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ENVIRONMENTAL LAW

Asset Purchasers Can Take Reasonable Steps to Mitigate Risks of Successor Liability

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A popular acquisition structure for purchasers of ongoing business operations is through an asset purchase agreement. While an asset purchase is generally a preferred structure for minimizing the risk of environmental successor liability of the target business, an asset purchase structure does not automatically protect an asset purchaser from successor liability. This article discusses steps that an asset purchaser can take to minimize their risk of unwittingly succeeding to the environmental liabilities of the selling entity.

CAREFULLY DRAFT CRITICAL PROVISIONS IN THE ASSET PURCHASE AGREEMENT

The general rule is that a purchaser of assets is not responsible for a seller's liabilities simply because of the ownership of the assets. However, purchasers can be held responsible for the liabilities of the seller in certain circumstances. Purchasers should identify what creates risks of successor liability exposure and draft the asset purchase agreement to avoid them.

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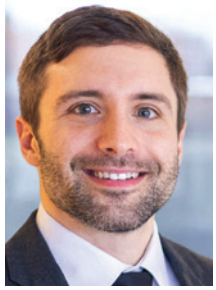

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As a general matter, there are four traditional exceptions to the general rule that an asset purchaser does not succeed to the liabilities of the seller. Those are:

- When the purchaser expressly or impliedly assumes the seller's liabilities.
- When there is a de facto consolidation or merger of the seller and the purchaser.
- When the purchaser is a "mere continuation" of the seller.
- When the transaction is entered into fraudulently to escape liability.

The first exception is one that counsel can generally draft around in preparing the asset purchase agreement, and the fourth is a rarity in practice. But the proper application of the second and third exceptions—which courts often treat as the same and analyze together—can often be not only highly fact-specific, but also jurisdiction-specific.

In CERCLA cases, federal courts differ in whether to look to federal common law or state law for the law on successor liability. And the choice of law determination is not only unsettled, but it can also be dispositive, as states do not always view the de facto merger and mere continuation exceptions similarly. Pennsylvania and New Jersey happen to provide a great example. In Pennsylvania, courts consider continuity of ownership (such as through a stock transfer from the buyer to the seller) to be critical. But New Jersey has endorsed a much more expansive view, allowing successor liability to be established in environmental cases even in the absence of common ownership, if the facts show that the purchaser intended to assume all of the benefits and burdens of the seller's business. Thus, in a recent federal court decision in New

Jersey, the court held that an asset purchaser was liable under the New Jersey Spill Act for environmental contamination that occurred during the seller's operations even in the absence of continuity ownership, where the purchaser held itself out as the continuation of the seller and where the seller itself was no longer around. See *Public Services Electric & Gas v. Cooper Industries,* No. CV2113644KMJBC (D. N.J. June 26, 2023). In Pennsylvania, the result would have almost certainly been different.

• Include Clear Language Identifying What the Purchaser Is Not Assuming

While it may not be possible to avoid some of the elements of the tests while achieving the business goals of the transaction, it is important to avoid needlessly creating circumstances that give weight to the successor argument. In particular, the purchaser should attempt to avoid expressly or impliedly assuming the general liabilities of the seller and should avoid paying the seller stock in the purchasing company as consideration for the sale (rather than cash).

• Avoid Purchasing Nonessential Assets

Avoid acquiring assets that are not important to the operation of the business or may result in significant remediation obligations. Taking title to excess real estate increases the chances that these properties may be the source of remediation liabilities and could strengthen the argument that the purchaser is acquiring the entire enterprise of the seller.

• Avoid Confusing or Conflicting Public Statements

Avoid statements to the public that characterize the transaction as an acquisition of the seller or a "merger"; and avoid statements where the purchaser holds itself out to the public as being a continuation of the seller. Those statements, which may be useful for public relations or marketing purposes, could be used years or even decades later as evidence to support a claim of successor liability. For example, in the New Jersey case cited above, the asset purchaser touted in its product catalogues, reports to shareholders and marketing materials that it had been around since the mid-19th century, even though it did not acquire the business operations at issue until the mid-1970s.

THOROUGHLY IDENTIFY AND EVALUATE THE ENVIRONMENTAL LIABILITIES OF THE SELLER'S BUSINESS

To understand potential exposure from the transaction, purchasers should conduct a thoughtful due diligence process that focuses on potential liabilities related to seller's business operations, focusing primarily on the business relating to the assets that are being purchased.

This should include evaluating historical, current and potential future environmental compliance issues, any known or potential site contamination at (and from) the sites where the operations have occurred, review of litigation against the seller's company, third-party sites at which the seller has been identified as a potentially responsible party or received some other kind of notice letter and understanding how Seller disposed of wastes generated at its facilities. If the asset purchase will include the purchase of real estate, it will also be critical to perform environmental due diligence relating to the site, which at a minimum should consist of conducting "all appropriate inquiry" to potentially qualify for the innocent landowner (ILO) and bona fide prospective purchaser (BFPP) defenses to federal liability pursuant to the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. Section 9601 et seq. (CERCLA). Pursuant to EPA regulations, "all appropriate inquiry" can be satisfied by performing a Phase I environmental site assessment that complies with ASTM Standard 1527-21.

> *"In acquisitions that involve the purchase of assets, it is important to draft the asset purchase agreement to minimize the risk that the purchaser will be considered the successor of the seller."*

Do not exclusively rely upon indemnities or risk-sharing provisions to shield the purchaser from liability to the government or other third parties. While beneficial in the right circumstances and with a creditworthy seller, such provisions only have value so long as the seller remains viable. In circumstances where the seller will be liquidating following the transaction, not only has one of the factors for successor liability been met, but there is no realistic recourse in the event liabilities arise.

TAKE STEPS TO AVOID SHIFTING REMEDIATION LIABILITIES TO THE PURCHASER

As mentioned above, if a purchaser conducts "all appropriate inquiry," it has the opportunity to establish a defense to liability as an ILO (Section 101(35)(A)(i) of CERCLA) or a BFPP (Sections 101(40)(B)(iii) and 107(r)(l) of CERCLA).

In either situation, the purchaser is subject to "continuing obligations" with respect to the property, which include no further disposal of hazardous substances, compliance with land use restrictions, not impeding institutional controls, taking "reasonable steps" to manage releases, and providing full cooperation and access to the property. Properties being remediated where the EPA has incurred costs pursuant to CERCLA may also be subject to EPA windfall liens. Some, but not all, states have parallel provisions providing purchasers defenses to liability for response costs. Whether a purchaser qualifies as a BFPP or ILO or has met its continuing obligations is subject to the enforcement discretion of the agency in question. This introduces risk for the purchaser.

The EPA and some states offer administrative mechanisms to limit or define this risk. This may include agreements to limit the prospective purchaser's liability for environmental cleanup of the property and provide contribution protection against claims by the agency and third parties. The EPA may also agree to release its right to a windfall lien. In return, the purchaser must take certain actions on the impaired property. These actions often take the form of restrictions to prevent activities that would result in exposure to contamination (institutional controls) and defined actions to cut off exposure pathways, such as capping contaminated soils (engineering controls). Such an agreement might specifically relieve the purchaser from responsibility for source remediation, groundwater remediation, and other similar obligations if the purchaser complies with the specific requirements of the agreement. Such agreements are usually negotiated in the context of brownfield redevelopment of properties but can be available in the context of a business transaction.

However, what the government offers may not be satisfactory if a distressed property will require the purchaser to conduct remediation where the cost of that remediation cannot be reliably estimated or, if estimable, are in excess of the value of the property in the transaction. The risk of excessive or undefined financial exposure can arise in remediation of emerging contaminants such as PFAS, excavation of large areas of contaminated soil, or remediation of groundwater at technically complicated sites. A purchaser should also be wary of onerous conditions in such agreements (such as stipulated penalties for noncompliance, unreasonable reopeners, or obligations to pay unbounded agency oversight costs). See the EPA's August 2022 model administrative settlement for removal action by prospective purchasers.

If the available arrangement with the EPA or state will not meet the purchaser's objectives, the purchaser can consider other commercial arrangements to avoid having the purchaser qualify as the owner/operator of the property or to provide security to cover the potential liabilities. The alternative arrangements can range from toll/contract manufacturing agreements and supply agreements, on the one hand, to representation and warranty insurance, pollution legal liability insurance, escrows and third-party guarantees, on the other.

CONCLUSION

In acquisitions that involve the purchase of assets, it is important to draft the asset purchase agreement to minimize the risk that the purchaser will be considered the successor of the seller, assess the potential exposure relating to the assets being acquired and the environmental liabilities of the seller and, for liabilities that are inherent in the transaction, take steps to define and limit the exposure. •

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