

Anticipating Environmental Issues in an Economic Downturn



Economic downturns present certain recurrent environmental problems for all kinds of businesses. In a downturn, the imperative to find grounds to avoid absorbing an environmental liability becomes more urgent.

By David G. Mandelbaum | [Summer 2009](#) | Natural Resources & Environment

On December 1, 2008, the Business Cycle Dating Committee of the National Bureau of Economic Research—the group that officially defines the beginning and ending of business cycles—declared December 2007 the peak of the last economic expansion and the beginning of a recession. www.nber.org/cycles/dec2008.html. For most lawyers, the only part of that sentence that was news was the fact that a group of economists exists in Cambridge, Massachusetts, that officially declares business cycles. As of December 2008, the economic news had not been good for a year. In a January 8, 2009, speech, then-President-Elect Obama observed that “[w]e start 2009 in the midst of [an economic] crisis unlike any we have seen in our lifetime.”

Economic downturns present certain recurrent environmental problems for all kinds of businesses. However, because we experienced a sustained expansion for six years preceding the downturn, many may not have those problems in mind.

Moreover, the problems of the last recession have become so bound up in popular memory with the attacks of September 11, 2001, that many may have to look back to the early 1990s to recall a conventional down economy. Those in practice fewer than fifteen years may have no such recollection.

This article briefly categorizes the sorts of legal issues that environmental managers and their lawyers may already be encountering and may expect to encounter that, in my experience, are associated with this point in the business cycle. Of course, each enterprise or public body has its own issues. Further, this economic “crisis” may have features “unlike any we have seen in our lifetime.” Nevertheless, like all downturns, this one is characterized by tightened budgets for most of our clients, reluctance to pay bills that do not lead to increased revenues, and business failures. No one has as much money as he or she would like.

As business conditions worsen, credit tightens everywhere. Every business examines its ordinary trade credit to reconfirm the creditworthiness of its customers. Often, however, businesses and public bodies fail to recognize the reasonably large amounts of “environmental credit” that they may have extended. One can think of “environmental credit” as rights to require another person to satisfy some environmental obligation. Many of the reported cases have to do with obligations to respond to contamination. However, obligations often exist to assure compliance with regulations governing current operations. One person may have promised to assure that an operation will achieve air emission or water discharge standards, for example.

In an economic downturn, an enterprise’s environmental debtors—the persons owing obligations to the enterprise to achieve some environmental outcome—may become less creditworthy. Environmental debtors may actually fail. On the other hand, in a downturn, environmental debtors may simply become “slow pay.” They will not react quickly or completely to demands that they fulfill their obligations. In either circumstance, the environmental creditor faces an increased risk of governmental or private enforcement without the benefit of the promised performance by the environmental debtor.

In a downturn, the imperative to find grounds to avoid absorbing an environmental liability becomes more urgent. Litigable issues that in better times might be ignored or settled are often litigated. Putative environmental creditors find reasons why agreements or public law puts obligations on others. Arguable environmental debtors find reasons why agreements or laws do not impose obligations on them. Environmental regulators or neighbors of a facility rarely want to wait for the parties to work out a resolution of this kind of dispute. Accordingly, the possibility of a dispute—even a good-faith one—renders a right less valuable.

In good times, an enterprise tends to assume that others will perform as they have promised and that they will fulfill the requirements of relevant statutes. If a contract calls for a counter-party to complete a cleanup or maintain a wastewater treatment plant, an enterprise tends to treat liability on that cleanup or maintenance as remote. However, in a downturn, everything becomes harder to count on, and an enterprise becomes exposed to defaults by environmental debtors.

To address that risk, the enterprise has to take inventory of the credit it has extended. Who owes it a cleanup? Who has promised to maintain compliance? What are others’ statutory obligations, and can the enterprise rely on them? The sales or accounts receivable department typically has all of the extended trade credit handy. Not so in the case of environmental credit an enterprise has extended. Enumerating it all may require some effort.

Once an enterprise identifies the environmental “credit” it has extended, it can take appropriate steps to protect itself. If a debtor seems poised to fail, perhaps the enterprise should ripen and assert a claim while the defendant still has assets that in better times the environmental creditor might have deferred. An

environmental creditor may want to seize opportunities to obtain additional security or to insure an obligation. In some cases, it may choose to take over a problem and to take a proactive approach in working with regulators because the problem may no longer be ignored as “somebody else’s issue”; that “somebody else” may have no money.

Enterprises extend environmental credit in different ways. Historical transactions often lend themselves to this practice. Most large enterprises have a history of buying and selling assets or other entities. Many, if not all, transactions involving regulated operations or potentially contaminated properties include internal allocations of responsibility among the parties. Buyers may have assumed liabilities, and sellers may have retained others. When counter-parties in these historical transactions experience distress or fail, those private contractual undertakings may be of limited value. Even if the counterparty does not fail, it may not be quick to honor a litigable obligation.

When imagining these issues, many immediately think of sites that may give rise to large cleanup liabilities under the federal Superfund statute, the Comprehensive, Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. §§ 9601-75. But one should also consider those transactions where, for example, the abrupt closure of a plant will cause an environmental issue because waste piles, landfills, wastewater treatment plants, groundwater pumping systems, and similar features require ongoing operation to be safe. In those circumstances, when a seller’s materials are also to be found in the waste facility, regulators may pursue a seller when the buyer shuts down unsafely.

One would like to assume that now, almost thirty years after CERCLA’s enactment, and even longer since the adoption of the Clean Water Act and Clean Air Act, one could rely on clear agreements allocating responsibility for environmental cleanup and environmental compliance. Without delving into too much nuance, contracts can allocate CERCLA liabilities essentially in the same way that they allocate all other liabilities. To be sure, early decisions held that doctrines such as caveat emptor could not operate as a defense to CERCLA liability. *Smith Land & Improvement Co. v. Celotex Corp.*, 851 F.2d 86 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989). However, Section 107(e) of CERCLA does allow private allocation of liability. *See, e.g., Harley Davidson, Inc. v. Minstar, Inc.*, 41 F.3d 341 (7th Cir. 1994), *cert. denied*, 514 U.S. 1036 (1995). Therefore, if the parties have an agreement about allocation of responsibility, courts will enforce it.

Figuring out whether they have that agreement often is a problem. To cite some of the more widely read and venerable cases, an “as is” clause counts as a transfer of CERCLA liability to the buyer, at least in a contract governed by New York law. *Keywell Corp. v. Weinstein*, 33 F.3d 159 (2d Cir. 1994). Similarly, an indemnification against all claims “in any way connected” with a purchase will cover CERCLA liability associated with an industrial facility that has been transferred. *Mardan v. C.G.C. Music Ltd.*, 804 F.2d 1454 (9th Cir. 1986). On the other hand, in *Jones-Hamilton v. Beazer Materials & Services, Inc.*, 973 F.2d 688 (9th Cir. 1992), CERCLA liability did not necessarily arise from “noncompliance or violation” of environmental law, so a triable issue existed as to whether an indemnification applied under California law. But in New Jersey contamination seems to trigger indemnification under a similar clause. *Caldwell Trucking PRP v. Rexon Technology Corp.*, 421 F.3d 234 (3d Cir. 2005).

The litigation issue sometimes arises from imprecise language. More often, in my experience, the issue arises from too much language. An environmental clause often provides a reasonably clear allocation of responsibility, but so do several other provisions in a fifty- or one-hundred-page acquisition agreement, and they do not all track each other. Moreover, when a transaction does not yield satisfactory results for the purchaser—as is typically the case in a downturn—the disappointed party may claim to have been the victim of a misrepresentation. In one particularly lengthy set of lawsuits arising from the 1990s downturn, the environmental clause clearly foreclosed a claim by a purchaser under CERCLA. *Teleflex, Inc. v. Collins &*

Aikman Products Co., 961 F. Supp. 368 (D. Conn. 1996), *aff'd mem.*, 125 F.3d 845 (2d Cir. 1997). After trial, one state court declared that the environmental representations of the agreement had not been breached, so the seller had no duty to indemnify. *Collins & Aikman Products Co. v. Sermatech Engineering Group, Inc.*, 297 A.D.2d 248, 746 N.Y.S.2d 698 (2002). And yet, another state court held that a provision of the agreement that made reference to the Connecticut Real Property Transfer Act could independently impose liability on the seller. *Collins & Aikman Products Co. v. Teleflex, Inc.*, 847 So. 2d 1143 (Fla. App. 2003). That case involved more than ninety pages of agreements and schedules. Had the agreement contained fewer provisions, the lawsuit(s) may have been shorter and clearer.

Similarly, many transactions involving real estate with less dramatic contamination have closed over the past decade or two in reliance on state voluntary response programs, such as Pennsylvania's "Act 2" program, the Maryland Voluntary Cleanup Program, or the Arizona Voluntary Response Program. Many of these transactions have "risked away" significant cleanups on the assumption that simple "institutional controls" remain in place: a fence, a parking lot surface, or a production well serves to break an exposure pathway. But notice that these institutional controls depend critically on whether the property owner continues maintenance. That party becomes an environmental debtor of all of the predecessors who depend upon the institutional controls to avoid further liability. If that current owner of the property shuts down, cleanup protections may unravel. Agreements typically do not contain crystal clear language on these sorts of obligations.

Parties to current transactions also form a group of potential environmental debtors. If an enterprise occupies space as a tenant, leases space as a landlord, or shares common facilities with other tenants, and if the other parties handle environmentally regulated materials—including simple trash—then the enterprise relies on the continued environmental compliance of the other parties. If a landlord does not maintain required systems or allows contamination to occur, if a tenant does not remove its materials, or if a co-tenant affects common space, then an enterprise may face liabilities for another's poor environmental performance. Pursuing contractual or tort remedies in those circumstances can prove frustrating. For example, when a biotechnology company vacated its leasehold, it left 75 tons of solid waste inside its building, more than half of which was either radioactive, biohazardous, or a controlled hazardous substance (a hazardous waste) under Maryland law. The tenant became insolvent after moving out. Tort claims against the tenant's officers and directors failed because abandoning hazardous materials in leasehold does not constitute a tort in Maryland. *Hanna v. ARE Acquisitions, Inc.*, 929 A.2d 892 (Md. 2007).

Enterprises with Superfund liabilities for sites with other potentially responsible parties should attend to the possibility that a party with a substantial share may become insolvent. This issue can arise with sites in the earliest stages of consideration, where allocation arguments can become meaningless if a party declares bankruptcy, or with sites long-since settled and only the last stages of work to complete. If other parties have not provided adequate financial assurance for later performance and are particularly affected by economic events, an enterprise may have reason for concern.

Just as an enterprise may be concerned with the creditworthiness of parties to past transactions, landlords, tenants, cotenants, and co-responsible parties, so too will those parties be concerned with an enterprise. Their concern may lead them to decide to accelerate issues and claims, for example. So, a long-disposed asset may give rise to a claim this year merely because the current owner wishes to pursue a remote seller while the seller is solvent.

Downturns create other kinds of circumstances outside the most recent norm. For example, when money is tight, it is tight all over. Corporate mandates may require cuts in costs throughout an enterprise, including in environment, health, and safety compliance. In deciding whether a general tightening makes sense, in determining which particular cost cutting or project deferral satisfies that imperative, and in describing the

internal decision making, managers should take great care. If something goes wrong, certain kinds of rationales—including cost cutting—may not play out well. Those who give these rationales are generally criticized for skimping on environmental compliance merely to save money. Efficiencies offer better rationales and more sensible opportunities for cost cutting than budget imperatives, and straitened circumstances focus managers on those efficiencies. An enterprise that slashes the Environmental, Health, and Safety (EHS) budget faces a serious risk of enforcement penalties or even criminal sanctions should anything go seriously wrong.

The financial creditors of those kinds of enterprises also face environmental risk and must be careful not to treat all liabilities as if they were within the CERCLA-secured creditor protection. Foreclosure rates have increased over the past year. Many companies may have retained or otherwise received a security interest in a property or business. Although foreclosing lenders have significant protections from liability under CERCLA, 42 U.S.C. §§ 9601(20), (35), this protection may turn out to be a trap for the unwary. Foreclosing lenders do not have protection from quite a number of other environmental liabilities. While defaulting on monetary payments, the distressed borrower may also be defaulting on its environmental obligations under water and air-pollution control, waste, and other laws. To take an obvious example, acquiring a partially built subdivision along with a sewage treatment plant that is out of compliance with its national pollution discharge elimination system permit can generate liabilities in the form of nondeductible penalties and requirements for investment of additional capital. Financial creditors should remember that CERCLA is only one source of environmental risk.

In the downturns of the 1980s and 1990s, environmental lawyers spent relatively little time concerned with accounting and disclosure issues. That may not prove to be so in this downturn. Since the 1990s, there has been much more attention paid in the financial reporting of public companies to the proper presentation of cleanup liabilities and obligations on the retirement of facilities. In the past few years, climate risk—both the risk of climate change negatively affecting an enterprise and the risk of greenhouse gas regulation imposing costs or competitive disadvantage—has become an additional area of concern. New York Attorney General Andrew Cuomo has extracted climate risk disclosure concessions from certain large energy companies. A number of public employee pension funds have petitioned the Securities and Exchange Commission for guidance on accounting and disclosure of climate risk.

In a similar way, businesses have engaged in “greening” over the past several years and may continue to do so. For example, many have seen the series of television advertisements run by a large computer company suggesting that investing in information technology solutions can “save up to 40 percent on our energy bills, and we spent \$17 million on energy last year.” Most of the “greening” projects in which companies have invested and most of the “green” products that they have produced make perfect sense and do what they are represented to do. But, as in all new markets, there are snake oil salesmen. One can expect false claims litigation as the result of this new “greening” investment. In a downturn, aggressive litigation increases, so businesses have to be aware of the possibility that they will become defendants in false claim litigation.

Downturns do present some opportunities. As Rahm Emmanuel, the White House Chief of Staff, is reported to have said, never waste a good crisis. This particular downturn appears to have been triggered by developments in subprime lending. However, energy prices, particularly volatility in the price of oil, have exacerbated the situation. Reducing exposure to volatility in energy prices, and indeed in all materials costs, may make particular sense in a recession. Far from being a luxury and the first jettisoned project, attention to an enterprise’s energy use may have particular value when oil and electricity prices are fluctuating.

Also, environmental capital projects typically are constructed by consultants and contractors, not by company employees. Economic downturns often lead to a softening of business for environmental consultants and reductions in the cost of capital goods, such as remediation equipment. Thus, economic

downturns often provide opportunities for enterprises to achieve cost savings through the aggressive negotiation of reduced rates with consultants and contractors that might otherwise be forced to reduce their own headcounts. Economic downturns also provide opportunities for cost reductions when acquiring equipment because of reduced demand as other enterprises defer their own capital projects.

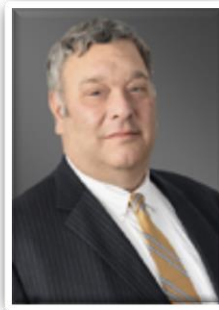
On February 17, 2009, President Obama signed a massive \$787 billion stimulus package, with billions of dollars allocated for infrastructure construction, including building roads, bridges, and ports. Those sorts of linear developments affect wetlands and endangered species habitats, create erosion and sedimentation control and storm water control problems, and affect contaminated sites. And then there is the National Environmental Policy Act, which some of you may remember. All of those regulatory problems have to have been worked out in order to receive funding. Projects may receive approvals and funding, but it is hard to imagine that at least some of them will not induce environmental litigation.

None of these issues presents a radically new concern. Indeed, some of them are unfamiliar because they have not been seen regularly in our practices for more than a decade. But they are here now. A downturn presents grave risks for the unwary, but opportunities for the alert and the adept.

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