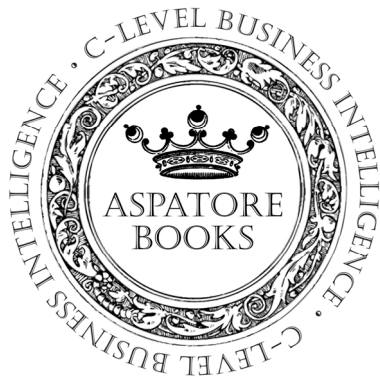


I N S I D E T H E M I N D S

Environmental Law Deal Strategies

*Leading Lawyers on Identifying Environmental
Liabilities, Structuring Transactions, and
Developing a Negotiation Strategy*



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ISBN 978-1-59622-868-9

Library of Congress Control Number: 2007942411

For corrections, updates, comments or any other inquiries please email TLR.AspatoreEditorial@thomson.com.

First Printing, 2008

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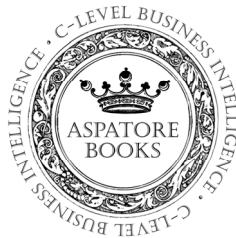
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From Fear to Greed: The Business of Environmental Law

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Introduction

This essay is offered in the context of hopefully providing thought-provoking guidance in the area of environmental business counseling and transactional matters. My environmental law practice, and the skill sets I bring to the table on behalf of clients, have their origins in almost 30 years of training and experience as both a scientist and environmental lawyer. As a non-contentious environmental lawyer (i.e., non-litigator), my practice focuses on identifying, quantifying and developing strategies to manage environmental risks—what is known as the “business of environmental law.” This generally falls into two areas of environmental legal practice: (1) domestic and cross-border corporate, real estate and energy transactions; and (2) compliance/business counseling. While these non-litigation aspects of environmental law are by no means new, the demands presented by the business world are dynamically imposing a new construct on, and portend a new paradigm for, environmental lawyers. Environmental issues are increasingly being seen as business issues, and C-level executives and their in-house counsel demand that their environmental lawyers add value, in a measurable way, beyond traditional approaches.

A brief aside about the somewhat provocative title is warranted. There is increasing recognition that the role and function of the environmental lawyer is evolving. While the field of environmental law is relatively new in context of the overall legal profession, the focus of environmental law has changed over the past 30-plus years. For perspective, 1970 is viewed as the birth of the field of modern environmental law with the creation of the U.S. Environmental Protection Agency (EPA) through an executive reorganization plan. The 1970s also saw the enactment of major new federal environmental laws and important amendments to older laws that greatly expanded EPA’s responsibilities, and it was not until 1980 that this country saw a comprehensive federal environmental cleanup statute.

In the past, many environmental lawyers were viewed as using “fear” as a basis for client advice—focusing on what costs/liabilities would be associated with cleanup obligations at a Superfund/CERCLA site; or what penalties could be incurred for violations of “end-of-the-pipe” environmental laws, such as the Clean Water and Clean Air Acts. In fact, it may be safe to say (and some business lawyers may still think this way) that

environmental lawyers were often only called on—somewhat reluctantly I might add—at the proverbial “eleventh hour” of a deal as a necessary evil, in order to quickly review the environmental aspects of the transaction, identify any major environmental issues, and offer ways to minimize the potential for subtraction from the bottom line—but never, ever, to add to the bottom line. This construct was self-fulfilling; the environmental lawyer had little time and room to maneuver to truly add value—and in the post-game locker room evaluation of the deal, that would be what was remembered. Further, the desire by clients and their business counsel to “get the deal done” and view environmental issues as merely impediments to the transaction could lead to the potential for missing (or mismanaging) critical environmental risks that could be material or, in the worst-case, turn a transaction upside down.

On the other hand, business/corporate lawyers have always focused on the “bottom line”—the value added/financial aspects of a business transaction. The corporate lawyer did, and continues to, look for ways to maximize shareholder value and return on investment; in other words, using “greed” (in the non-judgmental sense) as the basis for client advice.

While there are still (and will continue to be) opportunities for traditional environmental law practice, we are increasingly seeing changes to traditional media-based (air, water, waste) “command and control” environmental laws, where the government determines that a particular substance is hazardous to human health or the environment, and sets standards for the maximum amount that can be discharged into the environment—what are known as “end-of-the-pipe” controls. In fact, while further engineering controls demanded by traditional environmental law constructs are technically feasible, the environmental benefits of such controls are shrinking in relation to the greater dollars needed to achieve the desired pollution reductions. Thus, future national and international laws need to embrace “before-the-pipe” concepts and will undoubtedly focus on pollution prevention, conservation, recycling and renewable energy issues. Importantly, future developments in environmental law must also address the world’s real problem: too many people consuming limited resources—the “tragedy of the commons.”

Critically, we are seeing the investing world—both institutional investors and individual shareholders alike—driving the evolution of the role of the environmental lawyer and the development and application of new environmental laws (e.g., the Carbon Disclosure Project—*see* www.cdproject.net). Because of this, in part, corporate attitudes toward the environment have changed. Companies now recognize the importance of sustainable development in the context of their manufacturing/energy supply activities; thus, compliance with environmental laws, and the utilization of best management practices, is becoming *de rigueur*. (Not to mention that all of the major U.S. environmental laws today contain provisions that can impose criminal sanctions—jail time and fines—on C-level executives for noncompliance with environmental laws, including seemingly benign activities such as recordkeeping and reporting.) The circle is complete—shareholder demands are driving corporations to be better environmental citizens, and environmental lawyers are being asked to assist in this process and identify ways to increase shareholder value (i.e., play to the “greed” factor).

Today, pervasive environmental problems top political, social, and legal agendas globally, and environmental lawyers are being asked to add value in non-traditional environmental areas, such as: establishing corporate policies/governance structures and advising on the regulatory compliance issues under the Kyoto Protocol (in force globally but not yet in the United States), and state/regional initiatives such as the California Global Warming Solutions Act and the east coast’s Regional Greenhouse Gas Initiative (RGGI), disclosure obligations, and other risks presented by climate change; advising on other climate change agenda items, such as investment strategies, emissions trading and “carbon footprint” reduction projects, and the development and permitting of alternative energy sources such as wind farms and carbon capture and storage projects; advising property owners, tenants and developers, building contractors, and architects on voluntary or mandatory green building issues associated with carbon reduction and other environmental agendas; developing risk/liability transfer or “exit” strategies for boxing-in remediation obligations and associated potential environmental liabilities; advising on tax benefits/credits, public-private partnerships, and other financial/economic programs and incentives to facilitate cleanup efforts to redevelop historically contaminated sites (e.g., “brownfields”); assisting clients with satisfying natural resource damage

assessment (NRDA) and restoration obligations under federal and state laws; helping clients identify environmental and natural resource aspects of their businesses/properties that can be viewed and valued as assets (such as carbon credits, wetland banking credits, and natural resource damage offsets); advising on EHS issues associated with nanotechnology R&D and manufacturing; advising corporations on environmental aspects of corporate social responsibility and concepts of sustainability; and advising clients on the implications of and steps needed to ensure compliance with a range of emerging EU legislation such as directives concerning Waste Electrical and Electronic Equipment (WEEE), restrictions of the use of certain hazardous substances (RoHS) and the chemicals reforms under the Registration, Evaluation and Authorization of Chemicals (REACH) regulation, which requires industry to register all existing and future new substances with a new European chemicals agency.

These types of issues are very different from the assignments most environmental lawyers are familiar with; suffice it to say that the environmental lawyer who does not “evolve” to handle these new opportunities will find him/herself out of the mainstream and going the way of the dodo bird and dinosaurs.

The Role of the Non-Contentious Environmental Lawyer: Transactional Law

Virtually all transactions, whether for assets or stock, have liability components associated with past and future environmental, health, and safety (EHS) activities and conditions associated with currently or formerly owned and operated properties and/or assets. As a transactional lawyer, my role is to assist the multidisciplinary corporate deal team that handles complex country-specific and cross-border mergers, acquisitions, and divestitures with environmental risk identification, allocation, and avoidance strategies to minimize the potential for EHS issues to be “deal killers.” This “front-end” work is also important in that it can help identify issues early on that need to be resolved in order to avoid the potential for litigation down the road.

In the environmental due diligence context, my practice encompasses all transaction phases. In addition to traditional due diligence activities, this can

also generally entail assisting with project development and land use/siting issues; the application and structuring of environmental insurance; and advising on a “target’s” compliance with federal, state and local EHS regulatory and permitting requirements. We are typically brought in at an early stage to assist in formulating a strategy that minimizes potential liabilities, such as to: design the appropriate nature, scope, and timing of the environmental due diligence effort; advise on the use of environmental consultants/engineering firms or others with special expertise to interface with the deal parties, lenders/investors, and possibly environmental regulators; and negotiate the risk allocation and management strategies appropriate to meet the client’s business objectives.

The Role of the Non-Contentious Environmental Lawyer: Environmental Business/Compliance Counseling

The second prong of my practice encompasses business counseling, which includes: (1) regulatory compliance counseling, permitting, and assisting with the identification and reporting of environmental risks and satisfying applicable disclosure obligations; and (2) assisting clients (such as marine insurers/insureds and manufacturers) with oil and chemical spill response/casualty events; and the assessment and restoration of natural resource damages (NRD).

Environmental compliance/permitting counseling encompasses the mandates of key federal EHS laws (and their implementing regulations) in the United States, including the Clean Air Act (CAA); Clean Water Act (CWA); Resource Conservation and Recovery Act (RCRA); Toxic Substances Control Act (TSCA); Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund); the Oil Pollution Act of 1990 (OPA); the Occupational Safety and Health Act (OSHA); state law counterparts; and unique state property transfer laws such as the Connecticut Transfer Act and the New Jersey Industrial Site Recovery Act (ISRA). In addition, clients frequently seek advice with respect to financial disclosure and reporting obligations associated with environmental issues, which have become closely scrutinized in the United States following the passage of the Sarbanes-Oxley Act of 2002 and the development/clarification of various accounting standards (such as FAS 143 and FIN 47) that have environmental implications. As a business lawyer, clients frequently seek counsel on developing and implementing proactive, preventive business strategies that meet the

environmental requirements of the above-referenced laws and regulations, and minimize potential exposure to costly criminal, administrative, and civil governmental compliance actions—all without unduly restricting business objectives.

In the area of NRD, legislation such as CERCLA, OPA and the EU Environmental Liability Directive (ELD) make responsible parties liable for not only the costs incurred to clean up a contaminated site or waters affected by hazardous substances or an oil spill, but also for the NRD (or biodiversity damage) suffered by the environment as a result of that pollution incident. While the statutory authority to pursue NRD claims has existed for some time in the United States, under OPA, significant marine casualties (collisions, explosions, oil spills, and groundings) routinely involve NRD claims, and, under CERCLA and state analogs, aggressive Attorneys General in several jurisdictions are increasingly pursuing NRD claims, even at sites that had been remediated many years ago.

Across the pond in Europe, the EU's ELD is just now imposing similar obligations across the EU's member states (from 30 April 2007) on those that cause pollution leading to biodiversity damage. For example, the key Annex II to the ELD (which provides a framework for selection of suitable primary, complementary, and compensatory remedial measures) is heavily based on the U.S. OPA regulations for carrying out NRDA's.

Success in managing multifaceted defense strategies in NRD cases, whether under OPA or CERCLA, has led to assignments to defend some of the most significant marine pollution incidents that have occurred recently in the United States. For example, over the course of the cases we have handled, we have constructed a scientifically-based claims avoidance/mitigation strategy employed during the all-important NRDA phase which has won praise from our clients and respect from government regulators (known as "trustees" in the NRDA context). Examples of our work in this emerging area include advising a leading marine insurer and its insureds on the OPA (and state law) spill response and NRDA process for marine oil spills and casualty events in locations throughout the United States, including: Buzzards Bay, Massachusetts; Point Judith, Rhode Island; Puget Sound, Washington; Mississippi River, New Orleans, Louisiana; Gulf of Mexico, Texas and Louisiana; Portland, Maine; and Staten Island, New York.

Environmental Law Deal Strategies

In the deal context, it is important to stress a few basics about my philosophy and approach to environmental issues in transactions and the concept of risk. Environmental due diligence in a corporate or real estate transaction necessarily focuses on the identification of environmental risks, and the facilitation of the disclosure of the nature and scope of those risks. However, just because something is identified as an environmental issue or risk does not mean it is necessarily a deal killer or significant problem in a particular situation. Rather it becomes a problem for the client, whose risk tolerance (see below) you must understand, when it presents risks that are unacceptable (from a financial, human health, or public relations perspective) or cannot otherwise be managed. Environmental issues should never be “overwhelming” to a client, and as their trusted environmental advisor, you should not let them become such. If environmental issues were major issues in every transaction, few deals would close. Fortunately, that is not the case, nor should it be. Every deal that has real property or other assets may have environmental risks. Although they need to be taken seriously, most can be managed and need not kill a deal. While occasionally a deal may fall apart due to an environmental problem, in most situations environmental issues need not be “deal stoppers.”

Given this background, below are offered some of the lessons learned from experience with environmental transactional/due diligence matters. These transactional considerations are vital to environmental law deal strategies—and importantly, but disconcertedly, none of these are typically taught in law school.

There is risk, and there is risk that matters. Virtually every choice in life presents risks and benefits. The key is being able to distinguish minor risks from major ones—and in the end, the only critical risks are the unacceptable ones. As your client’s trusted environmental counsel, your role is to identify all of the risks, separate out the “significant” ones, and present options to creatively manage them. For example, in the real estate arena, the key is to develop innovative solutions to environmental issues, which often pose significant obstacles to real estate conveyance, development, and construction. While risk allocation can be accomplished by using traditional contractual negotiations, environmental laws also present opportunities for utilization of environmental insurance to “shift” risk (see below), entering

into creative public/private partnerships with environmental agencies for voluntary cleanups based on site-specific risk assessments, and taking advantage of brownfield funding mechanisms. To do this, you need to have an understanding of all potential risk identification and management tools in the tool box, from traditional pre-contract environmental due diligence structuring (which can vary significantly, depending on the client's role in the transaction—whether buyer, seller, lender/investor—and can involve traditional environmental due diligence (EDD) techniques such as transaction screens, Phase I (or greater) environmental site assessments, or the emerging environmental disclosure due diligence (EDDD) approach that has come to life in this post-Sarbanes Oxley world of environmental disclosure); to contractual strategies (such as environmental representations and warranties, covenants, indemnities, environmental escrows, and post-closing access/remediation side agreements); to more creative tools such as environmental insurance (cost-cap/stop loss or pollution legal liability policies), risk/liability transfer strategies (such as guaranteed fixed-price remediation contracts, with or without the backing of environmental insurance) and corporate structuring strategies. The bottom line is simple: environmental issues can be managed in many different ways and need not—in fact should not—become the tail that wags the proverbial dog in a transaction.

Begin with the end in mind. Not every environmental issue is a risk in every transaction. Knowing the future use of the site can be critical in this context. For example, if the future use of the site will be industrial/commercial, the evaluation of the environmental risks and cleanup strategy will be very different than if the future use will be residential. If there is a type of contamination in the soil and/or groundwater that poses no risks to human health, given the absence of human receptors or a pathway to sensitive environmental resources (e.g., it is of a type that is not volatile and thus poses no indoor air risks through today's buzz word of vapor intrusion, or the groundwater is not used for consumptive purposes), then leaving residual contamination in place, that is still protective of human health and the environment, may be appropriate and acceptable to the environmental regulatory agency with jurisdiction and the parties to the transaction. Further, there can be tremendous synergies in cost and time savings in, for example, a brownfield redevelopment context, by combining and/or coordinating many of the remediation tasks with

redevelopment/construction plans (particularly with respect to soil moving/removing activities as well as utilizing construction elements, such as parking lots, as “caps” for soil with residual contamination to minimize off-site transportation and disposal costs).

Environmental counsel should be consulted early in the process.

While the tendency is to be cost-conscious in the early stages of the transaction (such as during the negotiations of the fundamental business terms or a letter of intent) and not involve environmental counsel at that time, early involvement can be essential, as the key strategic framework is often set at this time, and it becomes more difficult (if not impossible) for the environmental lawyer to be creative (i.e., add “real” value) later on if the business framework is set in stone. At that point, the assistance environmental counsel can add will be limited to being reactive to decisions that have already been made, and solutions will be focused on risk minimization/damage control rather than having the opportunity to creatively shape the environmental aspects of the deal and offer creative risk management options that can box in the environmental risks/costs (see discussion about environmental insurance and risk/liability transfer options below). Environmental issues need to be integrated into all of the deal documents, such as: the letter of intent; the purchase agreement; any scope of work or remediation agreement; environmental insurance policy; post-closing access/remediation/environmental escrow agreement; and voluntary cleanup order with an environmental regulatory agency. Given the breadth of this undertaking, consultation with environmental counsel should be like voting—early and often—so that environmental issues do not become a “drag” on the transaction.

Pick experienced environmental consultants/experts. Consultants who have generic science backgrounds and little business savvy will be less successful in interacting with the legal and non-legal business team members than those who are well-credentialed, experienced in the transactional setting, and who possess the specialized expertise for the issues at hand. In my experience, environmental consultants have a significant role and are made a valued part of the deal team, including being apprised of the key transactional documents and client’s business drivers. This team effort is critical in that clients today demand that the environmental lawyer be conversant with environmental consultant

“speak,” and be able to assist in translating the technical issues into creative business solutions for the matter at hand.

Define the risk, know the hot-bed jurisdictional issues, and understand the remediation options. In the old days, soil remediation was traditionally done by the “dig and haul” method, affectionately known as “remediation by Bubba”—where Bubba drove the backhoe and removed all “dirty” dirt (i.e., contaminated soil) to background levels. Today, in many jurisdictions, it is “remediation by RBCA” (phonetically Rebecca). That term does not refer to a matter of the advancement of women’s rights; rather, many jurisdictions have cleanup programs that permit the use of risk-based cleanup approaches (hence the RBCA) that allow cleanups to satisfy less onerous, risk-based standards, utilizing monitored natural attenuation, engineering controls (e.g., vapor barriers), and institutional controls (e.g., site-wide or localized activity or use limitations that are memorialized in deed restrictions placed on the land records) in lieu of the application of more rigorous cleanup standards that would require more extensive and expensive active remediation.

Environmental issues need not be deal killers. In many deals, environmental lawyers are often seen, sometimes appropriately, as impediments to the deal progressing. Further, many environmental lawyers who I have sat across the table from treat a transaction as a litigation matter, and feel they must “fight to the death” over environmental issues and risk allocation. In my experience, this is unnecessary and unwarranted. These are transactions, not litigation—the role of the environmental lawyer is to turn the rocks over, identify the risks that may lurk thereunder, advise their clients of those risks, and offer creative risk allocation and management strategies, with the goal of closing the deal. In the end, which environmental risks are acceptable and how they are allocated are business decisions made ultimately by clients, not environmental lawyers. Good environmental lawyers recognize this, and work across the table from each other, representing their clients well, but negotiating in good faith within the deal constraints to further the overriding goal of creating a “win-win” scenario to allow the transaction to proceed.

Understand your client’s business. While this seems obvious, it is critical to understand your client’s business, whether: for real estate market clients, its sector or role as a developer, landlord or lender/investor; or, for manufacturing

clients, its industry sector, the raw materials it uses, products it manufactures, the wastes it generates and where they go, the overall corporate management structure, and its environmental management philosophy and system (if any).

Understand the full deal context and the client’s level of risk tolerance. Many times I have been asked to assist in a transaction and “just review the environmental provisions” of the deal document(s). In fact, the environmental sections are the last provisions I review (and I train my associates to do so as well). It is critical to review the entire deal document (or documents, as the case may be, including any letters of intent or related financing agreements) to understand: the type of transaction (e.g., asset vs. stock vs. debt or equity financing vs. securitization deal); dollar value of the deal and the overall deal structure (i.e., an arms-length one-off deal or a bid situation); who the various parties are (and importantly, where our client fits in and what entity(ies) will survive post-closing); whether a due diligence data room (real or virtual) has been set up, or how environmental issues are otherwise being disclosed; how other (non-environmental) risks are being handled/allocated; the length and scope of any allowable environmental due diligence opportunity; how long the representations, warranties, and covenants survive; whether there are any indemnification obligations, and the details of same; how the various defined terms are used in the non-environmental provisions as well as in the environmental provisions; whether there is an “off-ramp” or other mechanism (e.g., price adjustment, environmental escrow) that can be triggered in case material issues (whether environmental or otherwise) are identified; whether a materiality threshold has been agreed to; etc.

Similarly, it is critical to understand the client’s risk tolerance generally, and in the context of the specifics of the transaction. While this is typically a dollar or materiality threshold for environmental risks (e.g., a \$25,000 leaking underground storage tank issue may be acceptable in a \$50 million deal), increasingly clients (particularly publicly-traded companies) are also concerned about reputational issues in the context of corporate social responsibility and disclosure obligations. Without an understanding of the client’s risk tolerance, the environmental lawyer is operating in a vacuum and cannot provide tailored business guidance and advice that is useful for the business lawyers (internal and external) and, importantly, the non-legal members of the client’s team.

Tell the client what it needs to hear, not what it wants to hear. This cannot be overemphasized. I have too often seen, and heard, environmental lawyers “soft-selling” the environmental risks of a deal. That is not in our job description—we are the messenger, and the goal is to be thorough and rational, not to ensure that your client likes you because of the message you are delivering. While it is great when it works out that what you tell the client is what it wants to hear, it is critical to be honest and direct with clients in discussing the potential environmental risks and liabilities of their deal. Equally as important, the good environmental deal lawyer will have in his/her arsenal risk elimination and/or mitigation strategies that can be employed to “box-in” the potential risks, understand where and how risks can become liabilities, and look down the road to devise an acceptable path forward to allow the deal to close.

Environmental insurance can be a useful tool to help manage risks and bridge the gap in risk allocation. The development and creative use of innovative environmental insurance products can be valuable in managing environmental risks and liabilities. While these risks and liabilities can be daunting, they are almost always manageable when approached creatively. Environmental insurance can be employed with great success to address environmental risks in a variety of business contexts, including: real estate transactions/brownfield redevelopment; corporate mergers and acquisitions/divestitures; balance sheet management; corporate insurance restructuring (i.e., coverage disputes); and resolution of responsible parties’ liabilities at hazardous waste sites.

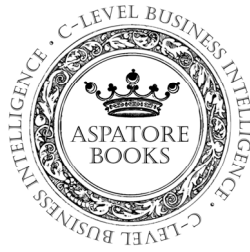
While environmental insurance is not necessary or even available (nor cost-effective) for every situation (such as when the expected cleanup cost is small and/or well-defined, or the cost of the premium for the environmental insurance policy is disproportionate to the value of the deal), the key is to identify environmental risks at the earliest stage possible, and then to craft solutions tailored specifically to the client’s business priorities. The goal is to maximize the use of the array of environmental insurance products available for the benefit of clients, using manuscripted policy forms. This is an area where many practitioners fall short; an environmental insurance policy (with its attendant endorsements), in its essence, is a contract, and needs to be negotiated and tailored to the specifics of the transaction and the underlying cleanup or other environmental risks, just

like any other deal document. Off-the-shelf, template or specimen policies are not acceptable in this context, and should be avoided. The relevant types of policies include manuscripted pollution legal liability (PLL); cleanup cost cap/stop loss; and secured creditor (or any combination thereof) policies. Environmental insurance policies, if properly structured, can be written to cover a broad spectrum of potential exposures, including property damage and bodily injury (“toxic tort” coverages); cleanup obligations and cost overruns; natural resource damages; liability associated with transportation and disposal of hazardous wastes/substances; project delays and business interruption; loss of collateral value; contract liability; and legal defense costs. Environmental insurance can be used to cap remediation costs and provide long-term (10 or more years) third-party liability protection at a single site or for a portfolio of impacted properties across one or many states in favor of a single entity, lenders/investors, all parties to a transaction, or a group of potentially responsible parties (PRPs).

Evaluate the use of risk/liability transfer options where technically feasible and cost-effective. A risk/liability transfer is a risk-allocation strategy that allows for the complete *contractual* resolution of environmental liabilities that may be associated with the conditions of a property, or a portfolio of properties. Applied properly, a risk/liability transfer can function to “take environmental issues off the table.” As the name suggests, a risk/liability transfer involves the contractual transfer of all liabilities associated with pre-existing environmental conditions (e.g., third-party, toxic tort liabilities, cleanup obligations) at a site or a portfolio of sites to a third-party contractor/insurer team. Such transfer is typically pre-funded and supported with a guaranteed-fixed price remediation contract/scope of work backed by a parent-level indemnity from the environmental contractor, as well as a long-term (e.g., 10 or more years) comprehensive environmental insurance policy (often combining both cost-cap/stop loss and PLL coverages) from a financially secure insurer. In some instances, the environmental contractor will enter into a cleanup consent order or voluntary cleanup program with the environmental regulatory agency with jurisdiction. It is important to recognize that each risk/liability transfer is negotiated extensively to meet a client’s goals for the specific risks associated with the specific sites involved in the deal.

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