

The Importance of Due Diligence in
Commercial Transactions: Avoiding CERCLA
Liability

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THE IMPORTANCE OF DUE DILIGENCE IN COMMERCIAL TRANSACTIONS: AVOIDING CERCLA LIABILITY

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INTRODUCTION

The impact that environmental law has had upon business transactions in recent years cannot be overstated. Increasingly, parties involved in both commercial and residential real estate transactions are finding that environmental issues can easily undermine proposed deals or, at a minimum, such issues have the capacity to substantially change the economics of the deal.¹ While parties to the transaction may often be motivated by conflicting goals, avoiding the retention or assumption, as the case may be, of environmental liabilities will undoubtedly be a top priority.²

This Article will first present an overview of the statutory scheme the parties to a business transaction are faced with, focusing on the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"),³ state transfer laws and lender liability. Part II of this Article discusses the allocation of environmental risks and liabilities in the context of a commercial transaction. Part III examines the due diligence process, which is used to identify

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1. See, e.g., Dave Lenckus, *Cigna Plan Scrutinized; Regulators in Several States Await Pennsylvania Action*, BUS. INS., Jan. 8, 1996, at 6, available in LEXIS, NEWS Library, BUSINS File; *Centromin Auction Fails*, PRIVATISATION INT'L, June 1, 1994, available in WESTLAW, PRVINT Database.

2. Thomas O'Brien, *Successor Liability—Are You Buying Trouble?*, METRO. CORP. COUNS., Jan. 1996, at 16, available in LEXIS, NEWS Library, MCC File.

3. 42 U.S.C. §§ 9601-9675 (1988 & Supp. V 1993).

potential environmental exposure, and analyzes the impact of due diligence findings on the bargaining process. This Article suggests possible reforms to the existing statutory scheme that would provide greater predictability for the business community in assessing exposure to environmental liability in commercial transactions.

I. THE STATUTORY SCHEME

For the purpose of this discussion, assume that ACE Corporation ("Seller" or "Target") wants to sell, and BEE Corporation ("Purchaser") wants to purchase, a New Jersey industrial facility ("Facility") which routinely generates hazardous substances in its operation. Since the Purchaser is in the same line of business as the Seller, it is familiar with the operations at the Facility. Assume further that the purchase of the Facility will be financed by a commercial lending institution.

There are a host of statutes on the federal, state, and local level that may affect the Target's operations and this transaction. There may, for example, be environmental liability associated with the Facility's hazardous waste disposal practices under CERCLA.⁴ The Facility's air emissions may require a permit under the Clean Air Act.⁵ Similarly, the Facility's waste water and storm water might require permitting under the Clean Water Act.⁶ The hazardous waste generated by the Facility may be regulated by the Resource Conservation and Recovery Act.⁷ If the Facility generates chemical substances,⁸ the testing, manufacturing, processing, and distribution of those substances will be regulated under the Toxic Substance and Control Act.⁹ The Occupational Safety and Health Act ("OSHA")¹⁰ will regulate workplace health standards vis-a-vis the toxic substances utilized at the Facility.¹¹ In addition, the transfer

4. *Id.*

5. 42 U.S.C. §§ 7401-7671 (1988 & Supp. V 1993).

6. 33 U.S.C. §§ 1251-1387 (1988 & Supp. V 1993).

7. 42 U.S.C. §§ 6901-6992 (1988 & Supp. V 1993).

8. Section 2602(2) of the Toxic Substances Control Act, 15 U.S.C. §§ 2601-2692 (1994), defines "chemical substance."

9. 15 U.S.C. §§ 2601-2692 (1994).

10. 29 U.S.C. §§ 651-678 (1994).

11. Under OSHA regulations, workers at the Facility must be kept informed of the hazardous chemicals to which they may be exposed. Occupational Safety

of the Facility may trigger the New Jersey Industrial Site Recovery Act,¹² which is, in effect, a real property transfer restriction law.¹³ Finally, local regulations may have an impact on operations at the Facility, which may be a concern for the Purchaser if a change in operations is anticipated after the sale.¹⁴

The laws cited above are not intended to be an exhaustive list of the statutes that may have an impact on this or any other transaction. A due diligence investigation¹⁵ should be performed in the early stages of the transaction so that the impact of any statute affecting operations at the Facility, as well as any statutes that might regulate its transfer, can be identified, considered, and addressed.

and Health Standards, 29 C.F.R. § 1910.1200 (1995). The primary mechanism for this disclosure is the Material Safety Data Sheet ("MSDS"). *Id.* Among other things, the MSDS should include the chemical's name, the hazards associated with exposure to the chemical, and the type of immediate medical treatment that should be administered if exposure does occur. *Id.*

12. N.J. STAT. ANN. § 13:1K-6 (West Supp. 1995).

13. *See, e.g., In re Cadgene Family Partnership*, 286 N.J. Super. 270, 274 (1995) (non-compliance may void sale of property).

14. *See, e.g., William L. Andreen, Defusing the "Not In My Back Yard" Syndrome: An Approach to Federal Preemption of State and Local Impediments to the Siting of PCB Disposal Facilities*, 63 N.C. L. REV. 811, 813 n.9 (1985). For example, in response to the enactment of the Toxic Substances Control Act, 15 U.S.C. §§ 2601-2692 (1994), which includes a provision ordering EPA to promulgate rules governing disposal of Polychlorinated Biphenyls, several counties enacted ordinances prohibiting storage or disposal of this substance. *Id.* (providing the following examples: DAYTON, OHIO, REV. CODE OF GEN. ORDINANCES §§ 97.01-.09, 97.97-.99 (1980); Warren County, N.C., Ordinance Prohibiting the Storage and Disposal of PCBs (Aug. 21, 1978); Union County, Ark., Ordinance 38 (Sept. 12, 1978); Chickasaw, Ala., Ordinance 1040 (Feb. 28, 1984)).

15. A due diligence investigation may be required to avoid liability under certain environmental laws. *See* John Webster Kilborn, Comment, *Purchaser Liability for the Restoration of Illegally Filled Wetlands Under Section 404 of the Clean Water Act*, 18 B.C. ENVTL. AFF. L. REV. 319, 347-348 (1991). Examples of due diligence include "a site investigation to spot hazardous waste problems, a historical review of a site, a search of agency files to detect past violations, an analysis of aerial photographs, and chemical sampling of soil and water." *Id.*

A. *Comprehensive Environmental Response, Compensation and Liability Act*

CERCLA authorizes the Environmental Protection Agency ("EPA") to remediate sites contaminated with hazardous substances.¹⁶ CERCLA also provides for reimbursement of EPA's cleanup costs from certain persons covered by the statute, known as potentially responsible parties ("PRPs").¹⁷ Under CERCLA section 107(a), PRPs are liable for costs of removal and remedial action incurred by the government, and response costs incurred by any other person.¹⁸ In addition, PRPs are liable for damages associated with the destruction or loss of natural resources.¹⁹ The four categories of PRPs under CERCLA include: (1) the current owner and operator, who are liable for their own disposal practices *as well as* those of past owners;²⁰ (2) any party who owned or operated the facility at the time of disposal of a hazardous substance;²¹ (3) generators of hazardous substances, who, by contract, agreement or otherwise, arranged for the disposal or treatment of such substances;²² and (4) transporters who disposed of hazardous substances at the site from which there is a release.²³

CERCLA provides only limited defenses. A PRP can escape liability only if it can establish that the release of the hazardous substance was

caused *solely* by—

- (1) an act of God;
- (2) an act of war; [or]
- (3) an act or omission of a third party other than an employee or agent of the [PRP], or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the [PRP]²⁴

16. See 42 U.S.C. § 9604 (1988 & Supp. V 1993).

17. *Id.* § 9607(a) (1988).

18. *Id.*

19. *Id.* § 9611(b)(1) (1988).

20. *Id.* § 9607(a)(1).

21. *Id.* § 9607(a)(2).

22. *Id.* § 9607(a)(3).

23. *Id.* § 9607(a)(4).

24. *Id.* § 9607(b)(1)-(3).

CERCLA also provides for the "innocent landowner defense,"²⁵ which absolves a party from liability when certain conditions are met.²⁶ In order to prevail under this defense, the party must have acquired the facility in question after the disposal of the hazardous substances.²⁷ Additionally, the party must demonstrate that there was no reason to know of such disposal, that due care with respect to the hazardous substance was exercised, and that precautions against foreseeable acts or omissions of any third party were taken.²⁸ These stringent requirements illustrate the importance of conducting a thorough due diligence inquiry.

CERCLA's statutory scheme is glaringly harsh in many respects. First, as noted above, liability may be imposed retroactively on past owners and operators of a facility if disposal of a hazardous substance occurred during their tenure, even if the disposal was lawful.²⁹ Second, CERCLA imposes strict liability,³⁰ meaning that liability will attach to the PRP regardless of intent. Thus, liability is not based on fault.³¹ Third, CERCLA provides for joint and several liability,³² so that any one of several PRPs can be held liable for the entire cleanup. Since the cost of cleaning up Superfund sites under CERCLA has, in some in-

25. *See id.* §§ 9601(35)(B), 9607(b)(3). Alternatively called the "innocent purchaser defense," this exclusion is referred to by courts and commentators alike. *Westwood Pharmaceuticals, Inc. v. Nat'l Fuel Gas Distribution Corp.*, 964 F.2d 85, 89 (2d Cir. 1992); *United States v. Peterson Sand & Gravel, Inc.*, 806 F. Supp. 1346, 1352 (N.D. Ill. 1992); Kilborn, *supra* note 15, at 347.

26. 42 U.S.C. § 9607(b)(3).

27. *Id.*

28. *Id.*

29. *United States v. Kramer*, 757 F. Supp. 397, 428-30 (D.N.J. 1991); *United States v. Hooker Chem. & Plastics Corp.*, 680 F. Supp. 546, 556-57 (W.D.N.Y. 1988).

30. *United States v. Mexico Feed and Seed Co.*, 980 F.2d 478, 484 (8th Cir. 1992); *see also United States v. Alcan Aluminum Corp.*, 990 F.2d 711, 721 (2d Cir. 1993) (listing the three factors that must exist for strict liability to apply).

31. *United States v. Shell Oil Co.*, 841 F. Supp. 962, 968 (C.D. Cal. 1993); *United States v. Parsons*, 723 F. Supp. 757, 760 (N.D. Ga. 1989).

32. *United States v. Lang*, 864 F. Supp. 610, 613-14 (E.D. Tex. 1994); *Shell Oil*, 841 F. Supp. at 968.

stances, exceeded \$30 million,³³ falling within CERCLA's broad PRP category can be very expensive.

One of the most troubling issues that the Purchaser in our hypothetical transaction will have to consider is the possibility that the Facility may become a Superfund site or that hazardous waste from the site may have been sent to a site that has been, or that may later be, designated as a Superfund site. In this regard, a thorough due diligence investigation should also incorporate a review of the Comprehensive Environmental Response, Compensation and Liability Information System ("CERCLIS"),³⁴ the database of potentially hazardous waste sites³⁵ that have been reported to EPA by various sources.³⁶ Some CERCLIS sites are also on the National Priorities List ("NPL") or are in the screening and assessment phase for possible inclusion on the NPL.³⁷

While the Seller may have arranged for disposal of hazardous waste in a lawful manner, CERCLA imposes strict liability for cleanup costs if EPA can demonstrate that the Facility's wastes were sent to a Superfund site.³⁸ The Purchaser should try to structure the transaction so as to reduce the possibility of acquiring the Seller's environmental liabilities and thus becoming a PRP by succession.³⁹

33. Paula Harrington, Note, *The Duty to Defend in California After Montrose Chemical Corp. v. Superior Court: Is the California Supreme Court Protecting Policyholders or Encouraging Litigation and the Early Settlement of Unworthy Claims?*, 31 CAL. W. L. REV. 165, 174 n. 65 (1994) (quoting MITCHELL L. LATHROP, *INSURANCE COVERAGE FOR ENVIRONMENTAL CLAIMS*, § 1.04[3] (1994)).

34. See Comprehensive Environmental Response, Compensation and Liability Act Information System, available in LEXIS, ENVIRN Library, CERCLS File.

35. John A. Adams, *Cost Recovery and Environmental Compliance Actions for Hazardous Substances and Petroleum Products*, UTAH B.J., Apr. 1993, at 9.

36. Potentially hazardous sites may be identified by several procedures, including governmental inspection. See, e.g., 42 U.S.C. § 9603 (1988) (CERCLA release reporting), 42 U.S.C. § 9605(d) (1988) (citizen request for site assessment); 40 C.F.R. § 300.405 (1994) (information from other sources).

37. A site must receive a score of 28.5 to be eligible for inclusion on the NPL. For more information on guidelines and factors used for scoring, see Adams, *supra* note 35, at 9.

38. *United States v. Price*, 577 F. Supp. 1103, 1113-14 (D.N.J. 1983).

39. See *infra* part II.A.

B. State Transfer Laws

As noted above,⁴⁰ our hypothetical transaction is also likely to trigger the application of an environmental transfer law at the state level, such as the New Jersey Industrial Site Recovery Act ("ISRA").⁴¹ New Jersey is one of several states that have enacted legislation that in some way restricts the transfer of real property.⁴² These statutes run the gamut from requiring disclosure of the environmental condition of the real property before it may be transferred,⁴³ to requiring state approval of the transaction.⁴⁴ ISRA is by far the most exacting of the transfer-restricting state statutes.⁴⁵ Generally, ISRA requires that the owner or operator of an industrial establishment satisfy certain cleanup and remediation requirements before selling or transferring either the business or the property, or before closing down operations at the site.⁴⁶

The ISRA process is initiated by filing affidavits with the New Jersey Department of Environmental Protection and Energy ("DEPE"), in which the transferor represents that there have been no discharges of hazardous substances at the site.⁴⁷ If there was

40. See *supra* text accompanying notes 12-13.

41. N.J. STAT. ANN. § 13:1K-6 (West Supp. 1995).

42. Other states that have enacted property transfer legislation include Connecticut, Illinois, and Colorado. Connecticut Transfer Act, CONN. GEN. STAT. § 22a-134 (1995); Responsible Property Transfer Act of 1988, ILL. ANN. STAT. ch. 765, paras. 90/1 to 90/7 (Smith-Hurd 1993 & Supp. 1995); State Hazardous Waste Siting Act, COLO. REV. STAT. §§ 25-15-200.1 to 25-15-220 (1989 & Supp. 1995).

43. See Connecticut Transfer Act, CONN. GEN. STAT. § 22a-134(a).

44. See ISRA, N.J. STAT. ANN. § 13:1K-9c (requiring approval by the Department of Environmental Protection and Energy of a negative declaration or a remedial action workplan prior to transfer of ownership or operations).

45. See generally Sarah L. Inderbitzin, *Taking the Burden Off the Buyer: A Survey of Hazardous Waste Disclosure Statutes*, 1 ENVTL. LAW. 513 (1995) (stating that while ISRA requires disclosure to the state before any property transfer, other states such as Illinois and Indiana, for example, only require disclosure to the transferee).

46. See, e.g., N.J. STAT. ANN. § 13:1K-9 (procedure for transferring industrial property).

47. *Id.* § 13:1K-9c. A representation that there has been no discharge of hazardous substances at a site is called a "negative declaration." *Id.* § 13:1K-8.

a discharge, it must have been cleaned up to the satisfaction of DEPE.⁴⁸ If these affidavits are approved, DEPE issues a “no further action letter.”⁴⁹ In essence, this is a clearance by DEPE giving permission to transfer the property.⁵⁰ It is important to keep in mind that since DEPE relies upon information submitted by the transferor, a no further action letter is not a guarantee that there will be no environmental liability associated with the site.⁵¹ Again, from the Purchaser’s perspective, conducting a thorough due diligence investigation is imperative.

If DEPE identifies an area of the site that it would like to re-view further, it will request that a remedial investigation work plan be implemented.⁵² A cleanup plan will also have to be developed if the DEPE deems it necessary.⁵³ DEPE will allow the transfer of the property to go forward once the cleanup plan has been approved. Depending on the condition of the property, obtaining state clearance from DEPE can turn into a lengthy process and may, in fact, cause a delay in the closing of the transaction.⁵⁴ While the ISRA process represents an extreme example of what a state may prescribe in this area of the law,⁵⁵ sellers and purchasers are well advised to identify and comply with the state transfer laws applicable to their transaction early on to avoid unnecessary closing delays.

48. *See id.* § 13:1K-9l.

49. *Id.* § 13:1K-8 (defining “no further action letter”).

50. *Id.*

51. *See* William W. Buzbee, *Remembering Repose: Voluntary Contamination Cleanup Approvals, Incentives, and the Costs of Interminable Liability*, 80 MINN. L. REV. 35, 117 n.257 (1995) (noting that a “no further action letter” provides only limited protection).

52. N.J. STAT. ANN. § 13:1K-9d(2).

53. *Id.*

54. After compliance with ISRA’s statutory requirements and submission of a negative declaration to DEPE certifying the absence of hazardous waste on the property, the DEPE has forty-five days to undertake its own investigation. *Id.* § 13:1K-9d(2). *See also* Inderbitzin, *supra* note 45, at 528.

55. *See supra* notes 42-46 and accompanying text.

C. Lender Liability

Recall that the Purchaser in our hypothetical transaction is seeking financing from a lending institution ("Lender") for the purchase of the Facility. CERCLA's statutory framework and recent case law have significantly increased the lending community's environmental exposure in commercial transactions.⁵⁶ Given the current state of the law, the Lender is likely to proceed with great caution.⁵⁷

Despite the apprehension in the lending community caused by CERCLA's inclusive liability scheme, there are reasons for lenders to feel comfortable participating in commercial transactions. As defined by the statute, "owner or operator" creates a qualified exemption for any person who, without participating in the management of a facility, holds indicia of ownership primarily to protect its security interest in the facility.⁵⁸ This qualified exemption is referred to as the "Secured Creditor Exemption."⁵⁹ The Secured Creditor Exemption came under great scrutiny in *United States v. Fleet Factors Corp.*,⁶⁰ a case which has created much concern within the lending community.

In *Fleet Factors*, a lending institution ("Fleet") agreed to advance funds to a cloth printing facility, Swainsboro Print Works ("SPW"), in exchange for an assignment of SPW's accounts receivable.⁶¹ As a condition of the loan, Fleet obtained a security interest in SPW's textile facility, along with security interests in SPW's equipment, inventory, and fixtures.⁶² After SPW defaulted, Fleet foreclosed on the equipment and inventory and contract-

56. See Joel Mack, *New Direction for Lenders Under Federal Superfund*, 112 BANKING L.J. 590 (1995); Karin Oliva, Note, *Lender Liability Under CERCLA*, 68 S. CAL. L. REV. 1417 (1995).

57. See *Lenders' Position Without Superfund Bill*, ENVTL. LIAB. REP., Dec. 13, 1994, at 16, available in WESTLAW, ALLNEWS Database; *FDIC Guidance to Banks on 'E' Liability*, ASBESTOS & LEAD ABATEMENT REP., Mar. 13, 1995, available in WESTLAW, ALLNEWS Database.

58. 42 U.S.C. § 9601(20)(A) (1988 & Supp. V 1993).

59. See *United States v. Fleet Factors Corp.*, 901 F.2d 1550, 1556 (11th Cir. 1990), cert. denied, 498 U.S. 1046 (1991).

60. 901 F.2d 1550 (11th Cir. 1990), cert. denied, 498 U.S. 1046 (1991).

61. *Id.* at 1552.

62. *Id.*

ed to conduct an auction of the collateral, but did not foreclose on the property.⁶³ Upon inspection, EPA found 700 fifty-five gallon drums containing toxic chemicals and forty-four truckloads of asbestos-containing materials.⁶⁴ The EPA later sued the stockholders of SPW and Fleet to recover the costs of cleaning up the facility.⁶⁵

The critical issue in *Fleet Factors* was whether Fleet had participated in the management of the facility sufficiently to incur liability under CERCLA. The court adopted a standard under which a secured party may incur liability under CERCLA by participating in the financial management of a facility to a degree indicating a "capacity to influence" the corporation's treatment of hazardous wastes.⁶⁶ Under this standard, "a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose."⁶⁷

Responding to the concern of banks and lending institutions following the *Fleet Factors* decision, EPA promulgated a lender liability rule ("Rule").⁶⁸ The Rule was meant to broadly interpret the Secured Creditor Exemption. The Rule made clear that a lender will not be held liable if the only reason that an ownership interest is held in the property is for the purpose of securing the loan, and the lender does not participate in the management of the facility.⁶⁹ Under EPA's Rule, a lender would fail to satisfy the criteria entitling it to the Secured Creditor Exemption if it exercised decision-making control over the day-to-day management of the facility's environmental compliance or operational matters.⁷⁰ The Rule also protected a secured creditor who foreclosed on its collateral, as long as the creditor took certain diligent efforts to divest itself of the property in a reasonably expeditious manner

63. *Id.* at 1552-53.

64. *Id.* at 1553.

65. *Id.*

66. *Id.* at 1557.

67. *Id.* at 1558.

68. 57 Fed. Reg. 18,344 (1992) (codified at 40 C.F.R. pt. 300).

69. *Id.*

70. *Id.*

and did not participate in the management of the property prior to foreclosure.⁷¹

In *Kelley v. United States EPA*,⁷² however, the Court of Appeals for the District of Columbia invalidated EPA's Rule. The *Kelley* court held that EPA lacked statutory authority to define, through regulation, the scope of lender liability under CERCLA.⁷³ It should be noted that a number of courts that have considered the Secured Creditor Exemption, and that have applied EPA's Rule, have held in favor of the lenders.⁷⁴ Given the holding in *Kelley*, however, it is not clear whether these courts would have ruled in the same fashion had they not been able to consider EPA's Rule. Nonetheless, the Secured Creditor Exemption has been at issue in many recent cases which have been decided in favor of lenders, without consideration of EPA's Rule.⁷⁵

One such case is *In re Bergsoe Metal Corp.*⁷⁶ In *Bergsoe*, the Ninth Circuit noted that CERCLA provides little guidance as to the level of control a secured creditor may exert over a facility before it will be liable for cleanup.⁷⁷ The court held that a secured party will not be held liable merely because it holds title to the property as part of a financing arrangement.⁷⁸ Although the court cited *Fleet Factors* in its decision, it chose not to adopt the standards set forth therein and noted that "there must be *some* actual management of the facility before a secured creditor will fall outside the exception."⁷⁹ The court further noted that the

71. *Id.*

72. 15 F.3d 1100 (D.C. Cir. 1994), *cert. denied sub nom.* American Bankers' Ass'n v. Kelley, 115 S. Ct. 900 (1995).

73. *Id.* at 1107-08.

74. *See, e.g.,* Ashland Oil, Inc. v. Sonford Prods. Corp., 810 F. Supp. 1057, 1060 (D. Minn. 1993) (holding that lender engaging in ordinary lending activities was shielded from liability by application of 42 U.S.C. § 9601(20)(A) and EPA's Lender Liability Rule); Kelly v. Tiscornia, 810 F. Supp. 901, 906 (W.D. Mich. 1993) (following the Lender Liability Rule and concluding that mere influence over a borrower is not a sufficient basis for the imposition of CERCLA liability).

75. *See* United States v. McLamb, 5 F.3d 69, 73 (4th Cir. 1993); Waterville Indus. v. Finance Auth. of Maine, 984 F.2d 549, 553 (1st Cir. 1993).

76. 910 F.2d 668 (9th Cir. 1990).

77. *Id.* at 672.

78. *Id.* at 671-72.

79. *Id.* at 672 (emphasis added).

sole fact "that a secured creditor reserves certain rights to protect its investment does not put it in a position of management."⁸⁰ The critical factor is not what rights the creditor has, but what rights have been exercised.⁸¹ It should be noted, however, that *Bergsoe* was decided before EPA's Rule was finalized.⁸²

Similar results have been reached in a number of cases: *Waterville Industries v. Finance Authority of Maine*,⁸³ *United States v. McLamb*,⁸⁴ *Northeast Doran v. Key Bank of Maine*.⁸⁵ In all of these cases, the Secured Creditor Exemption was upheld without consideration of EPA's Rule.⁸⁶ Interestingly, in all of these cases, the lenders foreclosed on the mortgagors' real property, which was later sold to another party.⁸⁷ Yet in all three cases, the courts found that "ownership" of the property did not invalidate the Secured Creditor Exemption.⁸⁸ The *Doran* court, quoting the *Waterville* opinion, noted:

[T]he purpose of the statutory exception, apparent from its language and statutory context, is to shield from liability those "owners" who are in essence lenders holding title to the property as security for the debt. Moreover, so long as the [security interest holder] makes a reasonably prompt effort to divest itself of its unwelcome ownership, we think continued coverage under the exception serves its basic policy: to protect bona fide lenders and to avoid imposing liability on owners who are not in fact seeking to profit from the investment opportunity normally presented by prolonged ownership.⁸⁹

80. *Id.*

81. *Id.*

82. EPA's Rule was finalized on April 29, 1992. See 57 Fed. Reg. 18,344 (1992) (codified at 40 C.F.R. pt. 300).

83. 984 F.2d 549 (1st Cir. 1993).

84. 5 F.3d 69 (4th Cir. 1993).

85. 15 F.3d 1 (1st Cir. 1994).

86. *Northeast Doran*, 15 F.3d at 2-3; *McLamb*, 5 F.3d at 73-74; *Waterville*, 984 F.2d at 554.

87. *Northeast Doran*, 15 F.3d at 2; *McLamb*, 5 F.3d at 70; *Waterville*, 984 F.2d at 550-51.

88. *Northeast Doran*, 15 F.3d at 3; *McLamb*, 5 F.3d at 71-72; *Waterville*, 984 F.2d at 552.

89. *Northeast Doran*, 15 F.3d at 2 (citing *Waterville*, 984 F.2d at 552-53).

Under the current state of the law, lenders may unwittingly find themselves saddled with liability under CERCLA simply because they attempted to protect their security interests.⁹⁰ To truly protect themselves, secured creditors who take control of their collateral through foreclosure should not take control over the management of the facility or the decision-making process concerning the disposition of the facility's hazardous substances.

II. THE ALLOCATION OF RISKS AND RESPONSIBILITIES OF ENVIRONMENTAL LIABILITY BETWEEN THE PARTIES

The allocation between the parties of the risks and responsibilities associated with environmental liability is an issue that must be addressed in every commercial transaction involving the transfer of real estate. CERCLA's statutory scheme and the case law interpreting it have had a significant impact on the issues related to commercial transactions, such as the manner in which transactions are structured, the due diligence that is performed on behalf of the purchaser, the subsequent negotiations that inevitably follow the due diligence investigation, and the form of purchase agreement ultimately executed by the parties.⁹¹

A. *Structure of the Transaction*

In structuring the transaction, one of the critical factors that will receive immediate attention is the allocation of risks and responsibilities in connection with the Facility's environmental liabilities. The Purchaser will seek to purchase the Facility without acquiring any of the Seller's existing environmental liabilities. In this regard, the Purchaser will need to consider a number of options. For example, ACE Corporation could be acquired indirectly by the Purchaser through a corporate subsidiary.⁹²

90. Oliva, *supra* note 56, at 1428.

91. STANDARD PRACTICE FOR ENVIRONMENTAL SITE ASSESSMENTS: PHASE I ENVIRONMENTAL SITE ASSESSMENT PROCESS E, E1527-93 § 1.1.1 (Am. Soc'y for Testing and Materials 1993) [hereinafter PHASE I ENVIRONMENTAL SITE ASSESSMENT PROCESS]; STANDARD PRACTICE FOR ENVIRONMENTAL SITE ASSESSMENTS: TRANSACTION SCREEN PROCESS E, E1528-93 § 1.1.1 (Am. Soc'y for Testing and Materials 1993).

92. *See, e.g.*, *Western Helicopters, Inc. v. Hiller Aviation, Inc.*, 97 B.R. 1

Alternatively, the Purchaser could acquire all of the Seller's stock in ACE Corporation and become the Seller's corporate successor.⁹³ On the other hand, the Purchaser may wish to limit the acquisition to certain assets currently held by ACE Corporation.⁹⁴ Unfortunately, and much to the Purchaser's dismay, none of these scenarios provides the Purchaser with a complete shield against the Seller's existing environmental liabilities under current law.⁹⁵

1. Corporate Parent Liability Under CERCLA

Under the doctrine of limited liability, a parent corporation is generally not liable for the debts or acts of its subsidiary.⁹⁶ While limited liability remains the norm under American corporation laws, the courts have created exceptions to this rule.⁹⁷ The issue of corporate parent liability has been analyzed in much detail by the courts in cases arising under CERCLA.⁹⁸ Parent corporations may be held liable for their subsidiary's environmental cleanup costs on either of two theories: (1) the corporate parent is found to be directly liable as an operator of the contaminated site,⁹⁹ or (2) the court may pierce the corporate veil so as

(E.D. Cal. 1988).

93. *See, e.g.*, *G.L. Canfield v. Rapp & Son, Inc.*, 654 F.2d 459 (7th Cir. 1981).

94. *See, e.g.*, *Schmidt v. Wilbur*, 783 F. Supp. 329 (E.D. Mich. 1992); *Packquisition Corp. v. Packard Press New England*, No. Civ. A. 91-5966, 1992 WL 345098 (E.D. Pa. Nov. 10, 1992).

95. *See* David Fink, *Impact of Clean-Up Laws on Property Business Deals*, MICH. LAW. WEEKLY, Sept. 26, 1994, at 29.

96. Thomas O'Brien, *Successor Liability—Are You Buying Trouble?*, METRO. CORP. COUNS., Jan. 1996, at 16, available in LEXIS, News Library, MCC File.

97. Exceptions to the general rule of limited liability are made in cases of: (1) corporate parent domination and control of its subsidiary corporation; (2) use of the corporation for fraudulent or illegal purposes; or (3) draining of the corporation's assets by its shareholders. *United States v. Jon-T Chems., Inc.*, 768 F.2d 686, 691 (5th Cir. 1985), *cert. denied*, 475 U.S. 1014 (1986).

98. *See, e.g.*, *United States v. Kayser-Roth Corp.*, 910 F.2d 24 (1st Cir. 1990), *cert. denied*, 498 U.S. 1084 (1991); *Joslyn Mfg. Co. v. T.L. James & Co.*, 893 F.2d 80 (5th Cir. 1990), *cert. denied*, 498 U.S. 1108 (1991).

99. *See, e.g.*, *Jacksonville Elec. Auth. v. Bernuth Corp.*, 996 F.2d 1107, 1109-10 (11th Cir. 1988); *Kayser-Roth*, 910 F.2d at 26-27.

to find the parent indirectly liable for the actions of its subsidiary.¹⁰⁰

The leading cases concerning corporate parent liability in the environmental context are *United States v. Kayser-Roth Corp.*¹⁰¹ and *Joslyn Manufacturing Co. v. T.L. James & Co.*¹⁰² In *Kayser-Roth*, the parent corporation was held liable as an operator for the cleanup costs of its subsidiary.¹⁰³ The Court of Appeals for the First Circuit noted that "a fair reading of CERCLA allows a parent corporation to be held liable as an operator of a subsidiary corporation."¹⁰⁴ Without deciding the exact standard necessary for a parent to be an operator, the court indicated that not only was a showing of complete ownership required, combined with general authority or the ability to control that comes with ownership, but that, at a minimum, there must be a showing of active involvement in the activities of the subsidiary.¹⁰⁵

The Fifth Circuit undertook a much different analysis of corporate parent liability under CERCLA in *Joslyn*.¹⁰⁶ The Court of Appeals found that CERCLA's reach did not extend to parent corporations whose subsidiaries are found liable under the statute.¹⁰⁷ While agreeing that a parent corporation could be found liable under CERCLA by piercing the corporate veil, the court

100. See, e.g., *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985).

101. 910 F.2d 24 (1st Cir. 1990), cert. denied, 498 U.S. 1084 (1991).

102. 893 F.2d 80 (5th Cir. 1990), cert. denied, 498 U.S. 1108 (1991).

103. *Kayser-Roth*, 910 F.2d at 27-28.

104. *Id.* at 27.

105. The following factors were considered by the *Kayser-Roth* court in holding the parent liable as an operator: (1) the parent corporation had total monetary control over its subsidiary, including collection of accounts payable; (2) the parent corporation restricted its subsidiary's financial budget; (3) the parent corporation directed that all governmental matters, including environmental matters, be funneled through the parent; (4) the parent's approval was required before the subsidiary could lease, buy, or sell real property; (5) the parent's approval was required for any capital transfer or expenditure greater than \$5,000; and (6) the parent placed its personnel in almost all of its subsidiary's directorship and officer positions as a means of ensuring that the parent's corporate policy was implemented and precisely carried out. *Id.* (citing *United States v. Kayser-Roth Corp.*, 724 F. Supp. 15, 18 (D.R.I. 1989)).

106. 893 F.2d 80.

107. *Id.* at 82-83.

held that the facts in this case did not justify such action.¹⁰⁸ In setting out the criteria for analyzing the issue of control in the parent/subsidiary context, the court made reference to its prior decision in *United States v. Jon-T Chemicals, Inc.*¹⁰⁹ In that case, the court provided a list of factors to be considered in determining whether a parent controls its subsidiary to an extent that justifies piercing the corporate veil.¹¹⁰

To some extent, the decisions in both *Kayser-Roth* and *Joslyn* provide "guidelines" that parent corporations can follow to avoid liability arising from the activities of their subsidiaries. The problem, however, is that the relationship between a parent corporation and its subsidiary, by its very nature, is often based upon a certain measure of control.¹¹¹ For example, the corporate parent frequently causes the incorporation of its subsidiary.¹¹² In addition, it is not uncommon for the corporate parent to finance its subsidiary, or for it to have some active involvement in the business of its subsidiary.¹¹³ In short, the guidelines provided by current case law are not clear and offer little reassurance to the

108. *Id.* at 83 (supporting piercing the corporate veil only in instances of fraud).

109. 768 F.2d 686 (5th Cir. 1985), *cert. denied*, 475 U.S. 1014 (1986).

110. The court held that the list of factors to be considered are:

- (1) the parent and the subsidiary have common stock ownership;
- (2) the parent and the subsidiary have common directors or officers;
- (3) the parent and the subsidiary have common business departments;
- (4) the parent and the subsidiary file consolidated financial statements and tax returns;
- (5) the parent finances the subsidiary;
- (6) the parent caused the incorporation of the subsidiary;
- (7) the parent operates with grossly inadequate capital;
- (8) the parent pays the salaries and other expenses of the subsidiary;
- (9) the subsidiary receives no business except that given to it by the parent;
- (10) the parent uses the subsidiary's property as its own;
- (11) the daily operations of the two corporations are not kept separate; and
- (12) the subsidiary does not observe the basic corporate formalities, such as keeping separate books and records and holding shareholder and board meetings.

Id. at 691-92.

111. See PHILLIP A. BLUMBERG, *THE LAW OF CORPORATE GROUPS: PROBLEMS OF PARENT AND SUBSIDIARY CORPORATIONS UNDER STATUTORY LAW OF GENERAL APPLICATION* § 2.02.3 (1989).

112. See, e.g., *Jon-T*, 768 F.2d at 689.

113. *Id.*

corporate parent who seeks to protect itself against environmental liability resulting from the actions of its subsidiary.

2. Successor Liability

If BEE Corporation opts to acquire all of Seller's stock in ACE Corporation, it may expose itself to Seller's environmental liabilities by virtue of successor liability. A transaction that is limited to the acquisition of certain assets, as opposed to a stock acquisition, may not necessarily enable the Purchaser to remain free and clear of the Seller's environmental claims. These two types of transactions are tied together in the analysis of corporate successor liability.

The issue of successor liability under CERCLA has not been specifically addressed by Congress.¹¹⁴ The courts, however, have tried to create a rule which is consistent with the broad remedial goals of CERCLA, and also takes into account traditional concerns of corporate law.¹¹⁵ The general rule with respect to successor liability is that "where one corporation purchases business assets from another corporation, and a fair consideration was paid, the purchaser does *not*, simply by virtue of the asset purchase transaction, become responsible for the seller's liabilities."¹¹⁶ There are, however, four well-recognized exceptions to this rule: (1) the purchaser of assets expressly or impliedly agrees to assume the obligations of the transferor; (2) the transaction amounts to a consolidation or a de facto merger; (3) the purchasing corporation is merely a continuation of the seller; or (4) the transaction is fraudulent because it was entered into to escape liability.¹¹⁷

114. *Louisiana-Pacific Corp. v. ASARCO, Inc.*, 909 F.2d 1260, 1262 (9th Cir. 1990); *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86, 91 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989).

115. *See, e.g.*, *United States v. Carolina Transformer Co.*, 978 F.2d 832, 837-38 (4th Cir. 1992); *United States v. Mexico Feed and Seed Co.*, 980 F.2d 478, 487 (8th Cir. 1992); *Louisiana-Pacific Corp.*, 909 F.2d at 1263.

116. *City Envtl., Inc. v. United States Chem. Co.*, 814 F. Supp. 624, 634 (E.D. Mich. 1993) (emphasis added), *aff'd sub nom. City Mgmt. Corp. v. United States Chem. Co.*, 43 F.3d 244 (6th Cir. 1994).

117. *Louisiana-Pacific Corp.*, 909 F.2d at 1263; *Atlantic Richfield Co. v. Blosenski*, 847 F. Supp. 1261, 1283-84 (E.D. Pa. 1994); *City Envtl., Inc.*, 814 F.

If the Purchaser acquires all of the Seller's stock in ACE Corporation, or even if the transaction is limited to a sale of certain assets, the "mere continuation" exception may potentially form the basis for corporate successor liability.¹¹⁸ The scope of this exception has been expanded in certain jurisdictions to determine whether one corporation is the successor of another.¹¹⁹ Under this expanded approach, also referred to as the "continuity of enterprise" theory, the court considers a series of factors, which include: whether the purchaser (1) retains the same employees and production facilities; (2) produces the same products; (3) maintains the same assets and business operations; (4) retains the same business name; and (5) holds itself out to the public as a continuation of the previous enterprise.¹²⁰

It should be noted that the law regarding corporate successor liability in the context of products liability differs among the states. The "product line theory" of liability, followed by a minority of states,¹²¹ was formulated in 1977 by the California Supreme Court, in *Ray v. Alad Corp.*¹²² Finding that none of the four traditional exceptions to the general rule of successor liability were present in that case, the *Ray* court created a new exception applicable in strict tort liability cases.¹²³ Under this new exception, strict liability is imposed upon the successor manufacturer if

- (1) the virtual destruction of the plaintiff's remedies against the original manufacturer was caused by the successor's acquisition of the business;
- (2) the successor has the ability to assume the origi-

Supp. at 634.

118. See, e.g., *Kane v. Magna Mixer Co.*, 71 F.3d 555, 560-61 n.1 (6th Cir. 1995).

119. See *City Envtl., Inc.*, 814 F. Supp. at 635.

120. *United States v. Carolina Transformer Co.*, 978 F.2d 832, 838 (4th Cir. 1992); *Atlantic Richfield Co. v. Blosenski*, 847 F. Supp. 1261, 1284 (E.D. Pa. 1994).

121. Some of the states that follow the product line theory are New Jersey, Pennsylvania, Massachusetts, Colorado, and Washington. See, e.g., *LaFountain v. Webb Indus. Corp.*, 759 F. Supp. 236 (E.D. Pa. 1991), *aff'd*, 951 F.2d 544 (3d Cir. 1991); *Roy v. Bolens Corp.*, 629 F. Supp. 1070 (D. Mass. 1986); *Hickman v. Thomas C. Thompson Co.*, 592 F. Supp. 1282 (D. Colo. 1984).

122. 136 Cal. Rptr. 574 (Cal. Ct. App. 1977).

123. *Id.* at 8-11.

nal manufacturer's risk-spreading role; and (3) it is fair to require the successor to assume responsibility for defective products that were a burden necessarily attached to the original manufacturer's good-will being enjoyed by the successor in the continued operation of the business.¹²⁴

It is important to note that following *Ray*, cases in California and elsewhere have required that all three prongs be satisfied before liability is imposed on the successor corporation.¹²⁵ Thus, the absence of the causation factor will generally result in a finding of no corporate successor liability.¹²⁶ In other words, corporate successor liability is generally not imposed if the purchaser played no role in the predecessor's dissolution.¹²⁷

Surprisingly, there is very little case law addressing the issue of whether successor liability may be imposed in a limited asset purchase transaction.¹²⁸ It appears, however, at least by implication, that successor liability cannot be imposed unless there is a showing that the successor corporation acquired "all or at least 'substantially all'" of the assets of the predecessor corporation.¹²⁹ In *New York v. N. Storonske Cooperage Co.*,¹³⁰ the State sued for cost recovery and relief under CERCLA, Container Management Corporation, the successor to the defendant, the North Storonske Cooperage Co.¹³¹ The defendant's position was that a necessary precursor to the imposition of successor liability is the requirement that there be, at a minimum, a transfer of all or substantially

124. *Id.* at 8-9.

125. *Phillips v. Cooper Labs.*, 264 Cal. Rptr. 311 (Cal. Ct. App. 1989); *Lundell v. Sidney Mach. Tool Co.*, 236 Cal. Rptr. 70 (Cal. Ct. App. 1987).

126. *See, e.g., Stewart v. Telex Comm., Inc.*, 1 Cal. Rptr. 2d 669 (Cal. Ct. App. 1991).

127. *Id.*

128. *See, e.g., City Env'tl., Inc. v. United States Chem. Co.*, 814 F. Supp. 624, 635 (E.D. Mich. 1993), *aff'd sub nom. City Mgt. Corp. v. United States Chem. Co.*, 43 F.3d 244 (6th Cir. 1994); *Green v. Firestone Tire and Rubber Co.*, 460 N.E.2d 895, 899 (Ill. App. Ct. 1984); *Fenton Area Pub. Sch. v. Sorenson-Gross Constr. Co.*, 335 N.W.2d 221, 225 (Mich. Ct. App. 1983).

129. *New York v. N. Storonske Cooperage Co.*, 174 B.R. 366 (N.D.N.Y. 1994).

130. *Id.*

131. *Id.* at 369.

all of the selling corporation's assets.¹³² The *Storonske* court cited two cases which, in dicta, bolster this argument.¹³³

The *Storonske* court did not, however, need to determine whether there may be a finding of successor liability when something less than all or substantially all of the predecessor corporation's assets are transferred to the successor because it found that such a transfer had been accomplished in this case.¹³⁴ The court noted that "given the remedial nature of CERCLA, a lenient reading of the 'all or substantially all' requirement is probably justified. . . . [A] strict construction of the 'all or substantially all' language would, in all likelihood, thwart the remedial goals of CERCLA; and thus this court does not countenance such an approach."¹³⁵

Given the *Storonske* court's lenient reading of the "all or substantially all" language, the decision provides little guidance in cases where it is unclear whether all or substantially all of the assets have been transferred to the successor corporation.¹³⁶ Though it did not squarely address the issue, the court's decision appears to indicate that the substantial-continuity-of-enterprise rule would be inapplicable in cases where the assets transferred are clearly limited in nature.¹³⁷

If we assume that the assets transferred to Purchaser are not limited in nature, or if Purchaser decides to acquire all of Seller's stock in ACE Corporation, a court must consider two additional factors prior to the imposition of successor liability under the continuity of enterprise theory. Although *all* of the factors which make up the continuity of enterprise theory¹³⁸ are examined by the courts with great scrutiny, two additional factors appear to play a decisive role in whether liability attaches to the successor corporation.¹³⁹

132. *Id.* at 377-78.

133. *See Williams v. Bowman Livestock Equip. Co.*, 927 F.2d 1128 (10th Cir. 1991); *Long v. AT&T Info. Sys., Inc.*, 733 F. Supp. 188 (S.D.N.Y. 1990).

134. *Storonske*, 174 B.R. at 378.

135. *Id.*

136. *Id.*

137. *Id.* at 387.

138. *See supra* text accompanying note 120.

139. *Storonske*, 174 B.R. at 388.

One of the additional factors is the presence of "substantial ties" or the existence of a relationship between the successor corporation and its predecessor.¹⁴⁰ In one case, for example, the substantial ties between the predecessor and successor corporation consisted of a familial relationship between the two parties and common shareholders.¹⁴¹ The other additional factor is the successor corporation's knowledge of the seller's environmental liabilities.¹⁴²

It should be noted that in holding that the successor corporation had knowledge of the predecessor corporation's CERCLA liability, the district court in *Atlantic Richfield Co. v. Blosenski* made the following observation in a footnote:

Although we are not inclined to limit the application of the substantial continuity test to occasions when the purchaser has knowledge or actual notice of the seller's CERCLA liability, it may be proper to reserve substantial continuity successor liability for a purchaser who should have known after reasonable investigation of the seller's potential liability. This would be consistent with CERCLA's "innocent landowner" defense, which is intended to prevent innocent purchasers of land from being held liable under CERCLA for unknown hazardous dumping or polluting by previous owners.¹⁴³

Based on this decision, the "prerequisite" of the substantial-continuity-of-enterprise rule may be interpreted as requiring that the successor corporation have no knowledge of the predecessor's environmental liability after having conducted a reasonable investigation into such matters.¹⁴⁴ Once again, the importance of a thorough due diligence investigation cannot be overemphasized.

140. *United States v. Atlas Minerals & Chem., Inc.*, 824 F. Supp. 46, 51 (E.D. Pa. 1993); *City Envtl., Inc. v. United States Chem. Co.*, 814 F. Supp. 624, 638 (E.D. Mich. 1993), *aff'd sub nom. City Mgt. Corp. v. United States Chem. Corp.*, 43 F.3d 244 (6th Cir. 1994).

141. *United States v. Carolina Transformer Co.*, 978 F.2d 832, 835 (4th Cir. 1992).

142. *United States v. Mexico Feed and Seed Co.*, 980 F.2d 478, 488 (8th Cir. 1992); *Atlantic Richfield Co. v. Blosenski*, 847 F. Supp. 1261, 1287 (E.D. Pa. 1994).

143. *Atlantic Richfield*, 847 F. Supp. at 1287 n.26 (citations omitted).

144. *Id.*

3. Corporate Officer Liability

Regardless of the form of the transaction, one of Purchaser's foremost concerns will be that the officers, directors, and shareholders of BEE Corporation are not held personally liable for the Facility's environmentally-related claims. Under traditional common law principles, unless a court determines that the existing facts warrant a piercing of the corporate veil, the corporation's separate legal structure is respected, and its officers, directors, and shareholders are protected from personal liability emanating from the corporation's activities.¹⁴⁵ The law has been changing over the years, however, with respect to environmental liability, with the result that officers, directors, and shareholders have found themselves personally responsible for the cost of cleaning up the facilities owned by the corporation.¹⁴⁶

In expanding the basis upon which officers, directors, and shareholders are held personally responsible for environmental liability, courts generally follow the same analysis applied in the context of corporate parent liability. One option is to hold the corporate officer liable in an individual capacity as an operator of the facility.¹⁴⁷ Under this view, the individual's liability is based upon his or her own acts or omissions, irrespective of corporate officer status.¹⁴⁸

145. See *Sidney S. Arst Co. v. Pipefitters Welfare Educ. Fund*, 25 F.3d 417, 420 (7th Cir. 1994) (stating that "it is generally settled that the shareholders, directors and officers of a corporation are not liable for the obligations or delicts of the corporation"). See also, e.g., *Main Bank of Chicago v. Baker*, 427 N.E.2d 94, 101 (Ill. 1981); *Gallagher v. Reconco Builders, Inc.*, 415 N.E.2d 560, 563 (Ill. App. Ct. 1980).

146. 42 U.S.C. §§ 9601(20)(A), 9607(a); see also, e.g., *Riverside Mkt. Dev. Corp. v. International Bldg. Prods., Inc.*, 931 F.2d 327, 330 (5th Cir. 1991) (stating that "CERCLA prevents individuals from hiding behind the corporate shield when as 'operators,' they themselves actually participate in the wrongful conduct prohibited by the Act"); *United States v. Kayser-Roth Corp.*, 910 F.2d 24, 26-27 (1st Cir. 1990) (noting cases in which shareholders were held liable as "operators" under CERCLA); *United States v. Northeastern Pharmaceutical & Chem. Co.*, 810 F.2d 726, 743-44 (8th Cir. 1986) (holding that the Congress intended CERCLA liability to attach to corporate officers), *cert. denied*, 484 U.S. 848 (1987).

147. See, e.g., *Riverside Mkt.*, 931 F.2d at 330; *Kayser-Roth*, 910 F.2d at 26-27; *Northeastern Pharmaceutical*, 810 F.2d at 743-44.

148. 3A S. FLANAGAN & C. KEATING, FLETCHER CYCLOPEDIA OF THE LAW OF

Under a second theory, the corporate officer is held derivatively liable through the piercing of the corporate veil.¹⁴⁹ Under this view, a court looks beyond the corporate structure and examines the activities of the officers as they relate to the corporation's waste disposal practices.¹⁵⁰ In this regard, CERCLA itself provides a basis for the imposition of this theory of liability in that any person who arranged for the disposal of hazardous substances is strictly liable for the costs of cleaning up the contaminated property.¹⁵¹ These words have been interpreted by some courts as including corporate officers.¹⁵² The Court of Appeals for the Eighth Circuit, for example, has held that the term "person" includes both individuals and corporations and does not exclude corporate officers or employees.¹⁵³

Different standards are applied by the courts when imposing liability based upon the activities of corporate officers. Indeed, it appears that there may be a split among the courts in this regard. A number of federal circuit courts have held corporate officers personally responsible for environmental liability only in instances where the officer (1) actually participated in the operation of the facility; (2) exercised control over the facility; or (3) was significantly involved in the corporation's operations.¹⁵⁴ This standard is referred to as the "actual control test."¹⁵⁵ Other courts have taken a broader approach to corporate officer liability.¹⁵⁶ Under this approach, referred to as the "prevention test,"

PRIVATE CORPORATIONS § 1135 (1994) ("Corporate officers are liable for their torts, although committed when acting officially.").

149. See, e.g., *Arst*, 25 F.3d at 420; *Riverside*, 931 F.2d at 330 (citing *Northeastern Pharmaceutical*, 810 F.2d at 744).

150. *Riverside*, 931 F.2d at 330; *Northeastern Pharmaceutical*, 810 F.2d at 744.

151. 42 U.S.C. § 9607(a)(3).

152. See, e.g., *United States v. USX Corp.*, 68 F.3d 811, 824-25 (3d Cir. 1995) (plain language of CERCLA imposes transporter liability on corporate officers and shareholders only if they "actually participated in liability-creating conduct").

153. *Northeastern Pharmaceutical*, 810 F.2d at 743.

154. See, e.g., *USX Corp.*, 68 F.3d at 822-23; see also *Jacksonville Elec. Auth. v. Bernuth Corp.*, 996 F.2d 1107, 1110 (11th Cir. 1993); *United States v. Kayser-Roth Corp.*, 910 F.2d 24, 27-28 (1st Cir. 1990).

155. *USX Corp.*, 68 F.3d at 822.

156. See, e.g., *United States v. Taylor*, No. 1:90:CV:851, 1994 WL 512758,

the corporate officer is held personally liable if he simply had authority over the corporation's hazardous waste disposal practices and could have prevented the contamination.¹⁵⁷ Given the foregoing, BEE Corporation's officers, directors, and shareholders must be cognizant of the fact that, if they exercise control over the Facility or have the authority to control the Facility's waste disposal practices, they may well incur personal liability with respect to the Facility's environmental claims.

B. *The Purchase Agreement*

The environmental conditions in our hypothetical transaction, associated with the Facility, both on-site and off-site, will have a significant impact on the purchase agreement from the perspective of both Seller and Purchaser. For the agreement to be comprehensive, Purchaser should ask Seller to make certain representations and warranties in the purchase agreement as to the environmental quality of the Facility. For example, Purchaser will clearly want Seller to represent that none of the Facility's hazardous substances has been sent to Superfund sites or to sites that are the subject of any investigations that may lead to environmental claims. Purchaser will also want Seller to represent that the Facility's hazardous wastes were handled and delivered to duly authorized and licensed carriers for disposal, in compliance with applicable environmental laws.

Additionally, Purchaser will want Seller to make certain representations concerning a number of issues, such as: (1) the presence of on-site contamination;¹⁵⁸ (2) the presence of asbestos and polychlorinated biphenyls at the Facility;¹⁵⁹ (3) the status of the Facility's compliance with applicable federal and state regula-

*12 (W.D. Mich. May 18, 1994); *Kelley v. Thomas Solvent Co.*, 727 F. Supp. 1532, 1543 (W.D. Mich. 1989); *Kelley v. Arco Indus. Corp.*, 723 F. Supp. 1214, 1219 (W.D. Mich. 1989).

157. For a discussion of these two standards, see *Robertshaw Controls Co. v. Watts Regulator Co.*, 807 F. Supp. 144 (D. Me. 1992).

158. Judith G. Tracy, *Beyond Caveat Emptor: Disclosure to Buyers of Contaminated Land*, 10 STAN. ENVTL. L.J. 169 (1991).

159. Matthew A. Melone, *Taxable Corporate Acquisitions: A Primer for Business and the Non-Specialist*, 25 U. TOL. L. REV. 673, 686 (1994).

tory requirements;¹⁶⁰ (4) the status of the Facility's environmental, health and safety permits;¹⁶¹ (5) the status of pending or threatened litigation with respect to violations of environmental laws; (6) the presence of underground storage tanks at the Facility;¹⁶² (7) the presence of liens on the Facility arising under environmental laws;¹⁶³ and (8) the presence of wetlands on the Facility.¹⁶⁴ To the extent the Seller is unable to make these representations, the relevant facts should be disclosed as exceptions in a schedule to the Purchase Agreement.

As mentioned throughout this Article, Purchaser should arrange to have a thorough due diligence investigation of the Target performed, which should include an environmental site assessment of the Facility. Ideally, this issue will be addressed in the Purchase Agreement by providing that Purchaser's obligation to close on the transaction is subject to the completion of an environmental assessment of the Facility by an environmental engineering firm acceptable to Purchaser.¹⁶⁵ Additionally, Purchaser should also require in the Purchase Agreement that Purchaser's approval of the assessment, as well as the report describing the results of the

160. Geoffrey D. Patterson, *A Buyer's Catalogue of Prepurchase Precautions to Minimize CERCLA Liability in Commercial Real Estate Transactions*, 15 U. PUGET SOUND L. REV. 469, 490-91 (1992); Tracy, *supra* note 158, at 224-26.

161. Patterson, *supra* note 160, at 491.

162. *Id.*

163. "All appropriate inquiry" includes "commonly known or reasonably ascertainable information about the property." 42 U.S.C. § 9601(35)(B) (1988). State and federal liens are considered to be included within that definition. Inderbitzin, *supra* note 45, at 518 n.11.

164. Development activities for wetlands and other water bodies are covered by the Rivers and Harbors Act of 1899, 33 U.S.C. §§ 401, 403, 407 (1988), and the Federal Water Pollution Control Act, 33 U.S.C. §§ 1251-1387 (1988 & Supp. V 1993). A permit may be required under one of these statutes for certain types of projects, sources and water bodies. 33 U.S.C. §§ 403, 1344. *See also* Sharon M. Mattox, *Regulatory Obstacles to Development and Redevelopment in the U.S.: Wetlands and Other Essential Issues*, in *THE IMPACT OF ENVIRONMENTAL LAW ON REAL ESTATE AND OTHER COMMERCIAL TRANSACTIONS* CA945 A.L.I.-A.B.A. 603 (1994).

165. *See supra* part III.A.

assessment, be prerequisites to the successful closing of the transaction.¹⁶⁶

Finally, the Purchase Agreement should include an indemnification section.¹⁶⁷ This section should provide, among other things, that Seller will hold Purchaser harmless against any liability resulting from any breach of Seller's representations or incident to any environmental claim arising out of the conduct of the Target prior to the closing.¹⁶⁸ The Agreement should also provide that Seller will defend and indemnify Purchaser for any such liability.¹⁶⁹ Seller is likely to insist that financial and temporal levels be set, which will trigger responsibility on behalf of Seller for the costs of a claim presented by Purchaser after closing. CERCLA-related claims are financially draining, however, and Purchaser may not have knowledge of such a claim until years later.¹⁷⁰ Thus, Purchaser should try to obtain indemnification from Seller that does not impose dollar or time limits on Seller's obligations to indemnify Purchaser.

A critical factor to be considered in this regard is that indemnification will provide Purchaser with protection only if Seller remains financially viable following the closing of the transaction. For example, the authors were recently involved in a transaction in which the purchaser was obtaining stock from a seller comprised of approximately forty different shareholders. This created a problem in securing an effective indemnification. The transaction was structured so as to provide that the purchase price would be paid in installments, with the last payment due at the expiration of the survival period provided for in the purchase agreement. This arrangement provided the purchaser with an adequate amount of comfort to proceed with the transaction.

166. See *supra* part III.B.

167. Elizabeth A. Glass, *The Modern Snake in the Grass: An Examination of Real Estate and Commercial Liability Under Superfund and SARA and Suggested Guidelines for the Reorganization*, 14 B.C. ENVTL. AFF. L. REV. 381, 439 (1987).

168. See *supra* text accompanying notes 158-164.

169. See Glass, *supra* note 167, at 439.

170. See *infra* text accompanying notes 172-174.

III. THE FACT FINDING MISSION: THE DUE DILIGENCE INVESTIGATION

The selection of the due diligence team is a vital step in the due diligence process. The risks involved in a commercial real estate transaction make the role of the due diligence team particularly important. The main function of the due diligence team will be the preparation of the Environmental Site Assessment.

A. *The Due Diligence Team and Its Goal*

To complete what might seem like a long and arduous process and, more importantly, to adequately protect itself both legally and financially, the purchaser's due diligence team should be formed as soon as possible. This team should, at a minimum, be composed of the purchaser's technical staff familiar with operations at the Facility, legal counsel, and an environmental consulting firm.¹⁷¹ The environmental consultant should be retained by the purchaser's counsel to protect, to the extent possible, the attorney-client privilege.

The team's mission is to analyze the information obtained about the Target and to quantify the potential liability if the transaction is consummated. The information that should be sorted out includes the legal issues affecting the Facility, such as pending litigation, as well as environmental, health, and safety issues such as on-site and off-site contamination, compliance with the Facility's permit parameters, and compliance with OSHA's standards.

Recall that operations at the Facility in our hypothetical transaction are industrial in nature. Thus, hazardous wastes are generated on a routine basis. It is important to realize that the purchase of such a facility is likely to involve some level of risk. Furthermore, while the goal of the due diligence investigation is to identify and quantify this risk, the task of precisely quantifying environmental risk under CERCLA is not possible for a number of reasons.

171. John L. Payne, *Environmental Auditing: Beyond Due Diligence*, in *THE IMPACT OF ENVIRONMENTAL LAW ON REAL ESTATE AND OTHER COMMERCIAL TRANSACTIONS*, C945 A.L.I.-A.B.A. 317, 324-26 (1994).

One reason that environmental risk is so difficult to quantify may be illustrated in the following example. If the Target's hazardous wastes were, in fact, sent to a Superfund site, the due diligence team would need to ascertain a number of factors, including how much waste was sent to the site, the Target's percentage of the total volume of waste, and the estimated cost of cleaning up the site. The extent of contamination at the site, however, may be difficult to determine.¹⁷² Furthermore, since remediation at the site may extend over a period of many years, it may be impossible to place a precise dollar amount on the percentage of the cleanup costs that will ultimately be allocated to the Target and other PRPs.¹⁷³ In addition, the Target may have sent waste to a site that has not yet been designated a Superfund site, but which may later be included on the National Priorities List. Thus, if the purchaser decides to go forward with the transaction, it must do so with the understanding that an "unknown" potential for liability will always accompany the deal.¹⁷⁴

It is important to keep in mind that many of the problems that are identified in the course of the due diligence investigation can be managed and solved in creative ways. The parties may agree that a portion of the purchase price be held in escrow for a specified period of time or that the purchase price be paid out in installments.¹⁷⁵ Another approach is to require the seller to purchase "First Party Pollution Cleanup/Environmental Remediation Insurance" coverage.¹⁷⁶ Although this type of insurance is limited in scope, in that it only covers government-mandated cleanup

172. See Bonnie H. Keen, *Tax Assessment of Contaminated Property: Tax Breaks for Polluters?*, 19 B.C. ENVTL. AFF. L. REV. 885, 898 (1992).

173. *Id.* at 898.

174. Chris M. Amantea & Stephen C. Jones, *The Growth of Environmental Issues in Government Contracting*, 43 AM. U. L. REV. 1585, 1628 (1994).

175. See Shawn R. Farrell, Casenote, *Leo v. Kerr-McGee Chemical Corp.: Recognizing a Need for Congressional Reform in Toxic Tort Actions*, 7 VILL. ENVTL. L.J. 109, 125 (1996).

176. See Julia A. Solo, *Urban Decay and the Role of Superfund: Legal Barriers to Redevelopment and Prospects for Change*, 43 BUFF. L. REV. 285, 300 (1995) (quoting Michael D. Zarin, *Who Pays to Clean Up the Property? Managing the Risks With the Insurance*, N.Y. L.J., June 6, 1994, at S8) (stating that, while it exists, such coverage is expensive)).

costs for a limited period of time, it can offer the purchaser a limited measure of comfort and protection. Again, the creative problem-solving approach, particularly in the practice of environmental law, can help move a transaction towards closing in a manner that is satisfactory to both parties.

B. *The Environmental Site Assessment*

In certain transactions, arranging for the performance of an environmental site assessment ("ESA") is a sensitive issue for all parties involved. For example, in auction sales, where the purchaser is one among many bidders, the seller may refuse to allow access to the facility, at least at the outset, in order to limit disruption to the facility.¹⁷⁷ Once the field has been narrowed down to one or two candidates, the seller may allow the potential purchaser or purchasers to visit the facility with their due diligence teams. A purchaser's bid may, in fact, be contingent upon the performance of a satisfactory ESA at a subsequent date.

In negotiated transactions, such as in our hypothetical transaction, the performance of an ESA is typically addressed early in the negotiation process. In preparing for the ESA, the first order of business is to identify the scope of the investigation. The actual performance of the ESA may take place in "Phases," commonly referred to as Phase I, Modified Phase I, Phase II, and Phase III, the remediation process.¹⁷⁸ Each Phase of the ESA widens the scope of investigation and requires the implementation of more invasive procedures.¹⁷⁹

While each transaction has its own particular concerns that require the attention of the purchaser's advisors, certain basic inquiries should be addressed in every ESA. To this end, the American Society for Testing and Materials has developed guidelines (the "ASTM Standard") for the performance of ESAs.¹⁸⁰ Adher-

177. For a discussion of the auction process, see Alan R. Kravets, *Going, Going, Gone! Real Estate Auctions in the 90s*, PROB. & PROP., May-June, 1993, at 38.

178. See PHASE I ENVIRONMENTAL SITE ASSESSMENT PROCESS, *supra* note 91, § 1.1.1.

179. *Id.*

180. *Id.*

ence to the ASTM Standard is important because it assists in satisfying one of the requirements of CERCLA's innocent landowner defense: the purchaser made all appropriate inquiry into the previous ownership and uses of the property.¹⁸¹

Under the ASTM Standard, Phase I has four components which the environmental consultant is required to follow.¹⁸² The first component consists of a records review. Information is gathered to identify potential sources of contamination in connection with the property and surrounding sites.¹⁸³ In addition, the environmental consultant will review current and historical aerial photographs to ascertain the previous uses of the facility in question.¹⁸⁴ The second component is a site reconnaissance. The objective of this is to obtain information that identifies recognized environmental conditions in connection with the property.¹⁸⁵ This component generally includes an inspection of the exterior and interior of the facility, a determination of the geological, hydrological, and topographical condition of the property, and identification, to the extent visually or physically observable, of the past and current uses of the property.¹⁸⁶ Interviews with the owners and occupants of the facility and local government officials make up the third component of the ASTM Standard.¹⁸⁷ Again, the objective is to try to gain information pertinent to the facility's history and age.¹⁸⁸ Finally, the fourth component requires the environmental consultant to prepare a report documenting his findings and the sources for his conclusions.¹⁸⁹

The scope of the Phase I ESA may be expanded into a Modified Phase I ESA. The Modified Phase I ESA should generally

181. 42 U.S.C. §§ 9601(35)(A), 9601(35)(B).

182. PHASE I ENVIRONMENTAL SITE ASSESSMENT PROCESS, *supra* note 91, § 6.2.

183. *Id.* § 7.2.1.

184. *Id.* § 7.3.4.

185. *Id.* § 6.4.

186. *Id.* § 8.4.1 to 8.4.4.7.

187. Stephen G. Hamel, *The ASTM Standard for Phase I Environmental Site Assessments*, 22 *COLO. LAW.* 2265, 2265 (1993).

188. Mark Halloran, *Environmental Site Assessments*, *PRAC. LAW.*, July 1995, at 61, 67.

189. *Id.*

include a more detailed characterization of the facility's operations¹⁹⁰ and its management practices.¹⁹¹ The final report should provide liability and risk evaluations and recommendations for managing the issues identified in the ESA.¹⁹² In addition, the report should provide recommendations for Phase II testing if it is deemed necessary.¹⁹³

If the environmental consultant concludes that there is potential for on-site contamination, he may recommend that a Phase II ESA be performed.¹⁹⁴ The techniques employed in a Phase II ESA will vary depending on, among other things, the physical conditions of the property, how quickly the results are needed, and the dollar limitations that may be imposed by the purchaser.¹⁹⁵ The performance of the Phase II ESA may, in turn, reveal that the on-site contamination is not significant. Alternatively, the Phase II may uncover very serious contamination at the site. If the contamination is indeed serious, remediation of the site will be required.¹⁹⁶ Whatever the results of the ESAs may be, the purchaser should take full advantage of this part of the negotiation process to obtain as much information as possible about the environmental condition of the site.

C. Protection of the ESA Report

Obviously, the ESA report may contain extremely sensitive information, and one would expect that its contents should remain confidential. It should, however, be noted that once delivered to the purchaser's attorney, the ESA report may be discoverable, notwithstanding the attorney work product privilege,¹⁹⁷ the attorney-client privilege,¹⁹⁸ and the self-critical analysis

190. The Phase I report addresses, for example, significant air, water and hazardous substances issues. *See id.* at 66.

191. Hamel, *supra* note 187, at 2266.

192. Halloran, *supra* note 188, at 67. *See also* Hamel, *supra* note 187, at 2266.

193. Halloran, *supra* note 188, at 67.

194. *Id.* at 67-68.

195. *Id.* at 68.

196. *Id.*

197. 8 CHARLES A. WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 2025, at 370-71 (2d ed. 1994).

198. *Id.* § 2017, at 266-70.

privilege.¹⁹⁹ For example, the ESA report will not be entitled to protection under the attorney work product privilege unless it was prepared in contemplation of litigation and, then, only the attorney's work product will remain privileged.²⁰⁰ In other words, the *facts* set forth in the ESA are discoverable.

The attorney-client privilege is meant to protect confidential communications between the client or the client's representatives and the attorney and the attorney's representatives in furtherance of the rendition of legal services.²⁰¹ The privilege may, however, be waived by the client, or may be lost if the privileged information is disclosed to a third party.²⁰² For example, if the results of the ESA are reported to a third party or to a regulatory agency through certain reporting requirements prescribed by regulation,²⁰³ this disclosure might be viewed as waiver of the attorney-client privilege.²⁰⁴

The protection provided by the self-critical analysis privilege is still evolving. In *Reichhold Chemicals v. Textron*,²⁰⁵ a case that was greeted with great enthusiasm by the business community, the District Court for the Northern District of Florida held that an entity's retrospective self-assessment of its compliance with environmental regulations should be privileged under certain circumstances.²⁰⁶ Specifically, the *Reichhold* court held that this privilege applied "only to reports which were prepared after the fact for the purpose of candid self-evaluation and analysis of the cause and effect of past pollution"²⁰⁷ The court further held that the reports would be entitled to the privilege only if they were created with the expectation that they would remain

199. 23 *id.* § 5431, at 346 (2d ed. Supp. 1995).

200. 8 *id.* § 2024, at 336-38 (2d ed. 1994).

201. 4 JAMES W. MOORE ET AL., *MOORE'S FEDERAL PRACTICE* ¶ 26.11[2], at 26-174 to 26-177 (2d ed. 1995).

202. *Id.* at 26-185.

203. *See, e.g.*, 40 C.F.R. § 302.6 (1995) (reporting requirements under CERCLA), § 264.56 (1995) (reporting requirements under RCRA).

204. MOORE ET AL., *supra* note 201, ¶ 26.11[2], at 26-185.

205. 157 F.R.D. 522 (N.D. Fla. 1994).

206. *Id.*

207. *Id.*

confidential and they had, in fact, been kept confidential.²⁰⁸ Finally, the court noted that this qualified privilege could be overcome if one or more of the defendants in the case could demonstrate extraordinary circumstances or a special need to obtain the reports.²⁰⁹

EPA recently addressed the issue of the self-critical analysis privilege. On April 3, 1995, EPA issued an interim policy statement on voluntary environmental self-policing and self-disclosure.²¹⁰ This statement was intended to promote environmental compliance by providing greater certainty as to the agency's enforcement response to voluntary self-evaluations, voluntary disclosure, and the prompt correction of violations.²¹¹ EPA's policy favors incentives over privileges.²¹² As such, environmental audits are not treated as privileged.²¹³ Instead, the policy provides that EPA will reduce civil penalties and refrain from making criminal referrals under certain conditions.²¹⁴ Essentially, the policy requires regulated entities which discover a violation through a voluntary environmental audit to disclose the violation to the appropriate agency when discovered²¹⁵ and to correct the violation within sixty days of such discovery.²¹⁶ The other conditions which must be satisfied are: (1) the entity must act expeditiously in remedying a condition that creates an imminent danger to human health and the environment;²¹⁷ (2) the entity must

208. *Id.*

209. *Id.*

210. Voluntary Environmental Self-Policing and Self-Disclosure Interim Policy Statement, 60 Fed. Reg. 16,875-879 (1995) [hereinafter Interim Policy] (stating that the policy seeks "to provide incentives for regulated entities that conduct voluntary compliance evaluations and also disclose and correct violations").

211. *Id.* at 16,876.

212. *Id.* at 16,878.

213. *Id.* at 16,876-878.

214. *Id.* at 16,877-878.

215. *Id.* at 16,877. Additionally, the violation must be reported "prior to (1) the commencement of a federal, state or local agency inspection, investigation or information request; (2) notice of a citizen suit; (3) legal complaint by a third party; or (4) the regulated entity's knowledge that the discovery of the violation by a regulated agency or third party was imminent." *Id.*

216. *Id.*

217. *Id.*

implement appropriate measures to prevent a recurrence of the violation;²¹⁸ (3) the violation does not indicate that the entity failed to take appropriate steps to avoid repeat or recurring violations;²¹⁹ and (4) the entity cooperates with EPA by providing requested documents, as well as access to employees during the investigation of the violation.²²⁰

It should be noted that a number of state legislatures have enacted laws creating a qualified privilege for ESA reports.²²¹ Acknowledging this trend, EPA's policy provides that, in order to maintain national consistency, the agency will scrutinize enforcement more closely in states with an audit privilege.²²² The policy also provides that EPA may increase federal enforcement where environmental self-evaluation privileges or penalty immunities prevent a state from obtaining

(1) information needed to establish criminal liability; (2) facts needed to establish the nature and extent of a violation; (3) appropriate penalties for creating an imminent and substantial endangerment or serious harm to human health or the environment, or from recovering economic benefit; (4) appropriate sanctions or penalties for criminal conduct and repeat violations; or (5) prompt correction of violations, and expeditious remediation of those that involve imminent and substantial endangerment to human health or the environment.²²³

Whether EPA's policy succeeds in its goal of encouraging voluntary disclosure of violations in exchange for immunity from certain penalties remains to be seen. For the time being, it is important to keep in mind that a company's environmental audit will not be considered privileged information under EPA's new enforcement policy.

218. *Id.*

219. *Id.*

220. *Id.*

221. Some of the states that have passed such legislation are Colorado, Indiana, Kentucky, Oregon, and Texas. COLO. REV. STAT. § 13-25-126.5 (Supp. 1995); IND. CODE ANN. § 13-10-3-3 (Burns Supp. 1995); KY. REV. STAT. ANN. § 224.01-040 (Michie/Bobbs-Merrill 1995); OR. REV. STAT. § 468.963(1) (1992); TEX. GOV'T CODE ANN. §522.124 (West Supp. 1995).

222. Interim Policy, *supra* note 210, at 16,878.

223. *Id.*

D. *Closing the Transaction*

At the completion of the ESA and other due diligence, the purchaser should have a fair idea of the risks and benefits that the transaction has to offer. Even if the results of the ESA are unfavorable, they may lead to further meaningful negotiations. The parties may consider changing the structure of the transaction, or reducing the purchase price to reflect an increase in potential environmental liability associated with the Facility. For example, in a recent transaction, the authors facilitated the closing of a transaction in which the facility in question had severe on-site contamination, by providing, in the purchase agreement, that the seller would remediate the site post-closing. This procedure shifted environmental liability in a manner that was acceptable to both parties and was essential to closing the transaction.

As previously mentioned, another avenue of negotiation might entail an escrow arrangement, pursuant to which, as a safeguard, a portion of the purchase price is held in escrow by a third party for a period of years following the closing. In the end, the purchaser may determine that it is not in its best interests to go forward with the transaction. Regardless of the purchaser's decision, the performance of an ESA will have armed the purchaser with knowledge critical to make an informed determination.

CONCLUSION

The parties to a commercial real estate transaction must be aware of the environmental issues that confront them. There are several laws, on both the federal and state levels, that the parties must consider. CERCLA will likely be the most prominent federal law in such a commercial real estate transaction. The broad scope of this law and its expansive liability scheme make CERCLA an important issue. The parties must also be aware of state laws, such as New Jersey's ISRA. The scope of these laws is not limited to the seller and purchaser. The lender must also ensure compliance with these laws. Failure to do so could lead to lender liability.

This liability scheme makes the allocation of risk of environmental liability between the parties a vital issue in a commercial deal. When structuring the transaction, the parties have several options. Regardless of how the deal is structured, issues such as

corporate liability, successor liability, and corporate officer liability must all be considered. The Purchase Agreement should be utilized by the parties to make clear to what extent each party will be responsible for environmental exposure.

The best way to limit the liability of the parties, however, is to learn as much about the subject property as possible, prior to the closing of the transaction. The due diligence investigation is an important part of this process. From the selection of the due diligence team to the preparation of the environmental assessment and the protection of the information therein, each step of the due diligence process should play a significant role in the commercial real estate transaction. It is important to remember that environmental issues need to be managed as any other legal or business issue, logically and systematically. The prudent purchaser must, therefore, realize that, under the current state of the law, environmental issues must be factored into the cost of doing business.