Webcast: Deal or No Deal: Recent Developments Impacting Environmental Due Diligence in M&A Transactions
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ASSOCIATION OF CORPORATE COUNSEL

Moderator: Vincent Gonzales
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Operator: Just a reminder, today's conference is being recorded. Please go ahead, Vincent.

Vincent Gonzales: Good afternoon. I am Vincent Gonzales, Senior Environmental Counsel for Sempra Energy and Chair of the ACC Environmental Health and Safety Committee. Welcome to today's Webcast entitled, "Deal or No Deal: Recent Developments Impacting Environmental Due Diligence in M&A Transactions."

This Webcast is a co-sponsored Webcast by the ACC, EH&S Committee, and the ACC Corporate and Securities Law Committee and is produced by the EH&S Committee sponsor, the law firm of Holland & Knight.

I would like to go over a few items before we proceed with our Webcast. First of all, please make sure that you are properly logged onto the Webcast and can see the presentation as well as hear me.

Please observe that on your screen you have the ability to type and send in a question or two to the panel during the Webcast. This is the question box located at the lower left hand corner of your screen. After you type in your question, click send.

Given the limited amount of time we have and depending on the questions received, I will plan to ask our panelists your questions towards the end of the Webcast rather than during the Webcast. Currently we plan to reserve about 10 minutes or so of this Webcast for Q&A.

Please note that the link box also located on the left side of your screen contains a number of links including the bios of our speakers and other reference material.

Identified as link number one is the Webcast evaluation form, which I would encourage you to complete and submit either during or after this Webcast. I also would like to remind those on the line that the ACC annual meeting for 2006, the registration, discounted registration deadline has been extended to September 15.

I would like to thank the law firm of Holland & Knight for its generous sponsorship of today's Webcast, especially our panelists, Amy Edwards and Jennifer Hernandez, for their countless hours spent in preparing for and producing today's Webcast.

I would also like to thank our two in-house counsel panelists, (Brian Hime) and Rose Murphy for giving us their time and energy as well as the benefit of their valuable insight and expertise in this area.

Finally, I would like to especially thank (Jacqueline Windsley), (Cap) Attorney at ACC and the facilitator of the EH&S Committee without whose focus and dedication this Webcast would not have been possible.

I would now like to introduce our panelists. (Brian Hime), the Senior Counsel for Environmental Health and Safety at International Paper and is based in Memphis, Tennessee. (Brian) is a graduate of George Washington University Law School.

Rose Murphy is Vice President and Associate General Counsel of Masonite Corporation and is based in Tampa, Florida. Rose is a graduate of Drake University Law School.

Amy Edwards is a partner in the Washington, D.C. office of Holland & Knight. She co-chairs the firm's environment team and is also a member of the firm's public policy and regulation group.

Not only is Amy a prolific author and frequent speaker on environmental law topics but she is also on the advisory board to B&A's environmental due diligence guide. Amy is also a graduate of George Washington University Law School.

Last, but certainly not least, Jennifer Hernandez is a partner at Holland & Knight where she also co-chairs the firm's environment team, dividing her time between the firm's San Francisco and Los Angeles offices.

She sub-specializes in Brownfields redevelopment and land use and teaches law school courses in those areas. Jennifer is the recipient of numerous professional and civic awards,

including the honor of having October 9, 2002, proclaimed by San Francisco Mayor Willie Brown as Jennifer Hernandez Day. Jennifer is a graduate of Stanford Law School.

Without further adieu, I'd like to pass this on to Amy Edwards, our first speaker. Amy?

Amy Edwards: Thank you very much, Vince. It's with great pleasure that we're going to take you through a speed course of environmental issues and M&A transactions. And there is a lot of material referred to in the reference documents that goes beyond what we're going to be able to cover today. So we encourage you to look at those materials.

As I'm sure all of those on the phone understand, environmental issues are frequently quite material to transactions. And one of the keys is trying to find transactional solutions for these issues in order to accomplish the deal.

We're going to be covering in particular some of the more novel issues that have arisen in recent months and years, particularly new environmental disclosure obligations where the concerns about disclosure have been heightened in light of the Sarbanes-Oxley law, the FIN 47 guidance, as well as a recent SEC enforcement action that was taken against Ashland.

We also want to briefly talk about the new environmental due diligence rules that are going into effect as a result of the Brownfields Amendments of 2002 and EPA's final all-appropriate inquiry rule which goes into effect on November 1st of this year.

We also want to be sure that you're aware of the transactional implications of a Supreme Court decision known as Cooper v. Aviall which was decided in December of 2004, which is

having an impact on liability allocation negotiations as part of environmental due diligence transactions.

So with that brief overview we're going to go into some of the general overview on the purpose and scope of environmental due diligence. Obviously one of the first thing that needs to be accomplished is to identify any material environmental conditions with, or constraints, that might affect the party's willingness to go forward with the transaction.

And one of these concerns tends to be legacy liabilities. And we're going to have commentary from our fellow panelists on how these issues arise in national transactions.

And I want to turn the microphone over briefly to (Brian) to talk a little bit about indemnities that have arisen in prior deals that he has worked on.

(Brian Hime): Without trying to tell too many war stories, what Rose Murphy and I are trying to do is bring some real world experiences of some of these issues. And as far as legacy liabilities, what I want to advise folks here is that you're looking at – from a buyer's perspective when you're looking at a target company, you're looking not just at that company but the history of that company.

And you're playing the part of a detective. And you look at, you know, what indemnities that target company had given in prior deals. And you can ask for copies of prior asset purchase agreements. You can on the Web and see prior filings.

And you just want to make sure that you're not buying a company or an asset that may have given indemnities in the past that dwarf the value of the company that you're buying.

And it's just a note of caution from experience that you want to go back and maybe, you know, 10, 20, 30 years of indemnities that you're buying and you just want to make sure you're aware of those before you close the deal.

Amy Edwards: Thanks, (Brian). One of the other things that becomes material as you're doing your environmental due diligence is to try to identify any ongoing liabilities that may be present or areas of non-compliance that may effect the overall advisability of going forward with the acquisitions. So that's obviously another purpose of the environmental due diligence process.

Another issue that comes up that we'll talk about in greater detail is if there are plans to expand or to modify a facility, whether there might be any regulatory or environmental impacts and constraints that would affect the ability of that facility to be expanded or modified in the manner that you would like it to be modified.

And Rose is going to offer a couple of comments on that point.

Rose Murphy: Thanks. One of the things that I've run into before is that you have to have a good understanding of what management wants to do with the facility.

We recently acquired a facility and what management really had in mind was expanding to put in a second line. So what we had to be careful of is that the air permits and the other

environmental permits that would impact our ability to do that expansion were broad enough to either allow it – and actually in this instance we were lucky that we discovered that they were not so that we did have to go back to the state and discuss with them the economic impact or whether it was even feasible for us to do the expansion.

So one of the things I would really advise people on the line is make sure that you understand the full management objectives. And even if they don't plan on expanding right away, at least warn them or advise them about the potential restrictions.

Amy Edwards: Thanks, Rose. As you can see, we're trying to give you some of the real practical implications of whether it makes sense to go forward with a particular acquisition because there may be issues such as substantial contamination on a site or it's the presence of wetlands or other kinds of protected species as just some of the examples that might impair your ability to do what you intend to do with a given facility.

We're going to move on to some of the other purposes and scope of environmental due diligence. One obviously is to satisfy any environmental disclosure obligations that the company may have.

And we'll talk a bit about Sarbanes-Oxley in a few minutes. But there is increased concern about the need to disclose potential environmental liabilities in this day and age. Greater shareholder attention to those issues and the environmental due diligence process can be quite critical in making sure you identify those potential obligations before obviously you are in the middle of knowing what those issues may be so you go in informed.

Similarly there are fiduciary duties to shareholders so that the environmental due diligence process can be quite critical in making sure you understand what the nature of those duties are and obviously comply with those duties to your shareholders.

And finally the environmental due diligence process is used to try to figure out what kinds of regular – what regulatory and transactional tools may be available to help resolve these issues and to make the deal make sense for you.

So obviously you're accumulating information as you go along and trying to figure out a transactional and a regulatory process for making the deal make sense as you plan to go forward.

With that we're going to move into some of the preliminary considerations that may affect both the scope of the environmental due diligence process and how you want to structure the deal.

And one of the key considerations is what kind of deal is it? Is it an asset purchase? Is it a stock purchase? Is it a real estate acquisition because the nature of the environmental due diligence may vary to some degree but depending upon how the transaction is structured.

So we'll start with an asset purchase. Typically in an asset purchase the purchaser is more able to shield itself from any liabilities that the seller company may have because those liabilities don't automatically pass to the purchaser as part of the acquisition.

And Rose, I believe you wanted to offer some commentary here.

Rose Murphy: You know, one thing that I've always been careful of, because we have run into this before where you think if you're doing an asset purchase that you're protected. I still think that in certain areas you should spell out retain liabilities and indemnities pretty clearly in your transactional documents even if it is an asset purchase.

I've ended up in litigation over asbestos cases in a facility that we purchased as a – it was a continuation of the enterprise. And under the state law where we acquired it, it was fine. But in the – you know, we would not have liability.

But there came into question whether or not that state's law would apply or the state in which the asbestos case was filed. So I'm a big fan of going ahead, putting in your retain liability section in the contract as well as making sure it's very clear that the seller will indemnify you as the buyer for past environmental or, in this case, asbestos injuries and liabilities.

Amy Edwards: Thanks, Rose. And obviously there are ways in which you can structure even an asset purchase where the courts would find that you, as the purchaser, still had liability.

So – and the case law can vary quite substantially from jurisdiction to jurisdiction. So all that needs to be assessed fairly carefully up front if you, as a purchaser, are trying to avoid potential liability that is on the seller's watch at that point.

So look at whether the case law would suggest that the kind of transaction you're engaging in would be considered a de factor merger or a continuation of the prior enterprise.

And obviously if there's an express assumption of the seller's environmental liabilities those will, in fact, pass to the purchaser. Or if there's any allegation that it's been a fraudulent transfer in order to try to cleanse the facility from the seller's liabilities, those liabilities will, in fact, pass to the purchaser as well.

So moving on from that, we were going to talk a little bit about a stock purchase and how does that differ from an asset purchase. And again, how does that impact the overall environmental due diligence process.

With a stock purchase, you, as the purchaser, are essentially stepping into the seller's shoes. So you clearly want to know what kinds of liabilities the seller may have because there's virtually no way that you can insulate yourself from that seller's liabilities.

So the environmental due diligence in a stock purchase is quite different than it would be in an asset purchase where you may feel that you may be able to insulate yourself from the seller's liability.

And the third type of transaction we wanted to talk about is just an outright real estate purchase. In that instance – and we'll be talking a bit about the new rules governing potential liability and how a purchaser might be able to relieve themselves from potential liability.

There is a new emphasis on trying to conduct what's known as all appropriate inquiry in accordance with EPA's final rule that goes into effect November 1st of this year and the

updated guidance offered by the ASPM on conducting phase one environmental site assessments because there is an ability under amendments to the federal super fund law that were enacted in 2002 to potentially qualify for a very broad-based exemption from liability known as the landowner liability protection.

So that becomes – that's a reason why parties are perhaps more concerned in this day and age to try to do fairly stringent due diligence to try to qualify for these liability protections that were enacted in 2002.

And (Brian), did you want to comment on that a bit?

(Brian Hime): Well, it's important to try to see if you can qualify for one of the landowner liability protections. You have to keep the size of the deal in mind.

International Paper just recently sold millions of acres of land. And it was virtually impossible for a buyer to qualify for any of these protections, (sort of, in the AII).

One mechanism the buyer has tried to use in qualifying for these protections is by trying to get environmental consultants to sign off on that they've engaged in a phase one in accordance with (11527) or some other standard.

Consulters may be willing to sign off on saying that they have met those requirements under the ASTM standards. However, what you'll find is that consultants also will put limiting caps on their exposure.

So for example, I mean, most of my consultants have been unwilling to give anything over $100,000 in indemnities for the work. So if you're talking about a multi-million dollar deal with potential millions of exposure if environmental contamination is found, you know, environmental consultants' indemnity or basic malpractice insurance is not going to be worth a whole lot.

So you have to be aware of the size of the deal. And if you don't think you're going to be able to meet the standard, you want to assess how much money you really want to spend on the due diligence side of things.

You know, you might be able to get it halfway there and that's enough. And so it's just something to keep in mind that the size of the acreage can very much affect whether you can comply with the landowner liability protection standards.

Amy Edwards: Thanks, (Brian). And we wanted to raise a couple other issues that will come up while you're doing your environmental due diligence. One of these concerns is confidentiality issues.

Frequently when transactions are being planned, the seller may not want its employees, its neighbors, its tenants, or the regulatory agencies that have jurisdiction over the site to know that the company is being acquired.

And similarly there is a need to frequently enter into a confidentiality agreement with the purchaser. And Rose and (Brian) wanted to offer a few comments on this issue as well.

Rose Murphy: (Brian), do you want me to kick it off?

(Brian Hime): Sure. Go ahead.

Rose Murphy: It is important to have a confidentiality agreement in place. But what I found in virtually every deal that I've done is you enter into your confidentiality agreement. You review certain information that's provided to you by the seller.

And after you've done some preliminary review based on what the seller will provide you, you enter into either a letter of intent or actually a purchase agreement. But both of those should be subject to due diligence.

And it is usually after you've entered into the agreement, kind of cut off some of the business terms in the deal that you do your environmental due diligence. And then that would impact the price, either positive – well, usually negatively for anything that may surface during the due diligence.

But that due diligence always happens after you kind of have an idea that you have a deal. And at that point you go to the, you know, you go to your regulatory agencies, your employees, your neighbors, your tenants, and advise them because it would be almost very, very unlikely for you not to want to talk to the regulatory agencies as well as all of these other parties as part of your due diligence.

(Brian Hime): At the same time if in the due diligence the buyer learns of an issue that is a compliance issue and that you, the seller, weren't aware of and the buyer expresses a desire to

discuss with a regulator how the (ENC) may react to this compliance issue, the seller wants to control the right to share that information with the regulatory agencies before a buyer goes and discusses it with the agency.

And what the seller will find is, you know, if you have a violation, you want to bring it to the agency's attention before the sale and while you're maybe still operating in that state because once the seller leaves the state and the agency wants to enforce it on you, they're not going to give you a whole lot of leeway because now you're (lost). They're not concerned about protecting any jobs you might have. And the agencies typically will come out harder on you after you've sold the asset than before.

Amy Edwards: Thanks, (Brian). And one other issue we wanted to raise at this stage was the disclosure issues that may be raised as part of the environmental due diligence process.

This can vary from state to state and jurisdiction to jurisdiction. But there are several different areas in which the disclosure issues may become important. One is whether you learn something through environmental due diligence that enhances what you need to report for the SEC as part of routine disclosure.

Similarly, because of the need to comply with release reporting obligations by a purchaser that's trying to qualify for one of these landowner liability defenses, they will be more insistent upon reporting releases than they might have been in a different day and age.

Third, in some states there are very clear disclosure obligations as part of transfer of real estate, such as the New Jersey Industrial Site Recovery Act or Connecticut has a similar statute.

So if you're operating with potential deals in those jurisdictions then there is that additional force that is going to trigger environmental disclosure obligations. And there may also be regulatory process implications, such as what (Brian) was just referring to, where a purchaser in particular who's concerned about compliance issues by the seller may feel a need to get in and start talking with a regulator about how best to fix those problems.

And finally there may be some additional employee right-to-know issues, depending upon what you find in the environmental due diligence process. So that, too, may trigger some additional disclosure obligations.

(Brian), did you want to talk about that a bit further?

(Brian Hime): You mentioned the transfer act here. And if anyone's had the pleasure of selling a site in New Jersey or Connecticut you may have had to deal with these transfer act requirements.

And all I have to do is caution everyone if you haven't had the pleasure of dealing with these acts that it'll take twice the amount of time that you expect to deal with the disclosure requirements with the transfer act as well as closing out the sale under state regulations.

So just be prepared in New Jersey and Connecticut and elsewhere potentially that you're going to have some challenges to comply with the transfer act requirements just administratively.

And also as far as disclosure goes there in your deal, you know, you may learn of new matters that you previously had not disclosed in 10-Ks or annual reports. And when you sell an asset – this is for a large public offering or public sale.

When you sell an asset there are firms out there and there are individuals looking for opportunities to compare annual reports against your asset purchase agreement that you've registered online. And I'm looking for inconsistencies between annual reports and sales agreements and looking for a potential for shareholder derivatives.

So make sure that if you're finding things in the process early that you're – the question was do you have to make any amendments to your annual reports to make them consistent with your sale agreement.

Amy Edwards: Thanks, (Brian). And with that we're going to turn over the microphone to Jennifer Hernandez to talk a bit about the actual process itself.

Jennifer Hernandez: And the process itself really is something that will vary tremendously, I think, both by the size of the transaction being contemplated and by the size of the entities that are engaged in the transaction.

But as a general matter, the first challenge is to figure out who should be on the environmental due diligence team and how that team should (lias) with the transaction negotiation team.

Generally the buy and sell sides tend to have an EH&S specialist manager within the EH&S function inside and sometimes outside environmental counsel. A business person who would really be more responsible for overall transactional questions and likely the liaison to the transaction team and then the various plant managers or designated on the case of the buyers, designated possible plant managers, to figure out nuts and bolts issues as we see them.

And then outside consultants, particularly those doing a phase one, phase two-type contamination work, and sometimes depending on the business objective that Rose mentioned, even biology consultants or wetland consultants or surface water consultants who tend to valuate transactional or facility expansion opportunities and constraints, if that's a key part of the business deal.

We often organize these teams around the work products that have to come out of the due diligence process, the work product that will meet disclosure needs, that will inform the business folks as they go through the negotiation process, and make assignments within the team based on the work product that has to come out.

The second thing that often comes up is what are we going to look at? Or on the sales side, what are we going to have to compile? This has gotten to be very complicated in the age of e-mails and dozens of (straps) before anything goes final.

I think a big challenge, especially the sales side, is whether to confine what's disclosed with the appropriate, you know, agreement that is, in fact, the limit of what's disclosed or to try to do a data dump. And if so, and it is a data dump, how far back in time and how to physically make the information available.

Central repositories where buyers, or prospective buyers, go to one seller location or multiple seller locations at each facility are, I think, still the most common feature. Hard copies of documents tend to wander around a little bit, are hard to retrieve. Similar with CDs.

But I think the most popular new approach is to set up secure Web sites. And (Brian), I think you wanted to talk a little bit about how that works.

(Brian Hime): Over the past year, IP's used several Web sites in large transactions. And it's been absolutely fantastic. One key feature that you may want to know about is that when someone adds a document to the database those on the distribution list are, receive an email off the Web site notifying what document has just been added.

And it's usually in a category. For example, an environmental document, would be sent to me and all the members of the environmental team. And it's been a fantastic resource. And I would certainly encourage anyone on a decent sized deal to explore the use of a Web site in combination with an email notification service.

Jennifer Hernandez: And the cost of that service is definitely decreasing and…

(Brian Hime): Sure.

Jennifer Hernandez: …is more feasible on smaller deals now. Going to the next slide then is identifying individuals with knowledge that's relevant to the company's representation and warranties.

The issue really here is first off the scope of any reps and warranties. And as we'll discuss in a minute, the seller interest is in very much limiting reps and warranties. And the buyer interest is in getting more reps and warranties.

But an early question that comes up is on what level are these reps and warranties being given? At the truly operational level where a supervisor, the night shift, will or won't have knowledge of a past release or is it all the way at the top of the ladder with the senior official who is unlikely to know even routine enforcement matters that have been handled without the adverse press and without reaching any materiality claim but nevertheless are materials of environmental condition.

Generally speaking we find, I think, that the disclosure line comes down as far as the EH&S director and plant personnel. But again, this varies by the size of the deal and is an issue that I think has to be worked out fairly early on.

The next issue is really the list of assets to be assessed. This is going to matter a lot on all deals. But increasingly for portfolio deals, whether surplus real estate or for operating sites

we have transaction structures that at least at the early stages have some opt-in rights or opt-out choices for assets that don't make the cut.

Those are very important to the pricing strategy as well as the overall transactional structure. And obviously the due diligence process is going to vary if there's a significant opt-in or opt-out choice.

An equally tricky issue, especially in the forms of transaction that result in success reliability are what to do with formerly owned facilities; that is to say facilities owned by the seller or formerly owned by the seller that have now passed on. The seller has no real access to get into those facilities and probably has a relatively limited (sale) set of documents related to those earlier-disposed of facilities.

(Brian), did you want to talk about that a little bit?

(Brian Hime): You know, it – the formerly owned facilities do create a unique challenge. In an asset purchase agreement you would say, well, just carve them out. They won't be part of the deal.

And as long as the seller gives you a decent indemnity from those formerly owned facilities, the buyer may be fine with that. But the buyer does have to be aware under the continuity of business theory that if, for example, the seller goes under and then the formerly owned facility is bankrupt or is no longer in business, the buyer might be tagged with success of liability there.

So if the seller – if you think the seller is going to be around for a while and is going to be able to back the indemnity then you probably don't have to assess those formerly owned facilities or take a too close look at them.

However, if it's a (fire) sale and you don't think the seller's indemnity is going to be worth much then you, the buyer, should be taking a look at those formerly owned assets or formerly closed assets to see whether that if there's potential environmental contamination there that could follow the liability of the business back into your purchase.

Jennifer Hernandez: And I think a similar analysis, thank you, (Brian), applies to formerly owned or formerly used, rather, disposal facilities versus currently used facilities. And that obviously also relates to the nature of the asset acquisition or stock acquisition strategy for the transaction.

But in general we're still seeing a strong desire, a prudent desire, to look at disposal facilities used at least over the recent period, 20 to 30 year period where there's a continuity in business enterprise or stock acquisition transaction contemplated.

The next issue we'd like to get to is probably something that takes a fair amount of time to work through in most of the transactions I work on involving reuse of property. And that's the issue of onsite quantitative data and the inevitable lease by buyers that there'll be data gaps that need to be filled before the transaction can really be fully structured or closed.

The purchasers generally are looking for the right to conduct sampling. Although sometimes are fine and generally should be fine with the right to ask the seller to engage in additional

sampling in order to quantify the risks and costs of potential clean-up obligations and satisfy some of the defense requirements under the Brownfield Amendments of 2002.

(Brian), did you want to talk a little bit about the sellers' control of sampling?

(Brian Hime): Well, again, this goes to the size of the deal and size of the parties involved here. When you have a seller like International Paper we'll say you're more than welcome to do sampling after you control the property and we'll give you a couple years, maybe, to do some sampling after the fact and in order to move the deal along.

Any time there's going to be sampling that's going to close, it's going to slow the deal down tremendously. If you're dealing with smaller parties, a mom-and-pop gas station owner, well, you're going to want to do sampling before the sale.

And if the seller isn't willing to allow that sampling then the (envirotech) will walk. But be prepared for a sophisticated seller to want to have some control over the sampling. We'll want a very clear sampling of protocols and for one (of rep), you know, the buyer to provide some rational for why they want to do the sampling.

So, you know, large industrial complex you'll have less sampling allowed prior to the deal just because of the nature of the facility. Smaller complexes you should be able to get some sampling done.

Jennifer Hernandez: And this is an issue where there are also sometimes fairly creative approaches brought in from the real estate development industry which, for example, on the buy side

will engage in sampling activities and then simply have the right to walk from the deal but no obligation to disclose or provide the sampling results to the seller.

And that can sometimes patch a seller concerned about having a reportable event come out of the due diligence process. The seller never provides the information to the seller – the buyer never provides the information. The seller doesn't have it. The seller doesn't report.

That's a freaky real estate move.

Going on to regulatory agency discussions, these are probably among the most sensitive both political and legal issues that come up in the environmental piece of the due diligence process which is the very, very important dialogue that buyers want to have with regulators so that they fully understand what they're getting into.

Rose, did you want to make some preliminary comments on that?

Rose Murphy: Sure. On the seller side obviously you want to be part of any discussion that's going on with the regulatory agencies. But on the buyer side, and I've been fortunate to be on both sides of this, you absolutely want the right to be able to talk to the regulatory agency directly in order to find out what their thoughts and feelings are about the property and especially if you're looking at any kind of expansion at that property.

Jennifer Hernandez: And that can definitely have a material effect on the relationship between the regulator and the seller if the regulator has a sense that they've got a little more leverage than expectations on when and what might occur may, in fact, change.

So there is a risk associated with having a regulatory agency discussion to the seller. But frankly to get the deal done it's generally not just appropriate but necessary.

There are also regulatory tools that are quite important to some kinds of transactions in the Brownfield world. One of the most effective tools, a perspective purchaser agreement, is actually a binding legal arrangement with the regulator about what the obligations regarding cleanup are to the buyer.

The classic due diligence question will revolve around whether the buyer can appropriate ascend itself from a regulatory agency requirement, for example, to do well water cleanup, with the understanding between the buyer and the seller that the seller will stay on the ground water side and the buyer will only do soil, if and as needed.

Having that (field) less by the regulatory agency is often really important. And a prospective purchaser is one of the – prospective purchaser agreements is one of the tools that can make that happen.

Vincent Gonzales: Jennifer, this is Vince Gonzales. Sorry for interrupting. I was wondering if we can speed things up a bit since we're running …

Jennifer Hernandez: Sure.

Vincent Gonzales: …about 10, 15 minutes late. I'm sorry.

Jennifer Hernandez: No problem. Well, on the sale side for the due diligence checklist the ideal is, you know, an as-is transaction with full releases to the seller, even indemnities, goodness, to the seller from the purchaser with, of course, no discount in pricing.

That virtually never occurs, at least I assume on the scale of transactions that we're talking about here. But because that's a desired objective that leads to a variety of transaction wish list items on the sale side, which is, we'll see, on the next slide really is the inverse for the buy side.

Just a couple things, we'll speed it up here, is one of the most common features of the sell side transaction structure that patches a bunch of questions about liability is the notion of prohibiting changes in use of the property that's being transferred without obtaining either approval from the seller for that change or with a preordained acquisition of the buyer of all the liabilities associated with the change in use.

That's a very, very frequent field term now with industrial properties that move into the market. And of course their designed to have the buyer pick up both the cost of the change in use as well as the increased value.

Rose, did you want to talk a little bit about pollution insurance?

Rose Murphy: You know, in the effort of speeding things up, I'm going to take a pass.

Jennifer Hernandez: OK. Amy, do you want to then pick up buyer due diligence?

Amy Edwards: Sure. As Jennifer just mentioned, if you're sitting on the buyer side of the table you're trying to get the opposite of what the seller is typically willing to offer. So you're trying to get very, very broad environmental reps and warranties so if you find some hidden surprise down the line you have a basis of going back in contract.

Or similarly if you do find environmental contamination issues as part of due diligence you're looking for an ability to basically keep the seller on the hook to pay for those. And we'll talk in a minute about some of the mechanisms.

And as a purchaser where you may be planning, perhaps, sporadical changes to the property, you want as much ability over both the timing of cleanup and the type of cleanup to make sure that the cleanup is consistent with your future use of the site.

So a seller may – let's say it's an industrial property. They may have an interest in trying to keep any cleanup limited to industrial use standards. But if your company is planning to build condos then as the purchaser then what is done from a cleanup perspective is very critical to your future plans for this site.

So that affects both the amount of due diligence you can do and your interest as a purchaser in trying to do phase two work as well. And so let's assume you do find a few problems during your (normal) due diligence. How do you address that as part of the negotiation?

We're seeing a lot of very different types of tools used in these fields. Escrows are still used to some degree. But we'll find – I think everyone on this call has found that they're sometimes somewhat unwieldy.

Indemnities are certainly not as long lasting or as broad as they may have been in deals 10, 15 years ago. But we still see indemnities in transactions.

Sometimes pollution legal liability insurance is used as a mechanism to address particularly unknowns on a site. Or another type of environmental insurance product, known as a cost cap insurance policy or another variation on that, where a contractor comes in and guarantees the cleanup for a fixed price are additional ways in which these issues can be addressed as part of the deal structure.

Female: And then the old favorite always is trying to get as much of a reduction in the purchase price to address the fact that you as a purchaser are going to be dealing with contamination that you have identified during the due diligence process.

(Brian), I think you wanted to talk a little bit further about escrows. (Brian)?

Female: (Brian), please go ahead.

(Brian Hime): Sorry about that. I had you on mute. The escrows work when you have a clearly identifiable definable environmental issue. And when you're dealing with public companies, if an environmental issue is definable and your costs are pretty much (assignable), the seller can't really make much of an excuse as to why an escrow should not be given because arguably the seller's going to have to reserve for that environmental liability after the sale in any event.

So if you are the buyer and you really want that escrow set aside, that's one argument to use on a seller where the seller is a public company saying, "The seller's going to have to reserve for this anyhow so why not just put it into an escrow?"

Just a negotiating point you might want to consider.

Amy Edwards: And then one other issue that tends to come up is whether the cleanup should occur prior to closing or post closing. And one of the reasons why this issue has become so important is a Supreme Court decision that came out not quite two years ago where it's become much more difficult for a purchaser who, quote, "voluntarily cleans up a site," to recoup those costs from any other party that might have liability for those costs.

So it's both put pressure – the Supreme Court decision has put more pressure on doing more due diligence but also trying to find some type of mechanism to deal with those response costs as part of the negotiated deal because it's going to be much more difficult to recoup those otherwise through some kind of subsequent litigation.

I just wanted to briefly cover some of the different types of standards that exist that deal with obtaining or doing environmental due diligence. And this goes back again to the type of deal that is occurring, whether it's a straight real estate purchase or whether it's a stock acquisition or an asset acquisition.

So for example with real estate acquisitions those phase one environmental site assessments are done in accordance with the ASTM standard E1527. And the most recent version is version 05.

And it's obviously important for a purchaser to have the ability to rely on that due diligence document and that the document be relatively recent, i.e., typically within six months of closing of the deal.

If instead you're acquiring a company through a stock acquisition and are concerned about picking up the seller's liability you may want to be conducting an environmental regulatory compliance audit instead.

And there is a separate ASTM document, E2107, which describes the general process for conducting a regulatory compliance audit.

And third, in terms of ongoing operational issues, doing environmental management systems in accordance with the ISO standards may be very important to you as well. So we just wanted to be sure you were aware of these different types of guidances that exist that might govern what type of due diligence is appropriate.

On this next slide we wanted to talk a little bit about the basic dos and don'ts that go beyond what we've covered so far. And we're going to let (Brian) and Rose talk a little bit about some of the basic things they've learned in doing due diligence in transactions.

(Brian)?

(Brian Hime): This is (Brian). But I think this slide speaks for itself here. And I think we can just let it speak for itself.

Rose Murphy: I agree.

Amy Edwards: OK. We'll move on. And on this next slide we're going to talk just a little bit about SEC disclosure obligations and how those have changed in the last few years. Now Jennifer's slide.

Jennifer Hernandez: Well, in here the new disclosure obligations are worthy of day-long seminars in and of themselves. We just wanted to bring to your attention the fact that first these are obligations that apply to even real estate deals and certainly to M&A transactions.

As a general matter these are disclosure obligations designed to inform everyone on a more or less even playing field of material in environmental issues that would affect value or performance or other economic indicators for a company.

A couple really quick high points, the SEC filings that need to now be made are all about materiality, materiality in legal proceedings and certainly known trends in the (F statement 103), for example, trends leading to…

Vincent Gonzales: I'm sorry, Jennifer. I could hardly hear you. Could you please speak up.

Jennifer Hernandez: Sure. Sorry. Known trends leading to environmental expenditures or environmental liabilities that are publicly known.

The Staff Accounting Bulletin, SAB-92, really is all about the need to put a number around an uncertainty. Often environmental obligations or liabilities have an uncertainty range. In earlier days that uncertainty kept any kind of quantitative disclosure from happening.

You'll see that many of these now disclosure obligations are aimed at trying to get you to put a number on record, even if it's an estimate with appropriate qualifiers.

And given the time pressure I'd also like to commend to you the, I think it's number five on the link site, a very nice and quick summary paper (Bonnie Kauflin) in our firm did to disclose these environmental obligations relating to SEC disclosures.

Next and almost last on this topic is asset retirement obligations. This is sort of the big new thing. 1047 is the most well-known of them. And it really requires what amounts to a (rigorous) style closure, disclosure to be made if you know at some fixed point that your facility is going to have to be closed and cleaned up or decommissioned.

And that's required by existing legal requirements. You're obligated now to disclose the fact that you've got that obligation and estimate in that present value term the estimated cost of achieving or complying with that obligation.

Finally just touching on a couple other quick things, there's a lot of activity legislatively on global warming. California just adopted a big new global warming bill where I'm from. And I think we're going to see that as these global warming issues turn into legal obligations that the market will demand disclosure.

As long as they're not yet legal obligations, it's certainly trend information worthy of disclosure so probably not quantification yet.

Finally a touch, just a word on SEC enforcement. Many of these requirements have been on the books for a while. But in the absence of enforcement I think it's fair to say that a number of companies haven't taken them all that seriously.

The big new enforcement case is against Ashland. It's the first SEC enforcement action that was (typed) 10 years plus. And I think it sent quite a signal to the market that these are not to be ignored.

Amy, do you want to continue on?

Amy Edwards: Yes. We've covered a lot of the material in the next three slides. I'm just going to brief through it. Once again, there were amendments to the federal super fund law in 2002 that created or amended potential liability defenses to the broad base liability scheme under (cirqua).

And a lot of what is happening in environmental due diligence today is because of parties' efforts to try to qualify for one of these liability defenses.

Similarly as I mentioned there are additional obligations to preserve those defenses. So not only is it important to do environmental due diligence, otherwise known as AAI, all appropriate inquiry, but there are other obligations which you will probably see purchasers

asking for information, such as the need to cooperate, the need to report releases, the need to comply with land use restrictions and institution controls.

And this murky additional area of taking reasonable steps and exercising appropriate care after closing on the transaction to prevent releases and threaten releases, which is an area where we're going to continue to see a lot of emphasis as parties try to figure out exactly what that murky standard means.

And as I previously mentioned EPA (planners) and all appropriate inquiry rule, which goes into effect November 1st, and we're still seeing a lot of confusion in the courts over what this Supreme Court decision in Cooper v. Aviall means in terms of volunteers' ability to recoup their costs.

So all that is background noise that is affecting due diligence transactions right now.

Jennifer, do you want to talk about some of the other key areas that are important as one goes into the due diligence process?

Jennifer Hernandez: Sure. Actually I think maybe (Brian) and Rose, you each had some commentary you'd like to start with in terms of key areas to coordinate with the transaction negotiating team to focus the scope and the priorities on the environmental due diligence side.

(Brian Hime): Sure. I want to comment on bullet A there regarding the need to upgrade pollution control equipment or try to assess what needs to be done to improve this facility that you're looking to buy.

And during due diligence you may have an opportunity to interview employees regarding future expansion. And what I want to do is caution you to make sure that you also hire a consultant to really take a look at these facilities and do not rely solely on representations of employees of the facility you're looking to buy.

Quite frankly the employees are incentivised to make you think that this is the best deal in the world for you to buy. And they will undersell problems at the facility in order to get you to buy it.

So you need to do an independent due diligence, spend the money on engineers and other consultants to make sure you fully understand what this facility can do for you and whether there are opportunities for expansion.

Do not rely on the representations of the management team or of the employees of the target entity.

Rose Murphy: And I think equally important is that you take all the information that you receive during or obtain during the due diligence and bring it back to your management team so that they fully understand what the restrictions are and what the potential exposure is.

Jennifer Hernandez: And here just quickly going through is a mandatory upgrade to pollution control equipment are probably one of the clearest and easiest items to check and quantify for the (DL) team.

Future costs to comply with global warming is still in the relatively speculative world. But for companies that have a lot of CO2 emissions it's clearly a train that has left the track. And some informed speculation about what the (license) consequences will be of that train coming to town are important.

Moving on, the permitting issues we already touched on. I think the three that come up the most in these kinds of deals are for ongoing operations of industrial facilities, at least, related to resource review and (CST) permit questions.

In California we continue to require upgrades even for minor modifications. And that (complicates) in all other states for (everyone) knows.

TMDL, total maximum daily load issues, relating to stream discharges are also quite significant. And we need to have significant capital expenditures as well as vulnerability to third party (offense) in the clean water act.

We talked a little bit already about wetlands and endangered species constraints. The reserve land always intended for expansion to the next part of the facility that has a variety of natural resource habitat or occupied species issues may be anything but a candidate for expansion. And that needs to be addressed.

(Brian) and Rose, do you want to pull this to a close?

Rose Murphy: (Brian), I really think they've done a great job. And we're out of time. If you want to have a couple minutes for questions. I'd (hate to defer) questions.

(Brian Hime): Right. I would encourage individuals to look at the links that have been provided as part of this presentation, especially the SEC reporting obligations. It's very helpful.

And it's very important for the environmental professional to be up to speed on these disclosures. You can really get sideways in a deal if SEC issues arise.

Vincent Gonzales: All right, guys. This is Vince Gonzales. I have a couple of questions I'd like to ask the panel.

First, we earlier touched on the need for confidentiality in terms of the beginning phases of the transaction of a deal. And we also talked about the need to do some interfacing with public agencies, in particular with respect to the publicly available files or records pertaining to some companies or facilities.

To the extent that these two concerns are somewhat conflicting, does the panel have any concrete suggestions on how to basically meet the needs of both confidentiality and the need to interface with public agencies?

Amy Edwards: This is Amy. I think Rose already touched on this once in terms of the two-stage process. We see that happen a lot. And Jennifer touched on another way which is that there's

an agreement up front where the buyer does what the buyer feels it needs to do but doesn't disclose necessarily what it finds and walks away from the deal if it's not palatable to the buyer.

And those are two of the deal structures we've seen that try to essentially address the differing concerns of both a seller and a purchaser so each can get the essential information they need without obviously causing harm to the other side of the transaction.

Jennifer Hernandez: I'll also say that the regulators have become, I believe, more sophisticated. This isn't, of course, across the board but it is the case that senior regulators are now much more use to seeing transactions and are less likely, I think, to speculate out of school with their own staff level employees and staff confidentiality, especially within the sell side is, I think, a key objective so that employees aren't given information at an inappropriate time.

I think it's easier to talk to regulators on a fairly confidential basis as a buyer.

Vincent Gonzales: Great. Thank you. I wanted to ask both Jennifer and Amy another question involving the transaction to the extent that the assets seemed (purchase) of a facility that has emission, air emission, CO2 emission, (SO2) emissions, et cetera.

How would you advise a client in terms of either valuating or setting aside or including the emission reduction credit, (SO2) allowances, or in the case of facilities on the south coast in southern California, a so-called (reclaim) trading credit.

How would you advise the client, be it the buyer or seller, on how to account for those things? In particular, California has a bizarre rule that says so-called emission credits are, quote, "not property."

Jennifer Hernandez: Right. Notwithstanding that bizarre regulatory rule we routinely review emission credits as a quite valuable currency. And the credit value, as well as the uncertainty associated with credits, and some exist, is priced into the deal.

I'd also say that there are significant restrictions in some cases on the use of shut-down credits, facility shut-down credits. Either they have expiration dates or limitations on the kinds of sales that can be made.

And it's sometimes easier to leave those in the seller's hands than to try to bring a buyer who's not in the business into the air credit brokerage world. But those are quite significant transactions and assets. And we do value them and transact them, notwithstanding the code section of the property.

Vincent Gonzales: I have time for one more question. And this one is directed to Amy. Amy, what would you recommend to a buyer who wants to perform voluntary cleanup but cannot recover contributions of cost under the Cooper v. Aviall case?

Are there any other options to recover costs absent any preexisting EPA cleanup order?

Amy Edwards: Well, that obviously is the 11th hour issue these days because that's why when we're representing purchasers we certainly encourage them to try to get as much due diligence

done as they can within the structure of the deal so they have a good appreciation for what kind of issues they're going to be dealing with.

And then hopefully they've got a sufficient leverage to try to negotiate either a purchase price reduction, an escrow, an indemnity, any of the other mechanisms we talked about to try to address those costs.

And obviously how it works out in any individual deal is going to depend upon the leverage of the parties and how interested the purchaser is going forward, is in going forward with that particular acquisition, what they see the intended future use being, whether they see an upside in terms of going forward with the deal even if they can't recoup those costs.

So there are some potentially other mechanisms available, such as entering into settlement agreements with the regulatory agencies. But that can be a very tedious and cumbersome approach and probably would not work in a fairly routine transaction.

It would have to be a much more substantial deal to invest both the parties' time as well as the regulatory agency's time in trying to work out a deal where you might, through that mechanism, enhance your ability to recoup costs from the responsible party.

Vincent Gonzales: Well, we're at the end of our Webcast. I'd like to thank both (Brian) and Rose as our in-house panelists. Thank you very much for your insights as well as your real-world experience.

I'd also like to especially thank Amy Edwards and Jennifer Hernandez again for your excellent presentation and for all of the work and research you've done in putting this program together. It's very much appreciated.

I'd like to also remind those on the Webcast that if you will please complete the Webcast evaluation form so that we can do better Webcasts in the future.

Also, please click on some of the links on the left side of your screen. They contain reference material and other material that we unfortunately were not able to get to in much details during our conference, during our Webcast this afternoon. It'll give you more information about the subject matter.

Again, on behalf of the Environmental Health and Safety Committee as well as the Corporate and Securities Committee of the Association Corporate Counsel, I'd like to thank everyone for attending today's Webcast.

Female: Thank you.

Vincent Gonzales: Good afternoon.

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