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# HOW TO AVOID ENVIRONMENTAL LIABILITY IN BUSINESS TRANSACTIONS

by

Debra L. Baker\* and Lance L. Shea\*\*

THE application of the environmental laws has recently taken an unusual turn. Persons who never expected to be involved with toxic waste because they were not in the business of manufacturing, transporting, or handling toxic waste suddenly find themselves "responsible" for waste they have never seen or touched. Many unwary persons are, so to speak, left holding the (trash) bag. One of the most obvious categories of unintended victims of the environmental laws are persons involved in real estate transactions. As discussed more thoroughly in one of the preceding articles,<sup>1</sup> persons buying property have in many cases inadvertently "bought" their way into environmental liability with the advent of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA).<sup>2</sup>

The various legislative attempts to rescue the persons who incur liability for toxic waste due solely to their acquisition of property or structures that fall within the environmental laws support the premise that these people are unintended victims. Congress enacted the "innocent landowner" defense in the 1986 Amendments to CERCLA.<sup>3</sup> Because the defense was somewhat vague regarding the extent of the unintended victim's burden of proof to avoid liability, the Environmental Protection Agency (EPA) recently issued a guidance document to illuminate more clearly the pathway to landowner innocence.<sup>4</sup> In addition, Representative Curt Weldon, seeking to clarify further the steps needed to be taken to qualify for an innocent landowner liability exemption,<sup>5</sup> recently introduced legislation in the House of Representatives. Theoretically, the landowner victims are currently receiving relief from the unintended effects of the environmental laws.

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1. See *supra* Civins, *Environmental Law Concerns in Real Estate Transactions*.

2. Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified as amended at 42 U.S.C. §§ 9601-9675 (1988)).

3. 42 U.S.C. §§ 9601(35), 9607(b)(3).

4. Superfund Program: De Minimis Landowner Settlements, Prospective Purchaser Settlements, 54 Fed. Reg. 34,235-46 (Aug. 18, 1989).

5. H.R. 2787, 101st Cong., 1st Sess. (1989).

Other categories of unintended victims who are unlikely to receive such attention, sympathy, and assistance still exist, however. The legislature is unlikely to promulgate an "innocent corporation defense" in the near future, yet corporations conducting their traditional forms of corporate business are well on their way to being unintended victims under the environmental laws.

Victims involved in complex business transactions, usually corporations, are often more susceptible to acquiring hidden environmental liabilities than are those involved in simple real estate purchase and sale transactions, because they do not focus on the fact that their complex transactions involve real estate that may be subject to environmental liabilities. These sophisticated investors and business people focus primarily on engineering the takeover, structuring the leveraged buyout, and arranging the merger and acquisition. More often than not, they do not realize that their deals also encompass real estate transactions; since these transactions are usually not the primary purpose for the deal, they find themselves victims of the harsh application of the environmental laws.

The reality is that the potential for incurring environmental liability in complex business transactions is as great as in "pure" real estate transactions. In fact, the lurking environmental liabilities may be even more prevalent in traditional business or corporate transactions simply because no one expects them to be present. Of course, when real estate transactions are part of business transactions, business persons who acquire real estate have the option of claiming the innocent landowner defense just like any other landowner. If the business transaction was not originally structured with an eye toward establishing the innocent landowner defense, however, the defense is unlikely to be available.

In order for the innocent corporation and innocent business person to invoke the innocent landowner defense successfully, business transactions must be structured and negotiated to anticipate that environmental liabilities may be incurred and to take affirmative steps to avoid such liability. Avoiding environmental liability in business transactions requires planning ahead to structure deals to avoid liabilities to the extent possible, allocating responsibility by contract for liabilities that cannot be avoided, and conducting business operations in a manner that will not trigger new environmental liabilities.

This practical "how-to" Article offers insights into the types of business transactions likely to harbor hidden environmental liabilities and discusses factors to consider when seeking to avoid or allocate such liabilities. Part I discusses the need for advance planning and structuring of transactions in order to avoid environmental liability. Part II discusses the necessity of identifying current and potential environmental liabilities that cannot be avoided either by creatively structuring the transaction or by contractually allocating those liabilities among the parties. Part III addresses the need to ensure that post-transaction activities do not give rise to additional liability under the environmental laws.

### I. PLANNING AND STRUCTURING OF BUSINESS TRANSACTIONS TO AVOID LIABILITY

Many environmental liabilities that are inadvertently assumed in the course of corporate transactions and business deals can be avoided altogether with advance planning and structuring of the transaction. One of the most crucial components of advance planning is for the parties to retain an experienced environmental attorney at the *beginning* of transaction negotiations. The attorney should have a thorough command of the complex and intricate environmental laws and be able to recognize environmental pitfalls that may not be apparent to a general practitioner or may seem innocuous to nonenvironmental specialists. The authors' experience has shown that if the deal-makers retain an environmental attorney after the contract documents have been drafted and negotiations have virtually been completed, it is too late for the environmental attorney to do more than insert "damage control" language. The parties are most likely to avoid environmental liabilities during the drafting phase as part of the ongoing negotiation and structuring of the transaction. The issue of environmental liability is not something that should be addressed as an afterthought when negotiations are drawing to a close.

An example of the importance of taking an environmentally offensive posture and structuring transactions to avoid environmental liability can be seen in the areas of mergers and acquisitions.<sup>6</sup> For purposes of illustration, assume that the corporation, Megacompany, wishes to diversify its operations by acquiring a large, national moving van business, Vanlines, from Vanlines' owner, Global Company. Megacompany's principal purpose is to acquire the primary assets of Vanlines—its moving vans. In accomplishing its main goal, however, Megacompany incidentally acquires other assets located throughout the country, such as truck terminals, garages used to house the vans, maintenance facilities used to service or repair the vans, and the real property on which the structures are located. Acquisition of such incidental assets may occur for a variety of reasons. Perhaps these additional acquisitions are included in the main purchase, because Global wanted to get out of the van business completely and, having no use for the other structures, included them in the transaction for a minimal amount as a convenient way to dispose of unwanted facilities. Perhaps Megacompany believed that it needed to own the van service facilities in order to have effective control of the business and to adequately service its vans. Perhaps Megacompany viewed the incidental acquisitions as a bonus to the deal. Finally, Megacompany may have decided to purchase the stock and assets of Vanlines, although its original idea may have been to acquire only the vans in an asset transaction.

Megacompany, not considering potential environmental problems nor re-

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6. Merger and acquisition transactions are areas into which "hidden" environmental liabilities often creep undetected, primarily because potential environmental liabilities may accompany the acquisition of facilities that are themselves incidental to the principal or main focus of the merger-acquisition transaction.

taining environmental attorneys, uses its team of corporate attorneys to negotiate standard contract provisions to effect the transaction. Although the corporate attorneys may provide for many standard transactional contingencies in structuring the deal and drafting the contract documents, they are unlikely to be able to draft specific, thorough, and intricate contract provisions designed to deal effectively with any actual or potential environmental liabilities. Without contractual protection, Megacompany may assume mega-environmental liability that may greatly outweigh any profits derived from the moving van business.

The ways in which such environmental liabilities could manifest themselves to Megacompany are legion. The truck terminals and maintenance facilities where vehicles are serviced may be the sources of hydrocarbon contamination. Used oil from vehicle oil changes may have been improperly disposed of or spilled on the ground, resulting in soil and groundwater contamination. As a result, contaminated soils may have to be excavated and properly disposed of, and groundwater may have to be pumped and treated, a procedure that is usually extremely expensive. The terminals and maintenance facilities may also contain underground petroleum storage tanks that leak and spread contamination into the soil and groundwater. The tanks may have to be pulled out of the ground and any contaminated soil and groundwater remedied.<sup>7</sup>

The van storage garages may also be an unsuspected source of environmental liability. In addition to the potential for contamination due to leaking oil or the presence of other hazardous substances, the structures may be insulated with asbestos or have asbestos ceiling tiles. If the asbestos is "friable,"<sup>8</sup> various laws may impose monitoring and other stringent requirements.<sup>9</sup> If Megacompany wants to renovate or demolish a garage containing certain quantities of asbestos, it must notify environmental authorities prior to commencing such actions<sup>10</sup> and comply with strict requirements regulating the removal, including use of licensed asbestos contractors,<sup>11</sup> the manner in which the removal is undertaken,<sup>12</sup> the use of protective equipment and exposure monitoring,<sup>13</sup> and the storage and disposal of asbestos-containing

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7. Resource Conservation and Recovery Act of 1976, Pub. L. No. 94-580, 90 Stat. 2826 (1976) (codified as amended at 42 U.S.C. §§ 6991a-6991h (1988)).

8. Generally "friable" means "easily crumbled or pulverized; easily reduced to powder, as pumice." WEBSTER'S NEW TWENTIETH CENTURY DICTIONARY: UNABRIDGED 733 (2d ed. 1980). In regulatory language, "friable asbestos" is defined as "any material containing more than 1 percent asbestos by weight that hand pressure can crumble, pulverize, or reduce to powder when dry." 40 C.F.R. § 61.141 (1988).

9. 40 C.F.R. §§ 61.142-.147 (1988).

10. 40 C.F.R. § 61.146 (1988). An individual demolishing or renovating a building must meet the requirements of 40 C.F.R. §§ 61.146-.147 if 80 linear meters of friable asbestos is present on pipes or 15 square meters is present on other facility components. 40 C.F.R. § 61.145 (1988). If the quantity of friable asbestos is less than these threshold amounts, fewer requirements apply. 40 C.F.R. § 61.145(b) (1988).

11. 25 TEX. ADMIN. CODE §§ 289.141-.157 (Oct. 14, 1988).

12. 40 C.F.R. §§ 61.145-.147 (1988).

13. See generally 29 C.F.R. § 1910.1001 (1988) (§ 1001(d) discusses exposure monitoring, § 1001(g) discusses respiratory protection, § 1002(h) discusses protective clothing, and § 1001(i) discusses hygiene facilities and practices).

material.<sup>14</sup>

As if these potential and unbargained-for liabilities are not enough for a company that initially desired only to acquire moving vans, Megacompany may also find itself subjected to lawsuits from neighboring property owners who allege that their adjacent soil and groundwater have been contaminated by Megacompany's leaking petroleum storage tanks or that they have sustained injuries from exposure to hazardous substances released from Megacompany's property.<sup>15</sup> Employees who work in the garages insulated with asbestos may also sue Megacompany, alleging that their exposure to the asbestos has harmed their health.<sup>16</sup>

The lawsuits may not stop with private parties. The federal or state governmental authorities, or both, may sue Megacompany for notification violations, for damages to natural resources that might have been contaminated, and to enforce the cleanup of the contamination.<sup>17</sup> If the government pursues its causes of action against Vanlines or Global for liabilities alleged to have occurred as a result of their operations, Vanlines or Global may implead Megacompany as a defendant, alleging that Megacompany's actions subsequent to the acquisition caused the alleged release of the hazardous substances or that Megacompany's failure to mitigate the release increased the damage. The government might also decide to pursue a cause of action against Megacompany under the doctrine of successor liability if Vanlines or Global are unable to pay for cleanup.<sup>18</sup> Megacompany's newest acquisition, therefore, may have become its newest nightmare.

Megacompany could have avoided environmental liability in the transaction in a variety of ways. One way would have been to acquire only certain assets of Vanlines, such as the moving vans. Structuring the deal as an asset, rather than a stock, purchase could have protected Megacompany from the

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14. 40 C.F.R. § 61.156 (1988).

15. See generally *Sterling v. Velsicol Chem. Corp.*, 647 F. Supp. 303 (W.D. Tenn. 1986), *aff'd in part, rev'd in part*, 855 F.2d 1188 (6th Cir. 1988) (plaintiffs, who resided near defendant's landfill, claimed personal injury and property damages from contamination of drinking water by leaching of hazardous chemicals). The issues would be similar in Megacompany's situation where hazardous substances released from its property could contaminate the air, soil, or water.

16. See generally *Wilson v. Asten-Hill Mfg. Co.*, 791 F.2d 30 (3d Cir. 1986) (plaintiff's claims against employer found barred by Pennsylvania workers' compensation statute); *Tritt v. Atlantic Richfield Co.*, 709 F. Supp. 630 (E.D. Pa. 1989) (concerns jurisdiction of admiralty court over seaman's personal injury claim and his wife's loss of society claim against seaman's employer and manufacturers and distributors of asbestos product to which he was exposed while working in engine rooms of ships); *Neal v. Carey Canadian Mines, Ltd.*, 548 F. Supp. 357 (E.D. Pa. 1982), *aff'd on other grounds sub nom. Van Buskirk v. Carey Canadian Mines, Ltd.*, 760 F.2d 481 (3d Cir. 1985) (employer held liable under intentional tort exception to workers' compensation bar).

17. Comprehensive Environmental Response, Compensation, and Liability Act of 1980, Pub. L. No. 96-510, § 107(a)(4)(C), 94 Stat. 2767 (codified as amended at 42 U.S.C. § 9607(a)(4)(C) (1982 & Supp. V 1987)).

18. The EPA's position is that the government may seek to impose successor liability when a company has purchased all of the assets and stock of another company and continued to operate the same business. EPA Memorandum, Corporate Shareholders and Successor Corporations for Abandoned Sites Under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) (June 13, 1984).

possibility of assuming liability as a successor corporation. Limiting the assets purchased would have allowed Megacompany to have avoided ownership liability for leaking underground storage tanks or buildings containing asbestos. If Megacompany believed that it needed such facilities to service its vans, it either could have leased the facilities from Vanlines, thereby avoiding ownership liability, or serviced its vans elsewhere, thereby avoiding operator liability. Megacompany might have considered trying to structure the acquisition as a parent-subsidary transaction, although parent companies have been held liable for a subsidiary's environmental liabilities in certain circumstances.<sup>19</sup> Alternatively, Megacompany could have made the transaction contingent upon Vanlines' satisfactory removal and closure of the tanks and removal of any asbestos in buildings. In fact, Megacompany could have made the entire transaction contingent upon the results of an environmental audit and walked away unaffected from problems found. If it still thought the deal worth pursuing, it may have been able to buy the property at a substantially "discounted" price, with the discount representing the estimated costs of addressing environmental liabilities. If areas on which contamination were found to exist in the audit were identifiable and separable, those limited areas could have been carved out of the sale transaction and Megacompany could have acquired only noncontaminated land.

An environmental attorney present at the inception of negotiations could have advised Megacompany about the availability of such deal-structuring options to avoid liability. In addition, the attorney could have established the predicate for claiming the innocent landowner defense under CERCLA and advised Megacompany about the possibility of obtaining an EPA purchaser agreement, pursuant to which the EPA grants a covenant not to sue a prospective purchaser.<sup>20</sup>

## II. CONTRACTUAL ALLOCATION OF LIABILITIES THAT ARE UNAVOIDABLE

So that the parties may themselves determine who will bear the responsibility for environmental liability, actual or potential environmental liabilities should clearly be identified, addressed, and allocated among the parties in the contract. In order to be fully informed about the nature of any actual or potential environmental liabilities that need to be addressed in the contract, an environmental audit should be conducted. An environmental audit is a comprehensive survey of the existence of any current or potential environ-

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19. In *United States v. Nicolet, Inc.*, 712 F. Supp. 1193 (E.D. Pa. 1989), the court held that federal common law controls the issue of alter ego liability. *Id.* at 1201. The court fashioned a rule that would hold a parent corporation liable for the environmental liability of a subsidiary

[w]here a subsidiary is or was at the relevant time a member of one of the classes of persons potentially liable under CERCLA; and the parent had a substantial financial or ownership interest in the subsidiary; and the parent corporation controls or at the relevant time controlled the management and operations of the subsidiary . . . .

*Id.* at 1202.

20. 54 Fed. Reg. 34,241 (Aug. 18, 1989).

mental problems associated with a piece of property or structure. Audits can be structured in many different ways, but generally consist of a thorough physical and documentary investigation designed to reveal any past or present environmental liabilities. The physical aspect of the audit typically seeks danger signals of potential problems, such as discolored ground surface, the presence of storage tanks, drums, and other containers, and includes conducting physical testing of the soil and water. The documentary aspect of the audit focuses on documents that provide information both as to the historical and present uses of the property, such as deed notations and restrictions, permit and compliance records at the facility and in the possession of governmental authorities, governmental notices of environmental violations or requests for information regarding alleged violations, and outstanding enforcement orders or pending actions or settlements.

A business person who is seeking to sell or transfer properties or structures as part of a major transaction is likely to question the necessity for performing an audit because, after all, it could turn out to be the ultimate "deal killer," as the potential enormity of the costs associated with environmental liabilities can scare away an otherwise willing buyer. With today's heightened consciousness of environmental problems, however, a sophisticated buyer will probably require the seller to have an environmental audit performed on the subject property.

In addition, the presence of contamination does not necessarily mean that the deal will die; if the estimated cost of curing the environmental problem is ascertainable and not prohibitive, the problem may merely become one of many items negotiated as a part of the entire transaction. A seller who is having an environmental audit performed on its property may offer to sell the property at a discounted price in the event that contamination is found on the property. Typically, such a discount represents the estimated cost of remedying the property.<sup>21</sup>

In pursuing a path of full disclosure by allowing an environmental audit, the seller benefits by avoiding having to defend future lawsuits by the buyer based on claims of fraud or misrepresentation of the true condition of the property. By requesting an environmental audit, the purchaser can see for itself what it is buying and determine the conditions of the property. The seller may use the audit to show that it exercised good faith in the transaction by identifying all environmental liabilities to the buyer prior to the execution of the transaction, that the buyer had knowledge based upon the report regarding the subject property's or structure's prior uses and current status and, nevertheless, that the buyer freely elected to make the purchase. The existence of an audit report may also be useful to a former owner if enforcement actions or private party lawsuits are brought to show that the

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21. The seller can also offer to segregate problem portions of the property out of the sale. If the contamination is confined to one particular area, the seller may be able to go through with the deal as envisioned with the exception that specific portions identified as contaminated are not conveyed.

alleged problem did not exist as of the closing date and that any contamination had to have been the result of the subsequent owner's actions.

From a buyer's perspective, an environmental audit is probably the most effective defense mechanism available against incurring potential CERCLA liability. If the audit reveals significant existing or potential environmental problems, the prospective buyer can refrain from buying the property and avoid CERCLA liability. At the very least, it provides the buyer with information upon which to base a risk analysis of the potential transaction. If the buyer believes the risk to be justifiable and elects to pursue the transaction despite the existence of actual or potential environmental ramifications, it can take precautions to minimize risks, such as requiring the seller to indemnify the buyer from liability for CERCLA and private damage claims.

Environmental audits should, if possible, be performed by consultants under the supervision of, and sometimes at the direction of, the attorneys handling the transactions in order to protect information that may be privileged, a trade secret, or both, of one of the parties. An experienced environmental attorney is also better equipped to control and supervise the manner in which consultants perform their duties, to screen consultant reports for ill-phrased language, and to ensure that the consultants do not inadvertently draw unwanted attention to their testing and auditing activities from agency officials or others until the parties have had an opportunity to review the findings.

Once the audit has revealed the existing and potential environmental liabilities, the liabilities may be allocated between the parties in the contract governing the transaction. While private indemnity agreements between buyers and sellers cannot alter or excuse a party's CERCLA liability to the government or third parties, CERCLA does not bar buyers and sellers from entering into agreements among themselves as to who will ultimately pay for any CERCLA liability.<sup>22</sup> Courts have upheld the provisions of indemnification agreements between purchasers and sellers specifying which party is to assume liability for contamination known to exist at the time the parties entered into the transaction.<sup>23</sup>

The final contract terms are the result of many factors, including the relative bargaining or negotiating power of the parties and the uniqueness or desirability of the property or structure to be acquired. Ultimately, however, barring an "as is" sale where a seller makes no warranties and provides no indemnities, some type of indemnification provision is usually included in the contract. Buyers seek at least to be indemnified and held harmless for preexisting environmental conditions and sellers seek to be indemnified and

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22. 42 U.S.C. § 9607(e)(1).

23. See *Emhart Indus., Inc. v. Duracell Int'l, Inc.*, 665 F. Supp. 549, 574 (M.D. Tenn. 1987) (seller of electrical component facility obligated through provision in sales agreement to indemnify purchaser for all costs of cleanup of PCB-contaminated facilities and equipment transferred in the sale, as well as CERCLA response costs and consequential damages); *Mardan Corp. v. C.G.C. Music, Ltd.*, 600 F. Supp. 1049, 1056 (D. Ariz. 1984), *aff'd*, 804 F.2d 2454, 1461-62 (9th Cir. 1986) (private agreement between present and past owners of site released past owners from all claims concerning land where waste was stored).

held harmless for post-transfer activities. The relative bargaining power between the parties, however, is ultimately determinative of the degree of indemnification received, if any.

Obviously, indemnity interests of buyers and sellers differ. Generally, the buyer wants the most comprehensive indemnity provisions possible for lengthy periods of time with no ceiling limits, as well as detailed warranties and representations by the seller. The seller does not want to indemnify the buyer except as is absolutely necessary to close the deal and then only for limited items and for a limited period of time. The seller will try to avoid making overly broad warranties and representations and, in fact, may even want to sell the property or structure on an "as is" basis.

Additionally, buyers typically attempt to obtain as many specific representations and warranties in the purchase agreement as possible. Representations and warranties commonly sought by buyers include, but are not limited to, representations that the seller: (1) has secured and maintained all currently required federal, state, and local permits concerning environmental protection and regulation of the property; (2) is presently and always has been subject to certain exceptions specifically listed, in full compliance with any required environmental permits and any other requirements under any federal, state, or local law, regulation, or ordinance; (3) neither knows nor has received notice of any pending actions against the seller in connection with any environmental matter, nor has reason to suspect that any type of action may be pending; (4) knows of no past or current releases, or both, of hazardous substances, on, at, over, from, into, onto, or near the site; (5) is neither aware nor has any reason to suspect the presence of any environmental condition, situation, or incident that could in any manner give rise to an action or liability under any law, rule, ordinance, or common law theory; and (6) is not currently operating under any compliance order, schedule, decree, or agreement or any consent order, decree, or agreement, or any corrective action decree, order, or agreement issued or entered into under any federal, state, or local statute, regulation, or ordinance regarding the environment or health and safety in the work place.

Representations that the seller may request the buyer to provide are likely to include a representation that the buyer has inspected the property and conducted an audit that determined the property to be free from contamination. The seller may even wish to have the buyer represent that the buyer is entering into the transaction fully informed; has had an opportunity to inspect the company's files, records, and property; and is purchasing the property on an "as is" basis.<sup>24</sup> If the seller has made representations and

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24. Sellers should be wary of an "as is" sale since such sales may not necessarily limit the seller's liability. Even if the buyer takes title to the property on an "as is" basis, the seller may not be absolved of its liabilities to the government or be protected from CERCLA-based claims made by the buyer. 42 U.S.C. § 9601(35)(c); *see also* International Clinical Laboratories, Inc. v. Stevens, 710 F. Supp. 466, 469 (E.D.N.Y. 1989) ("While the 'as is' clause prevents a purchaser from recovering on a breach of warranty theory, it does not necessarily follow that a claim based upon CERCLA is similarly barred."). In addition, if the present owner is not financially able to remedy the property or pay for the government-ordered cleanup, the gov-

warranties and has made information available to the buyer, the seller should except from its representations and warranties matters that were identified in records and files to which the buyer has been given access, or matters that were or should have been apparent from an on-site inspection.

Both parties should be aware that broad terms used in indemnity agreements such as "environmental conditions," or "environmental liabilities," should be specifically defined and carefully drafted by an environmental attorney to ensure coverage of the desired circumstances. Representations and warranties should be tied to a full indemnification clause providing that upon the breach of a representation or warranty the breaching party is responsible for resulting liability.

The parties should also realize that although the indemnitee may believe that it has negotiated adequate protection against liability, it must always bear in mind that an indemnity's value is directly proportionate to the financial strength of the indemnitor. Accordingly, the potential buyer should maintain a realistic view of the seller's financial status. The prospective buyer may want to take additional precautions such as establishing an escrow account for seller's funds to be used in the event that certain environmental liabilities are found to exist.

### III. CONTROL OF OPERATIONS TO AVOID INCURRING ENVIRONMENTAL LIABILITIES

Consciousness regarding environmental liabilities should not end merely because the business transaction has been structured and the appropriate contract documents executed. Care must be taken to ensure that subsequent acts or operations do not give rise to liability.

In the Megacompany-Vanlines hypothetical, subsequent actions of Megacompany could conceivably cause Vanlines to incur additional environmental liability, even though Vanlines no longer owns the property or assets from which liability may arise. For example, if Vanlines disposed of hazardous wastes on site prior to its sale of the property, and Megacompany did not maintain the disposal areas or failed to mitigate a release from the disposal areas, Vanlines could be liable to the government as a past owner, assuming that the release began or occurred during Vanlines' period of ownership.<sup>25</sup> Negotiating a contractual indemnity provision making Megacompany liable for subsequently causing a release of previously disposed wastes or for failure to mitigate an ongoing release and restricting activities such as construction in the waste disposal area, however, could offer Vanlines some protection from subsequent liability.

Megacompany will want to make sure that its current operations remain in compliance with the environmental laws. Employees, officers, and directors of corporations are being charged more frequently with criminal viola-

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ernment will look to, among others, those parties who were owners at the time of disposal. 42 U.S.C. § 9607(a)(2).

25. 42 U.S.C. § 9607(a)(2).

tions of the environmental laws. Accordingly, Megacompany should ensure that it institutes safety standards and practices for employees concerning the handling and disposal of waste and that it provides education, control, and supervision in connection with waste-related activities.

Companies must also act cautiously when leasing property, particularly to lessees who may conduct industrial operations on the property. Because CERCLA imposes joint and several liability upon current landowners, which makes property owners potentially responsible for pollution caused by their tenants,<sup>26</sup> landlords should negotiate strong leases allocating liability for environmental problems. Traditional leases generally do not provide sufficient environmental protection to the landlord. First, security deposits posted by tenants provide little protection to the owner, since such deposits are far too small to cover the enormous costs of environmental cleanups. Thus, landlords, particularly those who lease to tenants who may conduct industrial operations on the property, should limit their exposure by employing lease provisions requiring higher security deposits and by conducting periodic environmental audits. Landlords who are aware of the need to protect themselves from environmental liabilities caused by a tenant's activities typically seek to incorporate lease provisions that restrict the uses of the land, require compliance with the environmental laws, require the tenant to notify the landlord of any release of hazardous substances, and require the tenant to indemnify the landlord for any resulting liabilities.

Landlords may also require the tenant's disclosure of any hazardous substances proposed to be used on the property and institute a default provision giving the landlord the right to terminate the lease upon the tenant's release of hazardous substances. Landlords, especially those with lessees whose activities may involve hazardous substances, may also consider incorporating a right of entry to perform a quarterly or biannual environmental audit of the property. The purpose of such an audit is to ensure that the tenant's activities are in compliance with the requirements and restrictions in the lease and to allow early detection of any improper treatment, handling, or disposal of hazardous waste. If environmental problems are identified early, they may be less costly to cleanup, and the tenant is less likely to have abandoned the property or become bankrupt, leaving only the landlord to conduct the remedial action. Landlords should also seek to impose restrictions upon the types of activities conducted by sublessees in the event that the tenant assigns the lease and should require the tenant to indemnify the landlord for activities of the sublessee.

Like landlords, tenants must consider a number of factors before signing a lease. Tenants should be concerned about entering into a lease, conducting operations, and being subjected to later allegations of causing contamination that may have been present on the property prior to the lease. To avoid this scenario, tenants should agree to or initiate an environmental audit before they take possession of the property. Tenants may be able to use the results

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26. *Id.* § 9607(a)(1).

of such audits to defend against alleged liability for damage to the property by showing that the alleged condition existed before the tenant leased the property. Tenants may also wish to perform an audit at the end of the lease term to show that the property was unharmed as of the tenant's departure, thus preventing later allegations of responsibility for subsequently discovered contamination. The tenant should seek an indemnity from the landlord regarding the presence of any hazardous material except for those specifically placed on the property by the tenant, and the indemnity should be made to survive lease termination.

The tenant should also obtain representations and warranties from the landlord as to past uses of the property in order to avoid later surprises as to the true condition of the property. Through these terms the tenant may discover such matters as the whereabouts of underground storage tanks and pipes, so that it can avoid activities that will harm or rupture such tanks and pipes. Finally, the tenant should seek to negotiate some type of default clause that will allow it to terminate the lease in the event that a government or other required protracted cleanup action prevents or interferes with the tenant's business operations.

#### IV. CONCLUSION

Parties involved in traditional corporate transactions are particularly susceptible to the assumption of "lurking" environmental liabilities simply because no one expects environmental issues to arise in connection with corporate issues. The reality is, however, that takeovers, mergers and acquisitions, and other corporate transactions often involve real estate pursuant to which environmental liabilities may be acquired or assumed by an unsuspecting party. Prudent business persons need to begin factoring environmental considerations into their corporate transactions so that they may assume an environmentally offensive posture and structure transactions to avoid environmental liability.