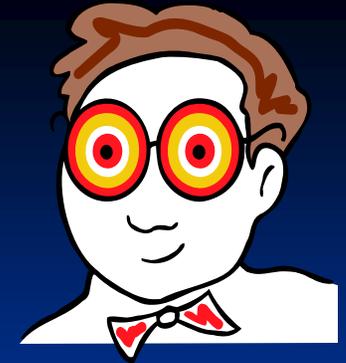
- Mining Wastes
- E&P Wastes

Eye Opener Liability Notwithstanding RCRA Exemptions



- Non-Exempt Wastes Associated with E&P Activities
- “Mixture Rule”
- Regulation as “Solid Wastes” Under Statutory Definition
- E&P Wastes – Regulated as “Hazardous Wastes” Under the Statutory Definition

Eye Opener Overlapping CERCLA/RCRA Regulation



- No “Petroleum Exclusion” Under RCRA
- No Mining Waste or E&P Waste Exemptions Under CERCLA

Surface Mining Control and Reclamation Act (SMCRA)

- Underground and surface coal mining
- “Reclamation Plan” as part of permitting process
- Agency may order cessation of coal mining operations, conducting of reclamation operations, and abatement actions

Regulation of Hardrock Mining

- Patchwork of Federal and State Environmental Laws
- State Laws Vary
- States Commonly Impose Permitting and Reclamation Requirements

Wetlands and Coastal Zone Issues

- Section 404 Permit from the U.S. Army Corps of Engineers
- Isolated Wetlands
- Storm Water Permit
- State Coastal Use Permits

The Oil Pollution Act (OPA)

- Regulates Discharge of Oil Into Navigable Waters and Shorelines from Vessels, Offshore Facilities, or On-Shore Facilities
- Owners and Operators Potentially Liable
- Liability Includes Removal, Cleanup Costs, Property Damage, and Natural Resource Damage

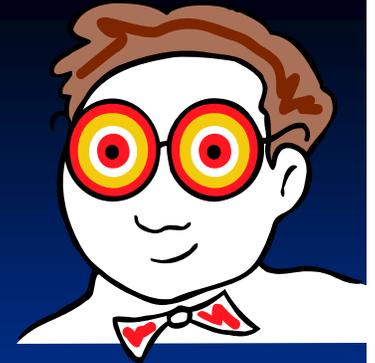
State Regulation of Oil and Gas Operations

- Typically Regulated Under State Law
- Current Owner or Operator Commonly Held Responsible for Management of E&P Wastes and Closure of Production Sites
- Restoration Obligations in Absence of Contractual Obligation to Restore

Eye Opener

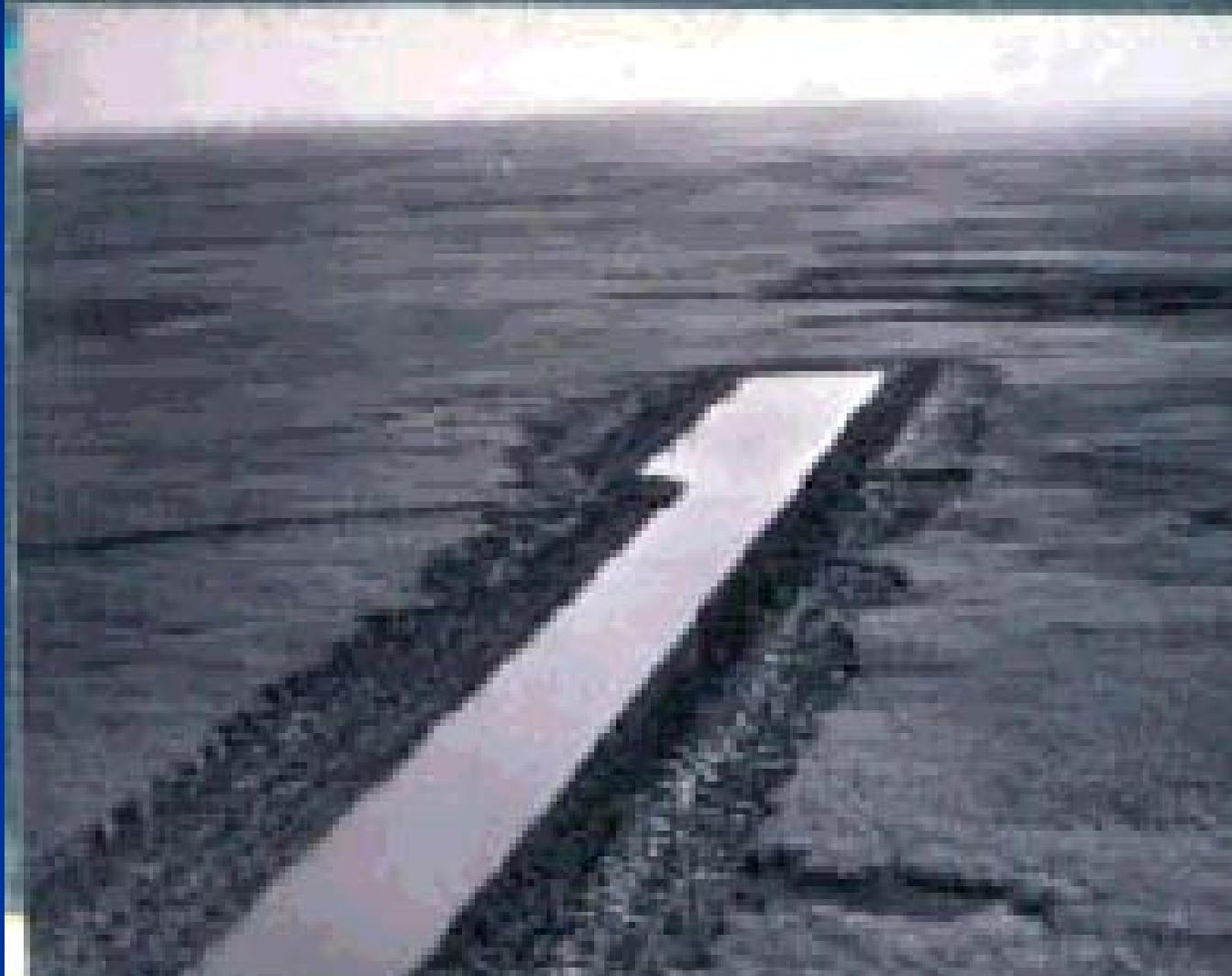
CASTEX Decision

(La. S. Ct. Jan. 2005)



- Mineral Lease – Authorized dredging of canals; no contractual obligation to restore; landowner argued obligation to backfill canals under La. Mineral Code
- Property value \$4,000 to \$7,000; restoration cost \$1.1 million
- Trial court ordered backfilling under La. Mineral Code, money to be deposited in court registry
- S. Ct. Reversed – No obligation to restore unless lease rights were exercised unreasonably or excessively

The *Castex* Decision



Contractual Liability

- Assignment of existing leases and other agreements
- May include obligation to restore or reclaim the property

Eye Opener

The *Corbello* Decision

(La. S. Ct., Feb. 2003)



- Surface lease to Shell Oil Company
- Lease required Shell to “reasonably restore the premises as nearly as possible to their present condition”
- Property value, fully restored, was \$108,000
- Court awarded restoration damages of \$33 Million - *300 times the value of the property*
- No obligation to spend the money on restoration

Eye Opener

The Hazelwood Farm Decision (La. App., April 2003)

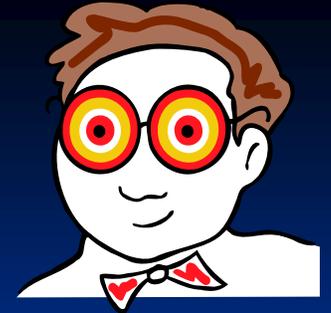


- *Corbello* rule applied to oil and gas lease
- Property value in uncontaminated state was \$304,000
- Mineral lessee ordered to pay \$2 million in restoration damages
- Jury finding - no reason to believe landowner would restore property

Tort Liability

- Typical Claims - Negligence, Nuisance, Trespass
- Likely Plaintiffs – Property Owner, Neighboring Landowners, Occupants of Contaminated Property
- Common Damages - Property Damage, Restoration Costs, Personal Injury (Toxic Tort Damages)

The *Grefer* Decision (La. App. March 2005)



- NORM suit by landowner against former tenant who conducted oil field pipe cleaning operations on property and its primary customer
- \$145,000 in general damages
- \$56 million in property restoration damages
- \$112 million in punitive damages (reduction of \$1 billion punitive damage award by trial court)

**Identifying the Risk:
Pre-Closing Environmental Due
Diligence**

Steps in an Acquisition

- The Purchase Agreement
- The Buyer's Pre-Closing Due Diligence Investigation
- The Sale

Environmental Due Diligence

- Environmental Assessment of the Property
- Compliance Audit

Purposes of the Environmental Assessment

- Identify and quantify environmental risks
- Establish a “baseline” of the environmental condition of the property
- Establish defenses or limitations on liability under CERCLA

Defenses to CERCLA Liability

- The Innocent Landowner Defense
- “Bona Fide Prospective Purchaser” Protections
- Protections to Contiguous Property Owners

Common Elements to All CERCLA Defenses

- “All Appropriate Inquiries” Prior to Closing
- “Reasonable Steps” After Closing

Satisfying the “All Appropriate Inquiries” Test

- The Current Test – ASTM Standards
- EPA’s Proposed “All Appropriate Inquiries” Regulations

Key Provisions of the Proposed “All Appropriate Inquiries” Regulations

- Qualifications of Environmental Professionals
- Data Gaps
- Interviews
- Records Review
- Visual Inspections
- Specialized Knowledge
- Property Value
- Commonly Known or Reasonably Ascertainable Information
- Sampling

Anticipated Effect of The Proposed “All Appropriate Inquiries” Regulations

- Expansion in Scope of Environmental Assessments
- Increase in Costs

Other Assessment Considerations

- Non-Scope Issues – e.g. NORM, Wetlands
- Stale Assessments
- Selecting the Environmental Professional

The Compliance Audit

- Assesses seller's compliance by Seller's facility and operations
- Usually involves a team of professionals
- Review of Seller's permits and other records; review of agency records; interviews with seller and agency representatives
- Can assist in an asset purchase, not only in a stock acquisition or merger

Strategies for Managing Environmental Liability

The Purchase Agreement

- Representations and Warranties
- Indemnities
- “As Is” Sales

Purpose of Representations and Warranties

- Require seller to identify environmental issues prior to closing
- Obligation to close can be conditioned on accuracy of representations and warranties
- Provide post-closing remedies if inaccurate

Common Representations and Warranties

- Compliance with Law
- No Hazardous Materials Handled Except in Compliance with Law
- No Pending or Threatened Environmental Claims
- All Permits Obtained and Transferable
- No Environmental Liens
- No Impending Changes or Events
- All Documents are True, Accurate, and Complete
- Miscellaneous Issues - e.g., No Underground Storage Tanks, Asbestos Containing Materials, Waste Drums, PCBs, etc.

Environmental Indemnities

- Shifts Potential Environmental Liability
- CERCLA Indemnities Effective Between the Parties, Not Binding on the Government or Third Parties

Key Issues in Negotiating Environmental Indemnities

- Losses, Liabilities, and Damages Covered
- Substances and Conditions Covered
- Presence versus Release
- Changes in the Law
- Floors, Caps, and Baskets
- Materiality
- Voluntary versus Mandatory Cleanup
- The Cleanup Standard

(continued)

- Survivability and Term
- Indemnity as a Sole Remedy
- Defense Obligations and Attorney's Fees
- Notice
- Other Sources of Protection
- Indemnified Parties

(continued)

- Financial Assurance for Performance of the Indemnity
 - Ask for a Portion of Purchase Price
 - Non-Dissolution and Maintenance of Financial Status Agreements
 - Guaranties by Third Parties
 - Letters of Credit
 - Insurance Policies Insuring the Indemnity Agreement
 - Others – e.g., Trust Fund, Security Bond, or Financial Assets Test

“As Is” Sales

- Acceptance of Property in Present Condition, Waiver of Warranties
- Some Courts Have Limited Effectiveness as to Environmental Liability
- Properly Drafted, Can Cause Buyer to Assume All Environmental Risk

The Sale

Managing Environmental Liability

Assignment of Claims

- Assignment to Buyer of Claims Against Prior Owners, Operators, and Other Third Parties for Pre-Closing Property Damage
- May be Required Under State Law for Buyer to Assert the Claim

The Seller's Insurance Coverage

- Seller's Liability May Be Covered Under Current or Prior CGL, Property, or Environmental Liability Policies
- Occurrence-Based CGL Policies
- Absolute Pollution Exclusion Not Introduced Until Mid-1980s
- Request Copies of Current and Prior Policies and Secondary Evidence of Coverage

Designating the Generator

- Generator Must Sign Waste Manifest in Connection with Cleanup
- No “Innocent Generator” Defense under CERCLA
- Request Written Agreement from Seller to Sign Manifests as Generator

Strategies for Addressing Known Contamination

Seller Agrees to Clean Up After Closing

- Problems:
 - Buyer may become liable to government when it acquires title
 - Difficult to ensure Seller will have funds to fulfill cleanup obligation
 - Remedies for breach may be inadequate

Seller Performs Cleanup Prior to Closing

- Advantage – Buyer does not acquire title until after environmental issues are resolved
- Disadvantage – Cleanup and agency approval may involve significant delays

Exclude Properties or Portions Thereof From the Transaction

- Avoids liability based on acquisition of contaminated property
- Contaminated areas may not be essential to the transaction

Reduce or Hold Back a Portion of Purchase Price to Cover Cleanup Costs

- Problems:

- Involves purchase of property prior to cleanup
- Cleanup costs unpredictable and often underestimated

Combination Approach

Example:

- Reduce or hold back a portion of the purchase price to cover estimated cleanup costs
- Seller purchases remediation stop-loss/cost-cap insurance policy to cover unanticipated cleanup cost overruns
- Seller indemnifies Buyer for costs exceeding insurance coverage, with some form of financial insurance for performance of indemnity
- Buyer obtains bona fide prospective purchaser letter from EPA and/or state agencies

Summing It Up

- Acquisition of mineral properties can involve exposure to significant environmental liability
- Liability can be managed through:
 - careful planning
 - environmental due diligence
 - contracting