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ABA SECTION OF ENVIRONMENT ENERGY AND RESOURCES

In-House Counsel Committee Newsletter

Vol. 13, No. 1 **May 2012**

MESSAGE FROM THE CHAIR

Brent Fewell

I want to begin by extending a special thank you to our contributing authors and Vice Chair Gary Gengel for helping pull together yet another excellent newsletter. This issue is packed with a wide diversity of topics and articles, from guns at work and corporate genealogy to emergency reporting and self-disclosing noncompliance, and we trust our members will find these beneficial.

One area of continued interest to the committee involves the discussion surrounding better management of environmental enterprise risks (EERs), which requires a deeper dive into identifying and mitigating those potential catastrophic events that can seriously wound or take down a company, by damaging reputation or market position. Back by popular demand, we are republishing an updated version of an article on EERs by Joe Suich of GE (presented during last year's annual conference) with some terrific tips on "black swan" hunting.

As a recovering lawyer now in management¾and reveling in not having to account for every six minutes of my life—I have grown to appreciate the subtle and inadvertent impacts of billable hours in reducing the quality of service each of us desires to provide our clients. Increasingly, due to the tyranny of billable hours and the clients' drive for economies in legal fees, lawyers are unable to spend time on those intangible factors of nurturing the client relationship and truly understanding their clients' business. As such, the legal profession is at times less effective and ill equipped to help the client. As Joe discusses in his article, outside counsel can be critical to bringing a fresh, new perspective to EHS risks, which can only occur through a full-immersion approach—often detached from the pressures of billables—and getting to know the client, its culture, and the lurking risks that may not be readily apparent to the company. My personal view is that we do our profession and our clients a disservice by settling for armchair lawyering. And one of the best things that outside counsel can do is offer to spend some quality time at a client managers' meeting or corporate off-site—as comp or part of client development—to get that full-immersion experience.

The notion of full-immersion lawyering can also help to advance greater transparency in corporate governance via greater rigor, new perspectives, and increased accountability. Transparency is essential to helping manage EERs, and demands that problems be promptly elevated for management response. It can also entail the additional step of "coming clean" under EPA's audit policy, as Benjamin Grawe, Natalia Minkel-Dumit, and Ned Witte discuss in their article. These services and perspectives are value-added and provide outside counsel the opportunity to shine.

On behalf of the committee's leadership, I hope you find these topics and articles helpful. And in furtherance of our efforts to better serve our membership, we encourage and welcome your ideas for additional articles.

In-House Counsel
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Gary P. Gengel II, Editor

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RESEARCHING CORPORATE GENEALOGY

Stephen G. Swisdak

A couple of years ago, I wrote an article in this publication on how to research a company's history ("The Value of Historical Research to In-House Counsel" (June 2009)). That article examined why in-house counsel should research their company's history and summarized some key electronic and print resources that professional historians use when researching corporate history. This article supplements my previous article and focuses on how to research corporate genealogy; that is, how to trace a company's history from incorporation, through merger and acquisition (M&A) transactions and other corporate actions, to bankruptcy or dissolution.

There are myriad legal reasons for attorneys to research a company's genealogy, including matters involving the search for potentially responsible parties (PRPs) to site contamination. In these instances, corporate genealogy research can determine if a historical PRP is currently viable (i.e., can be traced to a present-day successor), or whether the PRP is defunct and thus represents an orphan share to historical site contamination. Corporate genealogy research can also be used to understand historical M&A transactions, including whether specific transactions were stock or asset sales. This information can be particularly helpful in assessing a company's potential historical liability, for whereas in stock acquisitions buyers purchase a company's entire stock, including any known or unknown liabilities, in asset acquisitions buyers acquire only certain assets and assume only certain liabilities.

General Sources for Tracing Corporate Genealogy

When tracing corporate genealogy, researchers should first consult general business directories, which provide a readily accessible overview of thousands of American companies. The most comprehensive of these directories is *Moody's Manuals* (now *Mergent Online*), which consists of a series of industry-specific manuals (e.g., *Moody's Industrial Manual, Moody's Public Utility Manual*, etc.) that supply an overview of thousands of publicly traded companies culled from SEC filings, annual reports, and newspaper articles. Thus, each issue of *Moody's* provides information on a company's history, subsidiaries, business lines and products, principal plants, management team (officers and directors), and balance sheet. Mergent recently digitized historical issues of *Moody's* (dating back to 1909) and made them searchable by company name.

Historical newspaper articles are another excellent source of general information on companies. Over the past decade, newspaper research has become significantly easier to conduct with the digitization of national "newspapers of record," including the *New York Times* and the *Wall Street Journal*, and select regional newspapers (e.g., the *Boston Globe*, *Cleveland Plain-Dealer*, *Los Angeles Times*, *New Orleans Times-Picayune*, and *Washington Post*) by *ProQuest* and *NewsBank*. Often, though, local newspapers provide the best coverage of local companies. The challenge in researching most local newspapers, however, is that they are neither digitized nor indexed and, save a time-consuming search of microfilmed newspapers, are therefore difficult to access. When faced with such a situation, researchers should seek out available newspaper clippings files at local libraries and historical societies, which were created by the yeoman efforts of local librarians who clipped articles from local newspapers and organized them into subject-specific vertical files.

Sources for Company Incorporation Records

Company incorporation records are maintained in the state in which the company was incorporated. While the contents of a company's incorporation file varies from state to state, in general these records include the official name of the incorporated entity, its stated business purpose, a list of its registered agents and directors, and information on the company's preferred and common stock. In most states, the secretary of state's office maintains incorporation records, which are typically accessible online or, for historical records, via submission of a state Public Records Act request. However, it should be noted that in some states other

agencies maintain these records (e.g., the New Jersey Treasury Department's Division of Revenue maintains New Jersey's incorporation records).

Sources for Tracing Corporate Events and M&A Transactions

In researching major corporate events, including M&A transactions, facility expansions, and management changes, researchers should turn to historical corporate filings, and particularly corporate annual reports. Following the 1933 Truth in Securities Act, publicly traded companies doing business in the United States had to file certain reports, including official annual reports (10-K reports), with the Securities and Exchange Commission (SEC). While recent corporate filings (from 1993 to the present) are available online through the SEC's EDGAR database, historical SEC filings through the mid-1960s can be found within SEC records at the National Archives.

When tracing a company's genealogy, though, researchers should focus not on a company's 10-K report, but rather on its corporate annual report to shareholders. While some companies merge the two reports into a single document, 10-K reports are technically distinct from corporate annual reports, with 10-K reports tending to focus on required corporate financial information, whereas corporate annual reports tend to contain broader information on annual corporate activities, plant expansions, product lines, R&D efforts, and future business prospects.

Most corporate annual reports can be located through research into the *ProQuest Historical Annual Reports* database or at research at major university libraries and the National Archives. For its part, the *Historical Annual Reports* database provides a full-text searchable interface to complete runs of historical annual reports from over 800 large American companies. For companies not included in this database, researchers should turn to collections maintained at various academic libraries. To facilitate this search, the Purdue University Library has an *Annual Reports at Academic Business Libraries* database (http://www.lib.purdue.edu/abldars/), which aggregates the corporate annual report holdings of twelve leading academic libraries.

When investigating historical corporate activities, researchers should not neglect the potential benefits of targeted research into federal government records collections. Indeed, researchers can learn much useful information about specific companies, industries, products, and manufacturing processes by targeting historical federal government records at National Archives facilities and other federal records repositories across the country.

While historical SEC records will probably be most useful in researching corporate genealogy, other federal government agencies may also have maintained records on specific companies. Most of these historical records are today in the custody of the National Archives, which maintains approximately 9 billion pages of textual records at dozens of archival facilities and federal records centers across the country. Because of the volume of records at National Archives facilities and the idiosyncratic systems by which these records are organized, attorneys researching federal records should consider working with professional historians with experience conducting such research and with knowledge of the relevant historical context.

For example, it can be quite challenging to research the corporate genealogy of historical utility companies, especially for utility companies dating back to the 1920s and 1930s when a skein of holding companies controlled America's utility industry. Luckily for us, in 1928 Congress tasked the Federal Trade Commission (FTC) with investigating these holding companies and unraveling their complicated financial structures in order to determine which holding companies actually controlled which utility companies. Following their comprehensive investigation, FTC examiners reported their findings to Congress. The 101 volumes of published transcripts and exhibits resultant from these congressional hearings can be found at various federal repositories, including the FTC Library in Washington, D.C. As importantly, the National Archives maintains hundreds of boxes of the background materials from these hearings, including subpoenaed board minutes,

organizational charts, and various corporate records that the FTC collected and used to prepare its reports.

Sources for Corporate Dissolution and Bankruptcy

Since bankruptcy is a federal legal matter, when a company files for bankruptcy, an official federal court record is created and is permanently maintained. Thus, the National Archives preserves copies of historical closed bankruptcy records at the National Archives facility or Federal Records Center serving the geographic area in which the bankruptcy was filed (e.g., the National Archives or Federal Records Center in Denver maintains records from bankruptcy proceedings in Utah). On the other hand, if a company does not file for bankruptcy and simply dissolves, dissolution records can typically be found in one of the sources described above. For example, the secretary of state's office in each state in which the company conducted business should have a copy of the company's formal certificate of dissolution. Similarly, local newspapers may have coverage explaining the company's dissolution, as may the company's final 10-K report and final corporate annual report.

In sum, all companies have a genealogy—a genealogy that attorneys can trace through diligent historical research and can use to advise their clients on a range of legal matters.

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ENVIRONMENTAL ENTERPRISE RISK MANAGEMENT BENEFITS FOR A GOVERNMENT CONTRACTOR

Linda Guinn

An often overlooked advantage that an environmental enterprise risk management system (ERMS) offers to organizations is the added protection from the civil False Claims Act (FCA) for activities under a government contract.

An effective ERMS clearly enables an organization to meet the factors judges use to mitigate penalties under the U.S. Organizational Sentencing Guidelines (USSG, §8B2.1 (2010)). Many companies pattern their ERMS on the sentencing guideline requirements in order to more easily promote the organization's defense. However, criminal penalties may seem to be a sufficiently unlikely risk that some senior managers may not want to invest in an ERMS.

Some companies develop their ERMS as a stepping stone to obtaining ISO 14001 certification, thereby giving them a competitive advantage and demonstrating independent validation of their system (International Organization for Standardization, ISO 14001:2004—ISO 14004:2004). From a practical perspective, using these tools allows an organization to identify, analyze, and implement all of the elements of an ERMS to obtain compliance, avoid regulatory penalties, trend performance, and efficiently manage environmental risk. It also makes it simple for an organization to benchmark others, to readily incorporate lessons learned, and to include the resulting system improvements. Even with these benefits, the environmental professional might still encounter management reluctance to invest in an ERMS, especially in today's economy.

Companies that have government contracts have a strong additional incentive to use an ERMS. That incentive may not be noted by environmental professionals because it is an advantage rooted in government contract law. A good ERMS may make a multi-million dollar difference in an FCA case. When discussing an ERMS with senior management, the inclusion of the risk from the FCA makes the return on investment calculation for an ERMS highly attractive.

The FCA (31 U.S.C. § 3729 et seq.) originated after the Civil War as a response to allegations of widespread fraud, corruption, defective weapons, and illegal price gouging of the Union Army. The statute allows the government to obtain treble damages and penalties up to $11,000 per claim. Since each invoice, certification, or official representation/communication to the government may constitute an individual claim, the FCA can represent a significant and material financial risk to the company. The government at times has seen the FCA as a significant vehicle for revenue production/recovery, which has incentivized increased use of the statute. Fiscal year 2011 marked the second year in a row that the Justice Department recovered more than $3 billion from FCA cases. The Justice Department has recovered more than $30 billion under the FCA since the act was substantially amended in 1986. (Department of Justice Press Release, Justice Department Recovers $3 Billion in False Claims Act Cases in Fiscal Year 2011 (Dec. 19, 2011)). Most of the recoveries are in the area of health care fraud, which results in the application of the FCA to environmental cases being less well publicized or well known.

The FCA has an additional complexity: the "*Qui Tam*" provision (31 U.S.C. § 3730(b)). Under the *Qui Tam* provisions, any person may file a FCA claim on behalf of the government. This person is called a relator. The relator "stands in the shoes" of the government and is entitled to recover up to 30 percent of anything that the government would have recovered if the government had filed the case itself and was successful on the merits or had obtained a settlement. The process requires the relator to file the claim under seal with the court. During the time under seal, the government has an opportunity to review the case to determine if it would like to intervene to take over the suit. It is important to note that the target of the claim does not know of the claim or the review, and the government is not afforded the opportunity for the other side (the defense) to provide any additional explanation or evidence that might balance the evaluation to intervene or not. If the government decides to intervene, the suit

is unsealed and served. The suit proceeds with both the government and the relator as plaintiffs. The relator still recovers between 15 percent and 25 percent of the proceeds that the government recovers in the action or through settlement (31 U.S.C. § 3730(d)(1)). If the government decides not to intervene, the relator may proceed alone, and will keep up to 30 percent of the proceeds from the suit or settlement. When the government declines to intervene, the *Qui Tam* relator prevails in only about 20–30 percent of the cases. (Taxpayers Against Fraud Education Fund, False Claims Act Legal Center, http://www.taf.org/whistleblower.htm; Jonathan T. Brollier, *Mutiny of the Bounty: A Moderate Change in the Incentive Structure of the Qui Tam Actions Brought Under the False Claims Act*, http://moritzlaw.osu.edu/lawjournal/issues/volume67/number3/brollier.pdf.) In addition, the statute allows the recovery of reasonable expenses, costs, and attorney fees if successful (31 U.S.C. § 3730(d) (1)). In the 25 years since the FCA was substantially amended (in 1986), whistleblowers have filed more than 7800 actions under the *Qui Tam* provisions. *Qui Tam* suits hit a peak of 638 cases in fiscal year 2011 (DOJ press release (Dec. 19, 2011)).

While the FCA has been successfully used by whistleblowers to correct legitimate fraud perpetrated against the government, increasingly it is used by disgruntled employees, resentful subcontractors, and opportunists who see it as an avenue to "big bucks." Even employees that perpetrated or furthered the fraud may become relators. Often the cases are technically complex, involve large numbers of documents and can be very expensive—even if successfully defended. In a survey of defense contractors in the mid-1990s, proponents of deregulation found that of 38 *Qui Tam* claims that the government did not join, the defense firms' average costs in external legal fees per case were $1,431,660, whereas the mean governmental recovery under the FCA in these cases (where the government chooses not to intervene) was just $97,223. (William E. Kovacic, *The Civil False Claims Act as a Deterrent to Participation in Government Procurement Markets*, 6 SUP. CT. ECON. REV. 201, 226 (1998).)

In reducing FCA liability risk, having a robust ERMS is an advantage in three ways: (1) the ERMS discourages relators from filing because issues are easily raised and resolved; (2) an ERMS discourages the Justice Department from intervening; and (3) an ERMS can provide a strong defense, allowing the case to be resolved early (and less expensively) or ultimately resolved in the defendant's favor.

The basic FCA cause of action is against any person who presents or causes another to present a claim for payment or approval to the United States that is false or fraudulent and that the person knew that the claim was false (31 U.S.C. § 3729(a)(1)). Alternatively, if a false record is used to get a false claim paid, the person presenting the false claim does not have to have knowledge of the falsity of the claim (31 U.S.C. § 3729(a)(2)). False representations of compliance with environmental regulations that are incorporated into governmental contracts are considered false claims (*United States ex rel. Fallon v. Accudyne Corp.*, 880 F. Supp. 636 (W.D. Wis. 1995)).

Many government contracts have a general clause that requires the contractor to "be in compliance with all applicable laws and regulations." When certifying costs for payment, the contractor has to certify that the costs were incurred in compliance with the terms of the contract. Recent *Qui Tam* cases have alleged that if there were *any* environmental noncompliances, then the contractor was making a false claim every time that any cost, of any type, was submitted for payment (see *United States ex rel. Mock and LeBow v. Lockheed Martin Idaho Technologies Co.*, D. Idaho, 4:96-CV-00061-BLW, Jan. 5, 2001; *Marcy v. Rowan Companies*, 520 F.3d 384 (5th Cir. 2008)).

The 1986 amendments to the FCA added another basis for a false claim: "the reverse false claim." The reverse false claim is against a person who knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government (31 U.S.C. § 3729(a)(7)). This is used in the environmental setting when the compliance status of the organization is misstated or misrepresented in order to avoid regulatory fines or penalties. Under cost

reimbursable government contracts, the reverse false claim is applicable even when the fine or penalty is not payable to the federal government.

An effective defense against an FCA claim is that the government knew of the falsity (or inaccuracy) of the statement, waived the contract requirement, or did not rely upon the statement for payment (*United States ex rel. Boisjoly v. Morton Thiokol, Inc.*, 706 F. Supp. 795 (N.D. Utah 1988) and recently, *United States ex rel. UBL v. IIF Data Solutions, Inc., et al.*, 650 F.3d 445 (2011)). An ERMS that has its results available to the government can be effective in proving government knowledge of environmental noncompliances and potential violations.
Courts have looked at the criminal sentencing guidelines and agency policies for mitigation based on self-disclosure (e.g., the EPA audit policy found at http://www.epa.gov/compliance/incentives/auditing/auditpolicy.html and the DOJ environmental enforcement policy found at http://www.justice.gov/enrd/3058.htm) and have adopted a "due diligence" standard for evaluating organizational liability under the FCA. A company that has an effective ERMS can readily demonstrate the required level of due diligence and avoid FCA liability related to environmental concerns. Within the Medicare context, the government has argued that *lack* of a corporate compliance program actually may be evidence of "reckless disregard," an element of liability under 31 U.S.C. § 3729(b).

Difficult economic times increase the potential for companies to have to deal with FCA allegations. As companies are required to make hard financial choices, whether it is on investments in programs or releasing part of their workforce, they create opportunities for criticism and unhappiness. From such criticism can grow disgruntled employee (or ex-employee) complaints and FCA allegations. An effective environmental ERMS can save the company significant dollars and reputational impact through discouraging FCA claims initially, providing information that convinces the government not to proceed with a FCA case, or by allowing the company to quickly dispose of the action.

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Tree Planting Events

The Section has undertaken a five-year project with the goal of planting a million trees by 2014. As part of that effort, the Section is sponsoring local tree plantings this spring in thirteen locations around the country. If you live in one of these cities, we strongly encourage you to get out and help with a project—have some fun as well as make a lasting and tangible contribution to your community. For details please visit www.ambar.org/EnvironTrees.

If you can't plant a tree in person, please consider making a contribution to one of the Section's partner tree organizations. The Section's One Million Trees Project will get credit for one tree planted for every dollar donated through the Section website.

For current tree planting events or to make a donation to one of our project partners, please visit

www.ambar.org/EnvironTrees

UNCLE SAM WANTS YOU . . . TO REPORT: FEDERAL EMERGENCY PLANNING AND REPORTING RESPONSIBILITIES

Irene Hantman

Many, many companies are unaware of their emergency planning responsibilities under the Emergency Planning and Community Right to Know Act (EPCRA), Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), and the Clean Air Act (CAA). These statutes also specify notification requirements should hazardous chemicals be released into the environment. In addition, EPCRA requires annual toxic chemical release inventory reporting for certain industrial sectors. The broadest liabilities exist under the CAA general duty clause, which mandates "Owners and operators of facilities producing, processing, handling, or storing extremely hazardous substances have a general duty to

- identify hazards associated with a potential accidental release, using appropriate hazard assessment techniques;
- design and maintain a safe facility, taking steps to prevent releases; and
- minimize the consequences of accidental releases that do occur."[1]

Light industrial and agricultural entities are most likely to be ignorant of their responsibilities under these statutes. For example, the commercial refrigeration systems used by agricultural and food processing companies across the country may trigger emergency planning mandates because the anhydrous ammonia used in many of these systems is hazardous under federal law.

For example, noncompliance cost Firestone Pacific Foods more than $42,000. The company paid the penalty in 2010 after four years of expensive administrative proceedings. Firestone is a small fruit production and distribution enterprise. A closed anhydrous ammonia refrigeration system is used in the company's processing operations. The system holds more than 1,800 pounds of ammonia.[2] The facility's small quantity of ammonia, if released into the community, could kill more than 2,000 people living and working within six miles of the facility.

The presence of more than 499 pounds of ammonia triggers these emergency planning requirements. Records from the state Department of Labor and Industries indicate that more than 500 pounds of ammonia have been present at Firestone Pacific since 2001. Yet not until late 2006 did it file EPCRA emergency planning forms with the State Emergency Response Center (SERC), Local Emergency Planning Commission (LEPC), and local fire department. The 2006 filing was prompted by an April 2006 EPRCA compliance inspection. Firestone should have been aware of reporting requirements long before the inspection.[3] The companies that engineer and install heavy commercial refrigeration systems provide their clients with information on EPCRA reporting requirements and other state and federal emergency planning and reporting regulations. In addition, many LEPCs conduct extensive outreach to the businesses subject to these mandates.

Robust Enforcement

The EPA Administrative Enforcement Docket includes dozens of settlements addressing EPCRA, CERCLA, and CAA emergency planning, release notification, and reporting violations. Many actions focus on heavy industry. However, a number of these cases involved non-industrial entities. Examples from this calendar year include:

- *Salad Time LLC, Irvine, CA—$25,000 penalty: violation of release reporting requirements.*
  Failure to report the release of ammonia above the "reportable quantity" to the National Response Center (NRC), SERC, and LEPC committee. Salad Time was also cited for failure to prepare or have available a material safety data sheet for hazardous chemicals, and failure to submit an emergency and hazardous chemical inventory form to LEPC, SERC, and the local fire department.

- *Gregory Packaging, Inc., Atlanta, GA—$17,700 penalty: violation of release reporting requirements.*
  Failure to report the release of ammonia above the reportable quantity threshold (100 lbs) to the NRC, SERC, and LEPC.
- *Fleischmann's Yeast, Memphis, TN—$3,200 penalty: violation of emergency planning requirements.*
  Failure to update and submit risk management plan to EPA at least every five years.
- *Lindt & Sprungli, Inc., Stratham, NH—$19,000 penalty: violation of inventory reporting requirements.*
  Failure to submit hazardous chemical inventory form to LEPC, SERC, and the local fire department where sulfuric acid in batteries, diesel fuel in emergency generators, and propylene glycol in refrigeration systems were present.
- *Seviroli Food, Garden City, NY—$21,000 penalty: violation of inventory reporting requirements*.
  Failure to submit emergency and hazardous chemical inventory forms to LEPC, SERC, and the local fire department. Form submission required by presence of large quantities of anhydrous ammonia in refrigeration systems.
- *Packaging Corporation of America, Clyattville, GA—$20,500: violation of Toxic Release Inventory reporting requirements.*
  Failure to submit toxic chemical inventory reporting form. Reporting required by extensive chromium use—in excess of 10,000 lbs threshold quantity.

Companies subject to EPCRA, CERCLA, and CAA enforcement actions may also be subject to Securities and Exchange Commission (SEC) disclosure requirements. These regulations require publicly traded companies to disclose, at least quarterly, the existence of their involvement in certain administrative and judicial proceedings. Disclosure requirements are specified by SEC Regulation S-B Item 103 (17 C.F.R. § 228.103).[4]

Emergency Planning and Release Regulations

Emergencies involving hazardous waste releases are infrequent. However they pose such a serious danger to workers and communities that federal law mandates precautionary practices. For example, CAA general duty requirements are intended to prevent accidental release of extremely hazardous substances, reduce risks created by chemical processes, and communicate dangers with local emergency responders and the community. Toxicity, reactivity, flammability, volatility, and corrosive characteristics impose general duty requirements. Section 112 of the CAA specifies that these "extremely hazardous substances" are chemicals, which if released to the air, would cause death, injury, or property damage. Specifically the general duty clause mandates risk management planning and reporting by facilities using emergency hazardous substances.

EPRCA also imposes transparency requirements on the manufacturing, processing, or storage of these chemicals. EPCRA requires the following:

- Emergency Planning,
- Emergency Notification,
- Community-Right-to-Know, and
- Toxic Release Inventory

A release may or may not trigger reporting requirements under multiple statutes. However, federally permitted releases are not subject to release notification. This includes discharges in compliance with the CAA, the Clean Water Act (CWA), the Resource Conversation and Recovery Act (RCRA), and the Safe Drinking Water Act (SDWA) injection permits.

Is it hazardous? Knowing whether or not operations involve hazardous substances is necessary for safely managing operations. CERCLA establishes the basic list of "hazardous substances." The list includes more than 800 specific substances and 1,500 radionuclides. These substances are identified in 40 C.F.R. section 302.4. In addition, a number of wastes are listed as hazardous substances. These include wastes from common manufacturing and industrial processes such

as solvents used in cleaning or degreasing operations (see 40 C.F.R. § 261.31).[5] Extremely hazardous substances (EHS) are defined by EPCRA section 302 and CAA section 112(r). These substances are identified in 40 C.F.R. sections 68 and 355, appendices A and B.

Emergency Planning. Facilities using extremely hazardous chemicals must inform emergency responders and planners that such chemicals are present. In addition, emergency planning mandates may be imposed on facilities specifically designated for emergency planning purposes by SERC. Whether or not the quantity present of an EHS triggers emergency planning requirements depends on its threshold planning quantity in aggregate with all facility EHS. For some EHS, the presence of only 10 pounds triggers planning requirements.

EPCRA section 302 requires facilities to notify SERC and LEPC of the presence of EHS and facilities are required to appoint an emergency response coordinator. In addition, states may impose specific emergency planning requirements. EPCRA sections 311 and 312 require facilities to notify SERC, LEPC, and the local fire department of all hazardous chemicals for which the Occupational Health and Safety Administration requires material safety data sheets (MSDSs).[6] The facility must also submit either the MSDSs or a list of the substances for which MSDSs are maintained. If a list is submitted, hazardous chemical inventory forms must also be submitted.

CAA emergency planning requires development of a risk management plan (RMP). These plans must include worst case scenario analyses for processes involving toxic substances and information about facility emergency response procedures. RMPs must be updated every five years. Summary plans must be submitted to EPA. [7]

Incident reporting. Emergency notification is critical should an accidental release occur. Incident reporting is required under CERCLA (§103), EPCRA (§304), and the CAA (§112(r)). If an accidental chemical release exceeds the applicable minimal reportable quantity, the facility must notify SERC, LERC, and NRC immediately and provide a detailed written follow-up as soon as practicable. Information about accidental chemical releases must also be made available to the public. Notification must include

- chemical name,
- hazard type,
- estimate of quantity released,
- time and duration of the release,
- release type,
- known and anticipated acute and chronic health risks, and advice regarding medical attention for exposed individuals,
- proper precautions, such as evacuation or sheltering in place, and
- name and telephone number of facility contact person.

Toxic release inventory. EPCRA also mandates annual reporting regarding permitted release of hazardous chemicals. This requirement is limited to manufacturing facilities included in Standard Industrial Classification (SIC) codes 20 through 39, which have ten or more employees, and which manufacture, process, or use specified chemicals in amounts greater than threshold quantities. These facilities must submit an annual toxic chemical release report to EPA. Basic program information and guidance documents can be downloaded from EPA's Web site. The 2011 reporting forms were recently posted. More information on these mandates can be found at 40 C.F.R. section 372.

Compliance assistance. EPA's Contaminated Site Clean Up Information Web site provides an excellent overview of EPCRA, CERCLA, and CAA emergency planning and notification requirements. Industry-specific federal environmental compliance information can be found at the National Compliance Assistance Centers. For example, inputting general information about facility operations, into the Food Processing Environmental Assistance Center's compliance tool will create a compliance checklist linked to relevant reference materials.

Irene Hantman *is a legal fellow in EPA's Office of Enforcement and Compliance Assurance. This work is not a product of EPA. The views expressed*

are those of the author only and do not represent those of EPA.

Endnotes

[1] *Guidance for Conducting Risk Management Program Inspections under Clean Air Act Section 112(r)*, U.S. EPA (2011).

[2] *In the Matter of Firestone Pacific Foods, Inc.*, Docket No. EPCRA-10-2007-0204, EPA Office of Administrative Law Judges, Mar. 24, 2009.

[3] *Id.* at note 2.

[4] *See, e.g.*, U.S. EPA Notifying Defendants of Securities and Exchange Commission's Environmental Disclosure Requirements, *Enforcement Alert* (2001).

[5] Industry-specific wastes (e.g., petroleum refining or pesticide manufacturing) may also be hazardous substances (*see* 40 C.F.R. § 261.32). Similarly discarded chemicals may be deemed hazardous waste and dangerous waste discarded chemical products (*see* 40 C.F.R. § 261.33).

[6] Information on enforcement of material safety data sheet (MSDS) requirements may be found on OSHA's Web site.

[7] For additional information, see EPA's *General Guidance for Risk Management Programs.*

GUNS AT WORK: A QUESTION OF STATE LAW MORE THAN OSHA LAW FOR MOST INDUSTRIES

Shell J. Bleiweiss and Jamie Davidson

Forty-nine of the fifty states allow some form of open or concealed carrying of firearms. Across the country, employers are beginning to grapple with new laws requiring them to allow guns at work and employees that may want to bring them. These state laws have been subject to a battle involving two conflicting legal mandates: the requirement that employers provide a safe workplace as mandated by the Occupational Safety and Health (OSH) Act,[1] and the Second Amendment right to bear arms. While the Second Amendment protects an individual's rights to possess firearms in their homes, and maybe beyond, the OSH Act requires employers to regulate their workplaces in order to protect the safety of their employees. Currently, most laws in this field are state laws that prohibit employers from banning otherwise legal firearms in employee vehicles in company parking lots. Otherwise known as guns-at-work laws, these new state laws are being upheld as courts reject the argument that the OSH Act preempts in the field of workplace gun safety. While the guns-at-work laws are relatively new and the Supreme Court has not ruled directly on the subject, their validity has been upheld by courts as employers' attempts to preempt guns-at-work laws with the Occupational Safety and Health Administration (OSHA) have failed. Therefore, employers must determine their own workplace regulations of guns at work primarily under the purview of state and local legislation.

OSHA

Currently, OSHA does not specifically regulate the presence of firearms in the workplace. The only guidance issued on the subject by the agency is a letter released in 2006 in response to a public request for a nationally binding policy that would ban guns from American workplaces.[2] OSHA declined to issue such a ruling, noting that it generally defers to other federal, state, and local law enforcement agencies when the risk of violence and serious injury in the workplace are not significant enough to be "recognized hazards." The letter additionally pointed out that workplace homicides have been declining and that they typically involve employees being shot by non-employees entering the workplace to engage in criminal activity. Thus, workplace rules against employee firearms would be pointless (or, arguably, dangerous if employees are not able to defend themselves). Therefore, in typical workplaces that do not operate under some specific, serious risk of gun violence (a "recognized hazard"), OSHA does not forbid the presence of firearms.

The general duty clause supplements OSHA standards where a subject is not otherwise governed by OSHA regulations. The clause states, "Each employer shall furnish to each of his employees employment and a place of employment which are free from *recognized hazards* that are causing or are likely to cause death or serious physical harm to his employees (emphasis added)."[3] The general duty clause presents a potential legal weapon against guns-at-work laws: it has been argued that gun-related workplace violence is a recognized hazard under the clause, and that guns-at-work laws conflict with an employer's ability to comply with the OSHA general duty clause. Based on this argument, the doctrine of conflict preemption would invalidate guns-at-work laws because it would be impossible for an employer to comply with both state and federal requirements, or the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of the federal law.[4]

So far, the argument of preemption based on the general duty clause has failed. The strongest authority to date on guns-at-work laws is *Ramsey v. Henry*.[5] In this case, the 10th Circuit upheld Oklahoma's state law prohibiting employers from banning employees from keeping concealed, otherwise legal weapons in their vehicles in company parking lots. In the lower court, the plaintiffs, who were private employers, asserted that the legislation was preempted by the general duty clause of the OSH Act and sued to have its enforcement enjoined.[6] The district court agreed. On appeal, the 10th Circuit overturned the finding in the district court by holding that the OSH Act does not preempt the guns-at-work law.[7]

Several factors caused the court to reject the argument that the general duty clause preempts states from regulating in this area. First, potential violent behavior by employees does not constitute a "recognized hazard" within the meaning of the general duty clause. The court in *Ramsey* overturned the district court's finding of gun-related workplace violence as a "recognized hazard" because OSHA has not indicated that employers should ban firearms from company parking lots or workplaces in general. Employers do not face liability unless abatement of the hazard was possible, and an employee's general fear that he may be subject to attack is not enough for an employer to be able to abate it due to unforeseeable or unpreventable misconduct.[8] Next, as stated above, OSHA issued a letter specifically stating its refusal to ban guns in the workplace outright and thus left the issue of gun regulation to the states. Finally, because guns-at-work laws protect not only employees, but the public as well, they are part of the police power domain that is traditionally controlled by the states.

The issue of guns-at-work laws has been considered by another court as well. In *Florida Retail Federation*, the U.S. District Court for the Northern District of Florida considered whether Florida's guns-at-work law conflicts with the OSH Act.[9] The outcome of this case was similar to the 10th Circuit's ruling. Holding that the OSH Act does not preempt state law in this case, it determined that the general duty clause does not impose liability on employers for failing to ban guns from parking lots. Because there is no federal requirement, states are generally free to legislate in this arena, and a guns-at-work law preventing employers from banning guns need not be invalidated.[10]

In exceptional circumstances, an employer may be able to assert that OSHA preempts local guns-at-work laws as applied to his specific workplace. While OSHA declined to ban guns in the workplace outright, it did issue an enforcement policy stating that in a workplace where the risk of violence and serious personal injury are significant enough to be "recognized hazards," the general duty clause would require the employer to take feasible steps to minimize those risks.[11] In order to prove a violation of the general duty clause, OSHA must establish (1) the employer failed to render the workplace free of hazards to the employers, (2) the cited employer or his industry recognized the hazard, (3) the hazard caused or was likely to cause death or serious physical harm, (4) feasible means existed to eliminate or materially reduce the hazard; and (5) the employer knew or should have known of the recognized hazard.[12] If these factors can be established, a guns-at-work law that does not carve out permission for an employer to ban weapons in the workplace could be preempted for a particular workplace or industry.

Second Amendment

Beyond the issue of preemption, the legality of guns-at-work laws may be bolstered by the Second Amendment. In *District of Columbia v. Heller*, the U.S. Supreme Court held that the Second Amendment protects an individual's right to possess firearms for self-defense in the home.[13] Aside from reasonable restrictions (such as prohibiting possession of firearms by felons or the mentally ill, or forbidding it in sensitive places like schools), the right to bear arms has constitutional protection. While the Second Amendment has been determined to apply to the states,[14] it has not been applied to employers and their private property. Furthermore, the analysis regarding the right to bear arms applies to guns in the home for self-defense, not currently outside the home. However, the weight given to this constitutional protection at home could be extended to vehicles,[15] particularly due to the unique position individuals are in when they must use their vehicles both in public on their commutes, and on private property when they park at their place of employment. As the law stands, the rights guaranteed by the Supreme Court bolster the ability of states to support the permissibility of guns in workplace parking lots.

State and Local Authority

In addition to the states, including Florida, Oklahoma, and Georgia, that have already passed guns-at-work laws, more are considering similar bills and other laws that will affect employer liability regarding firearms in the workplace.[16] In Texas, a guns-at-work law went into effect on September 1, 2011.[17] The Texas Senate issued an analysis of the pros and cons of limiting the

ability of employers to prohibit concealed license holders from storing weapons in a parking area.[18] The pros: it would end inconsistency in state law that prevents employees from storing their weapons while no restriction applies to visitors and other nonemployees, and it would protect the right of workers to protect themselves during their commute. The Texas Senate also considered the holdings of the *Ramsey* court, noting that the bill in Texas would be similar to the Oklahoma statutes that have undergone close court scrutiny. Arguments against the bill include the rights of employers as property owners to make decisions about their property, and the potential for violence, especially in light of current economic uncertainties. The Texas law has not yet resulted in a court ruling.

In Wisconsin, a concealed carry law went into effect on November 1, 2011.[19] The law expressly provides immunity to employers who permit licensed employees to carry concealed weapons on their premises, but the extent of the immunity is not immediately clear for various reasons. For example, there is no controlling precedent in Wisconsin that the general duty clause of the OSH Act will not apply to employers, as opposed to in Oklahoma, where the 10th Circuit has ruled that the general duty clause does not generally require employers to prohibit firearms.[20]

Like in Wisconsin, some guns-at-work laws move beyond the domain of the parking lot. An example of legislation enforcing the right to bear arms in the workplace is in New Hampshire, where a town's selectmen voted to allow guns on municipal property.[21] While this is limited to local government and public buildings, it exemplifies an expanded interpretation of the Second Amendment and the right to exercise it in public. The legislation goes beyond permitting employees to merely keep their firearms in their vehicles, and it may indicate future decisions by municipalities and private employers in deciding gun policy for their premises. The law was passed in response to the Supreme Court ruling in *McDonald*, which is expected to help loosen gun laws and open gun-control laws to legal challenges across the country.

Conclusion

While state guns-at-work laws have only recently been passed and challenged in the courts, such legislation is being upheld as valid and enforceable. Except in situations where the potential for gun violence is a "recognized hazard" under the general duty clause of the OSH Act, OSHA does not dictate the permitting or banning of firearms in the workplace. Therefore, employers must look to state and local regulations to determine whether they are required to permit guns on company property when they are formulating company policies.

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Endnotes

[1] Occupational Safety and Health Act of 1970, Pub. L. No. 91-596, 84 Stat. 1590 (codified as amended at 29 U.S.C. §§ 651–78 (2006)).

[2] Letter from Richard E. Fairfax, Directorate of Enforcement Programs, U.S. Department of Labor, to Morgan Melekos (Sept. 23, 2006) (http://www.osha.gov/pls/oshaweb/owadisp.show_document?p_table=INTERPRETATIONS&p_id=25504).

[3] Occupational Safety and Health Act, 29 U.S.C. 654(a) (1970).

[4] See *Choate v. Champion Home Builders Co*., 222 F.3d 788, 796 (10th Cir. 2000). *Cf.* Shell J. Bleweiss, *Environmental Regulation and the Federal Common Law of Nuisance: A Proposed Standard of Preemption*, 7 HARV. ENVTL. L. REV. 41 (1983) (analyzing the doctrine of preemption in the field of environmental nuisance).

[5] *Ramsey Winch Inc DP v. Henry*, 555 F.3d 1199 (10th Cir. 2009), accessed online at http://caselaw.findlaw.com/us-10th-circuit/1277065.html.

[6] *ConocoPhillips Co. v. Henry*, 520 F. Supp. 2d 1282 (N.D. Okla.2007), *rev'd* 555 F.3d 1999 (10th Cir. 2009).

[7] The district court held that gun-related violence is a recognized hazard under the general duty clause and that the state laws impermissibly conflict with the plaintiff-employers' ability to comply with the general duty clause, and therefore enjoined the enforcement of the guns-at-work law in this case.

[8] *Ramsey*, *supra* note 5, at .1205-07.

[9] *Fla. Retail Fed'n, Inc. v. Att'y Gen.*, 576 F. Supp. 2d 1281 (N.D. Fla. 2008).

[10] *See also* Dana B. Royal, *Take Your Gun to Work and Leave It in the Parking Lot: Why the OSH Act Does Not Preempt State Guns-at-Work Laws*, 61 FLA. L. REV. 475, 506 (2009).

[11] Letter from Roger A. Clark, Directorate of Enforcement Programs, U.S. Department of Labor, to John R. Schuller (Dec. 10, 1992) (http://www.osha.gov/pls/oshaweb/owadisp.show_document?p_table=INTERPRETATIONS&p_id=20951).

[12] *National Realty & Construction Co. v. OSHRC*, 489 F.2d 1257 (D.C. Cir. 1973); *see also* Minnesota Department of Labor and Industry, *Workplace Violence Prevention: A Comprehensive Guide for Employers and Employees*, page 7, http://www.dli.mn.gov/Wsc/PDF/WorkplaceViolencePreventionGuide.pdf.

[13] *District of Columbia v. Heller*, 554 U.S. 570 (2008).

[14] In *McDonald v. Chicago*, 561 U.S. 3025, 130 S. Ct. 3020 (2010), the Supreme Court extended the rights of *Heller* to areas of state jurisdiction.

[15] Royal, *supra* note 10, at 479 n.25.

[16] *Id*. at 495 n.130.

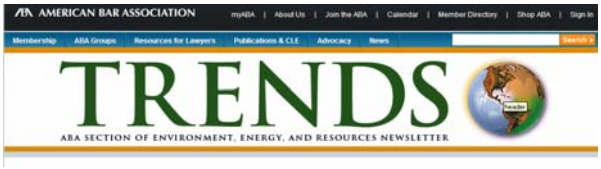
[17] Tex. Gv. Code Ann. § 411.23, Senate Bill 321 (82nd Leg. R.S.).

[18] House Research Organization Bill Analysis, *Restricting Employer Prohibitions on Guns in Workplace Parking Lots*, SB 730, May 23, 2009, available online at: http://www.lrl.state.tx.us/scanned/hroBillAnalyses/81-0/SB730.PDF.

[19] Wis. Stat. § 175.60

[20] J.B. Koenings & Joseph E. Gumina, *An Employer's Guide to Wisconsin's Concealed Carry Law*, http://wilaw.com/images/uploads/00395171.PDF.

[21] Ray Sanchez, *New Hampshire Town Allows Workers to Carry Guns to Work*, ABC News, July 2, 2010, http://abcnews.go.com/US/nh-town-employees-carry-guns-work/story?id=11057844#.TrgxaPRE5gE.



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RISK MANAGEMENT FOR BLACK SWAN RISKS: PLANNING FOR NUCLEAR CATASTROPHE, FRACKING PROBLEMS, AND OTHER ENVIRONMENTAL DISASTERS

Jeffrey M. Pollock

The purpose of this article is to assist counsel in planning for and responding to the increasing risk of catastrophic loss. Traditionally, risk management fell within corporate accounting or financial departments and only indirectly required input from corporate counsel. The days of relegating risk management to an outside broker or to the financial department are numbered as today's risk management involves complex legal concepts, cuts across corporate departments, and particularly for catastrophic loss requires detailed knowledge of New York insurance law. Both the magnitude and frequency of catastrophic risks are increasing. This article addresses in order: (1) planning for a catastrophic event, including an overview of risk; (2) a discussion of the various forms of insurance coverages, indemnity agreements, and other risk management tools that respond to those risks; and (3) a checklist of immediate action items that a company experiencing catastrophic loss must immediately implement even while in the midst of the disaster.

Worldwide, the number of environmental disasters is staggering. Looked at another way, in 2007, in excess of 21,500 people died due to 355 natural and man-made disasters. Property damage claims worldwide were in excess of $70 billion, and only one-third was insured. Of the insured amount, $23.3 billion of damage was natural catastrophes and the remaining $4.5 billion were due to major man-made disasters. *Id.* at 6 (2008). The risk in Fukushima risk from the tsunami and earthquake is over $265 billion as a result of the over 15,500 dead and 7,300 missing. From environmental exposures such as storm damage, typhoons, earthquakes, and nuclear risk, the array of potential direct and indirect harms is far more pervasive and real than we would like to believe. As noted in Adam Piore, *Planning for the Black Swan*, SCI. AM., June 2011, the "list of potential black swan threats is damningly diverse. Nuclear reactors and their spent-fuel pools are targets for terrorists. . . . Reactors may be situated downstream from dams that, should they ever burst, cold unleash biblical-level floods. Some reactors are located close to earthquake faults or shorelines exposed to tsunamis or hurricane storm surges." Is it sensible to plan for the anomalous catastrophic event? Yes. Both the scope and frequency of catastrophes, natural as well as technological, are increasing rapidly. Veronique Bruggerman, *Catastrophic Risks and First-Party Insurance*, 15 CONN. INS. L.J. 1, 2–3 (2008). Catastrophic losses increasingly arise every day: cyberattacks, greenhouse gases, global warming (flooding, storms), and of course man-made risks like fracking and nuclear contamination. Planning is essential not only because of the potential impact of catastrophic events, but also because first-party insurance has not been well developed to address catastrophic loss**.** *Id.* at 9. Insurance is also becoming a more expensive and difficult item to obtain for many risks. For the last five years, manufacturers have enjoyed in general a soft market, a market in which insurance is relatively cheap compared to risk and to historic values. The strong betting is that a hard market is upon us and planning is going to become increasingly critical not only due to the increase in black swan catastrophic events but also due to the hardening market.

I. Planning for a Catastrophe

A catastrophic risk is sometimes referred to as a black swan, an anomalous infrequent statistical event. Traditional risk management tools are adequate for routine risks such as labor, fire, fleet coverage (auto), and flooding. Because these risks are widespread and numerous, insurance brokers and insurers are able to capably predict what coverage will be appropriate given the risk. Black swan events are different. *Id.* at 28. As a species we routinely underestimate risk. Even the most prudent companies are routinely poor predictors of how bad a "bad day" can be. One theory behind our persistent failure to adequately perceive risk is the "gambler's fallacy." The gambler's fallacy shows that people have a very poor concept of randomness and assume that if a bad flood occurred in one year, than it is all the more likely that such a bad flood will

not occur the following year. (Presumably, the argument would be that the bad event, which is unlikely, has already occurred and therefore will not likely occur immediately again.) Another problem here is purely psychological because experimentation shows that many people would prefer the uncertainty of a possible loss rather than the certainty of the premium cost for insurance to pay against that loss now. Even engineers, whom many companies rely upon for rock hard numbers, admit that they are poor predictors of low frequency events. *Planning for the Black Swan* at 53. Corporations suffer from the same poor predictive tendencies that we endure as individuals. It is widely believed that the basis for our inability to predict risk is premised upon a combination of (1) overconfidence, (2) excess optimism, (3) the "halo effect" (namely that we don't believe bad things will happen to good people, that likeable people are better employees, etc.), (4) anchoring (that previous experience is a solid basis for future predictions), (5) motivational bias (we tend to believe that which is consistent with what will help us), (6) base-rate bias (we tend to ignore factors inconsistent with what we think the answer should be), and (7) small-sample/ inexperience bias (we are worst at predicting when experience is low). Corporate culture typically requires an optimistic view regarding the legitimacy of leadership and of the business model; hence there is a built-in bias against identifying risk because that risk's presence indicates a potential failure or weakness in the corporation. Our ability to anticipate collateral risks is even poorer than our ability to calculate risk.

A. First- and Third-Party Coverages

Fracking and nuclear failures, like that in Fukushima, pose both first-party and third-party risks to the insured**.** First-party coverage insures the purchaser for risks to them. Life insurance is first-party coverage, for example, and insures the insured in the event of death. Fire insurance insures the building owner in the event of a fire. Environmental risks are both first- and third-party coverages. Flood insurance is a form of first-party coverage. Business Interruption, which is a line of coverage that every business should own and understand, is another form of first-party coverage because it protects the business from financial loss. A good example of first-party risk arising from natural events is the 2011 Halloween nor'easter ice storm, which caused 3,389,000 power outages from Maine to West Virginia. Not only were homeowners without power, but many companies could not open without power, computer systems were inoperative due to extensive power outages, and workers were unable to leave their homes let alone navigate the downed power lines on their way to work.

Third-party coverage protects against risk of loss to property belonging to another. The most standard form of third-party coverage is the Comprehensive General Liability (CGL) policy, which was designed to protect against all risks (it was initially sold in 1941 as the "all risk" policy) that manufacturing might pose to others. Third-party environmental risks are pervasive. In addition, there are persistent risks of claims like the $1.4 billion study cost of the Passaic River natural resource damage (NRD) claims, Hanford Nuclear Reservation NRD claims, the Fox River, and others, including failing water infrastructure claims, that are posing new and major risks.

B. Contracting Away Risk

Beyond insurance coverage, there are a number of other risk management quills in the company's risk management quiver. One available to many companies is indemnification and other equivalent contractual agreements. In fact, perhaps the most common way of transferring risk is by contract or legal notice. Ken Brownlee, *Liability Insurance for Disasters Triggered by Human Activities*, CATClaims § 12:32 (Nov. 11, 2011). Another way of transferring risk is by means of exculpation. *Id.* The core problem with indemnity agreements, of course, is that the promise is only as good as that of the word of the indemnitor.

C. Concurrent Causes and Cause of Loss

A study of catastrophic insurance claims over the past 20 years reveals that a hidden vulnerability for both insurers and insureds is cause of loss. The difficulty is in definition of cause and causation. If an insured's policy addresses hurricane risk but not flooding, does the insured's claim fall within the scope of coverage if a hurricane hits Miami, does not injure the insured's building significantly, but then causes flooding that

destroys the insured's ground floor? Is the cause the hurricane, the flood, or both? Or take a more complicated example, the World Trade Center. Perhaps the safest approach is to negotiate an endorsement beforehand that if any covered claim is triggered that the claim will be covered regardless of other competing causes.

D. What Are the Direct and, More Importantly, Indirect Risks of Fracking and Nuclear Energy?

Although the conventional wisdom for now is that fracking is not a real risk and that U.S. nuclear plants are safe, for planning purposes we must assume that the risk of potential catastrophic loss from human-influenced risk is real. Contrary to the assertions that there is no proof that fracking poses a risk to surface water supplies, fracking has been proven, at least in some circumstances, to cause surficial contamination. Stephen G. Osborn, *Methane Contamination of Drinking Water Accompanying Gas-Well Drilling and Hydraulic Fracturing*, 108 PROC. NAT'L ACAD. SCI. 1872 (2011). Kirk Johnson, *EPA Links Tainted Water in Wyoming to Hydraulic Fracturing for National Gas*, N.Y. TIMES, 2011 WLNR 25454422 (Dec. 9, 2011). The loss to the property where fracking occurred or to the power plant is significant only to a limited few (the property or plant owner and perhaps to their indemnitor). Similarly, U.S. nuclear power plants are permitted legally to discharge tritium into waterways and into the air. *Radioactive Leaks Increasing at U.S. Nuclear Plants*, ASBURY PARK PRESS, 2011 WLNR 10498779 (May 20, 2011). Tritium is a form of hydrogen, which EPA has advised increases the risk of developing cancer, and is reportedly leaking from at least 48 of the United States's 65 commercial nuclear power plants. *Surry's Tritium Leak Is Common*, DAILY PRESS, 2011 WLNR 12463083 (June 22, 2011). Finally, and to make matters worse, there is a growing voice in the science community that fracking (injecting water into super hot layers of the earth below ground) could induce earthquakes. This risk, if real, was never contemplated by engineers designing our nuclear plants. Scientists in the United States and the United Kingdom are increasingly worried about the link between fracking and earthquakes. Mark Fischetti, *Ohio Earthquake Likely Caused by Fracking Wastewater*, SCI. AM., Jan. 4, 2012; *Tremors in UK City Likely from Gas Fracking*, Domain-b.com, 2011 WLNR 25881261 (Nov. 3, 2011).

E. The Planning Process

In the planning process, agree upon the goals and upon some of the core terms to be used in setting those goals. Perhaps a model goal would be to address through risk management the risk of loss posed by a catastrophic event so that the company can fulfill its manufacturing objectives and goals. What do these terms mean—*risk* and *loss*? *Risk* is the potential that an adverse event may or may not occur. *Loss* is a distinct concept in that loss requires there to have been an adverse event and for there to have been some consequence as a result of that event. Loss, which can be either partial or total, is, in short, injury or damage sustained by the insured. The definition of what constitutes loss varies but typically loss requires that there be an actual claim, settlement, or judgment for money damages. Prior to there being a claim, settlement, or judgment, there is normally the mere risk (potential) of loss but not a loss. This distinction is critical because many carriers will wrongly assert a "loss in progress" based upon the mere presence of risk.

Some possible issues to consider in the planning process are the following:

1. Bring in an outsider. Invite an outsider to assist you in planning—the corporate culture is often too strong to allow for independent assessment of what can and may go wrong.
2. Allocate responsibility and have a catastrophe risk management plan.
3. Make sure that your "backup" plan is not in the same geographic area.
4. Consider a modified captive insurer. With rising interest rates, it may be worthwhile from an institutional perspective to increase your self-insured retention (SIR) significantly and rely upon non-U.S. carriers to insure the amount over the SIR.
5. Pooling risk with other companies may not be a great idea depending upon the risk.
6. Start the renewal process early and have an agenda of coverages you want your broker to consider.

7. At the level of catastrophic coverage, many brokers push Bermuda form coverage, but few brokers really understand what it is that they are selling. Bermuda form coverage structurally favors the insurance carriers for a host of reasons and is costly to trigger—even if your client has a valid claim. If you are not proceeding with a surplus lines carrier, particularly Bermuda form coverage, make sure that you really understand how that policy will function if you are facing a catastrophic claim.

F. Some Likely Risks That Must Be Considered Based upon C atastrophic Disasters of 2011

In no particular order, risks that are likely to occur in the event of a disaster like Fukushima in or from fracking (and which may not be all that different from an ice storm or a hurricane) would include the following:

Loss of access to electronic data
Inability for employees to access the plant or corporate headquarters
Business interruption
Loss of clean rooms for manufacturing sensitive goods
Flood
Wind, hail, fire
Riot
Power outages
Sinkhole collapse, volcanic action, explosion
Lightning
Claims against the directors and officers
Noncompliant goods due to substandard water
Coverage for rebuilding

In brief, catastrophic layer coverage operates differently from primary layer insurance. After negotiating intensely for the best coverage and the best deal, the broker, insured, and the insurer are happy to establish that they have put coverage in place. Unfortunately, when disaster strikes, we find all too often that the documentation does not really reflect the understanding that the parties had at the inception of the insurance relationship. If you plan ahead, your insurance program will work synthetically, with all layers responding consonant with those layers below and there will be no gaps based upon a failure to appreciate the mechanical differences between primary, excess, umbrella, and catastrophe layer coverages.

II. Insurance Coverages That Respond to Catastrophic Loss

In discussing insurance coverage with your client and your broker, there are at least three discussions worth having when considering planning for a potential catastrophic loss. First, what kind of coverage should your client purchase and do those policies work together so as to avoid a gap in coverage? Second, what should your client be concerned about in the endorsements, which can limit or expand coverage? Third, drafting and finalizing insurance coverage at the corporate level takes time—what is adequate proof of an agreement regarding the existence and extent of coverage? If it were to occur, a catastrophic loss from fracking could poison groundwater, surface water, and the surrounding air and will raise a number of risks to adjacent property owners and businesses. Even a minor release from a nuclear plant could be equally and perhaps more devastating to down-gradient property owners. Property owners and businesses down-gradient of the release will suffer a first-party loss (flood, fire, business interruption, civil authority shutdown, etc.). Many manufacturers will also face liabilities of their own as there may be difficulties in manufacturing products that meet specifications with an impaired water supply; completed goods may be tainted; and the company may not be able to meet its manufacturing commitments (contractual liability). When discussing coverage for catastrophic risk with your broker, bear in mind that catastrophic layer coverage often requires consideration of surplus lines and non-admitted carriers. Whether the carrier is surplus lines, admitted, or non-admitted is not nearly as relevant as whether the carrier is a quality insurance company—getting insurance from a bad carrier is perhaps worse than getting no coverage at all. If you're considering non-admitted carriers, particularly Bermuda form coverage, make sure that your broker really has an understanding of how this policy is likely to function if your client is faced with a catastrophic loss. At the conclusion of purchasing coverage, *all understandings should be in writing.* A handshake

confirming that coverage is in place will later prove insufficient if a disaster strikes. If there is an agreement, document it now. Once disaster hits, there will no longer have been an agreement.

A. Basic Forms of Coverage to Consider and Which May Respond to Catastrophic Loss

Listed below are some basic forms of coverage to consider and discuss with your carrier:

1. Building and Personal Property Coverage (ISO Form CP 00 10) provides direct damage coverage for the repair or replacement of property damaged by a covered loss. Additional coverages available under this form include:
    a. Debris Removal[au: ok to move this entry of beginning of list?]
    b. Preservation of Property
    c. Fire Department Surcharge
    d. Pollutant Cleanup and Removal
    e. Increased Cost of Construction
2. Flood
3. Fire
4. Directors and Officers (D&O)
5. Product Liability
6. Product Recall
7. Employment Liability Coverage (EPL)
8. Comprehensive General Liability
9. Umbrella Coverage

B. Endorsements to Consider to Protect Your Client in the Event of a Catastrophe

When discussing coverage it also is essential to discuss endorsements to enhance the basic coverage obtained through standard form coverage. Some endorsements to consider would include:

1. Concurrent causes. Negotiate ahead of time what will be covered if there are concurrent causes.
2. Nuclear exclusion coverage. The most basic point here is that the nuclear exclusion is *not* nearly as broad as the insurance industry argues when faced with a claim. The Broad Form Nuclear Energy Liability Exclusion Endorsement, which was invoked in 1951 in most CGL and all-risk policies, does not exclude coverage of all radiation-related damages. If that had been the intended purpose, the exclusion would be significantly shorter and simply state that all injury arising from or related to nuclear material is excluded. Ronald J. Clark & Sean W. Carney, *Just Because It's Nuclear, Doesn't Mean It's Excluded: Liability Insurer's Potential Exposure for Commercial Uses of Radioactive Material*, 78 DEF. COUNS. J. 344, 346 (2011).
3. Cost of rebuilding and relocating. Negotiate a change in coverage from replacement cost to insured value plus a percentage.
4. Litigation is costly. Negotiate legal cost and control now**.** When purchasing insurance, pay attention to provisions regarding the "Duty to Defend," "Control of Defense," "Authority to Settle." You can modify this language and require the carriers to pay defense costs up front rather than when your company is reeling from a catastrophic loss. Control of defense and choice of counsel are critical because you will want to ensure that lawyers loyal to you are controlling a claim, not lawyers loyal to the carrier. Finally, negotiate legal fees now or agree upon a split now.
5. Pollution exclusion. Critically, the Absolute Pollution exclusion requires that the harm have been caused by pollution. Avoid the Total Pollution exclusion and seek to clarify the Absolute.
6. Other insurance. Negotiate a modification that if a risk of loss is covered, whether it is covered by another line of coverage or not, then the policy responds, but that the carrier will have a right of subrogation against another carrier. In short, let the carriers fight it out but make sure that you get paid. Beware of "co-insurance" provisions because some policies dictate that coverage exists only so long as other coverage is in place.
7. Follow the fortunes. To the extent possible (and it may not be possible with Bermuda coverage) *negotiate* a "follow the fortunes" provision, which in essence requires excess carriers to follow the underlying primary policy.
8. Carefully consider manuscript language. Standard language is to be interpreted in favor

of the policyholder under the doctrine of contra proferentum, which states that where one party (the carrier) has greater bargaining power, any ambiguities should be construed in favor of the insured. In manuscript coverage, where the language is arguably negotiated between equally sophisticated parties, the policyholder will likely lose contra proferentum.

9. Count occurrences now (or, at least know how your coverage counts occurrences).
10. Choice of law. In tough cases, choice of law (occasionally choice of forum) decides coverage claims. Catastrophe layer coverage is typically determined by New York law, which is heavily in favor of carriers over the interest of policyholders. Bermuda form coverage similarly looks to New York common law. Know which policies have a choice of law provision and how they will react in response to a catastrophic claim.
11. Dispute resolution provisions. It is relatively rare to have an enforceable dispute resolution provision in primary coverage but it is not at all unusual in an excess or umbrella coverage. Resolving insurance coverage disputes by arbitration is only slightly less expensive than simply litigating them, and in arbitration the policyholder often loses the rules of construction and choice of forum that could favor the policyholder.

C. Enhanced Coverages to Consider

1. Business Interruption insurance and Contingent Business Interruption coverage are both critical but complicated forms of coverage. Business Interruption coverage is triggered by damage to the property of third parties not insured by the policy. For example, the policy may insure the policyholder's suppliers, customers, or distributors. Notice must be given immediately. The most difficult part of Business Interruption coverage lies in calculating lost earnings. Obtaining an expert's advice is strongly recommended to understand how the insurance policy is interlinked to profit and loss statements, continuing expenses, past earnings, earnings projections, etc. When does the business interruption period end? Under Business Interruption, Contingent Business Interruption coverage, and Contingent Extra Expense coverage, pay particular attention to the period of restoration, to the nuclear exclusion's scope, to "waiting periods," and to the definition of loss (what income are you able to recover for, specifically).
2. Contingent Business Interruption coverage, which is distinct from Business Interruption coverage, is triggered if (1) the loss suffered by your company's supplier or customer *and* (2) the physical damage to the suppliers or customers (cause of loss) would have been an insured loss if it had occurred on your client's own property.
3. Contingent Extra Expense coverage is similar to Business Interruption and Contingent Business Interruption coverage, but Contingent Extra Expense coverage applies only to the increased cost incurred as a result of loss insured under coverages such as Contingent Business Interruption coverage or Business Interruption insurance. In short, if you have to look for a replacement supply while your primary supplier is unable to operate, Contingent Extra Expense coverage would protect against that risk.
4. Legal expense insurance (LEI), also known as legal protection insurance (LPI), insures the policyholder against the potential costs of legal action against the policyholder. There are two distinct forms of LEI/LPI coverage. The first addresses "before the event," which is in essence a glorified prepaid legal services agreement. "After the event" coverage is basically coverage to insure the risk of nonpayment for legal services incurred in response to a known loss.
5. Claims preparation coverage covers the reasonable expenses incurred by the insured for professional services such as auditors, accountants, architects, and engineers. In any sizable property insurance claim the policyholder incurs significant costs in collecting proofs for the claim, in presenting the claim, and in responding to the insurer's

demands regarding proof of the claim. The purpose of this coverage is to cover the risk of those expenses.

6. Civil authority coverage insures against the risk of loss from a governmental or military order, where that order affects or impairs your company's ability to operate normally.
7. Service interruption coverage protects against risk of loss of electrical power or other power supply interruptions.
8. Ingress and egress coverage insures against loss for sustained inability to access the property in question. This coverage is normally distinct from civil authority coverage but rather focuses on direct physical inability to access the property. The policy does not require direct physical loss but merely sustained inability to enter the insured facility.
9. Punitive damages coverage. Contrary to conventional wisdom, a sophisticated insured can insure against the risk of loss due to punitive damages.
10. Bumbershoot coverage (a bumbershoot coverage is designed to fill in any coverage gap-based exhaustion or difference in coverage between underlying and excess coverages). This can also be accomplished by difference in conditions (DIC) and difference in limits (DIL) coverage. Bumbershoot policies should be considered.

III. Checklist of Immediate Response Items

The first step is to provide immediate notice to all carriers of a potential loss. Elements of notice are simple: type of loss, location name, address of location, policy number, and the broadest conceivable description of damage. Seek immediate advice regarding framing of notice so that you can ensure coverage from all policies, particularly catastrophe layer coverage (which may involve Bermuda form coverage and New York law). Timing is particularly critical on business interruption coverage, adjuster's coverage, claims handling coverage, and accounts receivable insurance**.** Due to the nature of the policy itself, any costs incurred voluntarily before giving notice to the carrier regarding business interruption, adjuster's coverage, and claims handling coverage may be waived if notice is not immediately given. Although it is important to know which policies require more immediate notice than others, it is also important to know what not to do. For example, the insured should not engage in self-help before documenting the loss to the facility—and preferably, the insured should not take action until the adjuster has arrived and can document the loss independently of the insured.

1. Provide notice to *all* layers, paying particular attention to business interruption, adjuster's coverage, claims handling coverage, and accounts receivable coverage.
2. Do not make any changes to the property where the disaster has occurred until you've photographed and attempted to document the harm. A strong natural reaction is to jump in and start remediating the harm—document it first. Preferably, have your adjuster document it first.
3. Document all costs. Assign someone the task of documenting all costs, keeping all receipts, and being prepared to present all proofs of financial loss attributable to the risk.
4. Put a risk management response team in place. The insurer is not going to simply offer to pay up on a catastrophic loss. Rather, you are in for a fight. Plan ahead.
5. Litigation is a tool—be prepared to use it immediately. *Forum decides tough cases*. If your carrier files first and files in a hostile jurisdiction (one wherein the policyholder will lose), then your chances of securing coverage are greatly diminished. Most catastrophe coverages require New York choice of law. New York law was not chosen by chance—New York law strongly favors carriers. The policyholder buying catastrophe layer coverage needs to understand New York's definition of occurrence (is the World Trade Center one or two disasters?), New York's requirement for immediate notice, and New York's rules of construction regarding ambiguity, mutual mistake, and reformation.
6. Lean on your insurance broker. Your broker promised to protect you in the event of a risk and was paid well to do so. Malpractice claims against insurers are on the rise and in response

many insurance brokers are now requiring corporate clients to execute service agreements. Hidden within the service agreements, typically, is a provision that the broker will not be liable for its own negligence or that any exposure to the broker is capped at a nominal amount ($5 million or $10 million).

7. Be better prepared than your insurance carrier. Know where the money has been spent. Know what the source of the liability is and be prepared to prove it.
8. Determine the insurance company's exposure and risk before you meet with them.

IV. Conclusion

Catastrophic loss is different both because the frequency of the events leads to difficulty in predicting the likelihood of loss but also because the mechanics of catastrophic loss coverage are different than that of lower layer coverage. It is impossible to know at this stage whether a nuclear incident is likely or whether fracking will pollute groundwater or lead to an earthquake, but what is absolutely clear based upon current trends is that the risk of a catastrophic loss is increasingly likely. Forewarned is forearmed and I hope that this article has provided some food for thought as to steps to be taken now to ensure your company's ongoing viability in the future should we face another catastrophic loss.

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CONTROLLING ENVIRONMENTAL ENTERPRISE RISK BEFORE IT ENTERS OR LEAVES A COMPANY AND HOW OUTSIDE COUNSEL CAN ADD VALUE IN THIS PROCESS

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Initially Presented and Published at the March 2011 ABA SEER 40th Annual Conference, Salt Lake City, USA

Environmental enterprise risks (EERs) can result in serious negative impacts to a company's reputation, stock price, manufacturing, sourcing and supply chain operations, and market position. With some catastrophic exceptions,[1] what constitutes an EER will vary with the size of the company, its financial and reputational push points, and what it considers organic to its continued growth and business plan, among other factors. Companies that add an EER management (EERM) plan to their traditional review of environmental, health, and safety (EHS) metrics and compliance are often better equipped to anticipate EERs and prevent or minimize their impacts.[2] Company EERM plans often call for the formation of a corporate or lead risk committee, and implementation of consolidated reviews to evaluate companywide risk tolerances and liabilities across all functions. Other common elements of an EERM plan include communication strategies, periodic internal and third-party reviews, culture changes, drills, issue ownership and accountability, ensuring employees understand and have the ability to positively impact a company's EERM issues, and an EHS screening process for transactions.[3] This last step, a screening process for transactions, provides a company with one of its most powerful tools to identify, mitigate, accept, or avoid EERs before they enter a company, exit a company, or move beyond its control.[4] This article suggests several layers of review that in-house counsel can use, and how outside counsel can be leveraged, to improve a company's transaction screening process from an EERM perspective.

The first and most basic level of an environmental transaction screening process focuses on traditional remedial reviews.[5] Such remedial "due diligence" reviews analyze certain EHS factors that may, on occasion, identify EERs whether when buying or selling an industrial division, providing a commercial loan in an emerging market, or deciding to expand your business into a new sector or product (e.g., when due diligence in a proposed industrial portfolio purchase identifies $100 million of open-ended historical remedial cleanup liability). However, although what is an EER is company-specific, EHS counsel should be aware that typically only a small portion of EHS risks found during traditional remedial due diligence will rise to the level of EER in the eyes of their company. Additional layers of review should be added to increase the probability of identifying EERs.

The next suggested layer that in-house counsel can add to remedial-focused reviews is a compliance screen.[6] Expanding the traditional phase I/II remedial report approach to this second step can catch compliance issues that a business may consider EERs in certain contexts (e.g., systemic criminal permit violations; EHS-related anti-bribery concerns; significant costs in legacy asbestos toxic tort liability).[7]

Beyond remedial and compliance reviews, it is suggested that in-house counsel add a third layer of analysis that reviews social and reputational elements,[8] such as those used in the financial industry's equator principles.[9] This additional screening may spot EERs troubling to a company but not identified in a Phase I/II or EHS compliance report (e.g., a proposed legal, but highly controversial, removal of squatters from target sites; rain forest timbering issues or a proposed joint-venture partner's or supplier's improper labor practices).[10]

Transactional EHS risk reviewers—as functional EER managers—may wish to consider going one last step further with deals that involve certain high-risk ventures or take place in high-risk jurisdictions. In these cases, in-house counsel may find it prudent to inquire into EHS products liability and reasonable worst-case scenarios of established mitigants (e.g., what is the potential impact of human error on low-occurrence but high-impact operations; what happens if an essential safety component fails in a high-risk application[11]; do industry-accepted norms take into consideration prior experiences and global practices[12]). None of this is an exact science, but requires intuition, an understanding of the facts, and, at times, tenacity to tactfully challenge

established precedents when appropriate. In these situations, looking beyond accepted ways of reducing risk and asking the question: "I understand that this is what we and our competitors have done in the past, but what if . . .?" may catch dormant EERs not robustly reviewed due to your company's or its competitors' past precedent.

These periodic processes of self-evaluation and risk appetite adjustment help a company avoid repeat EERs.[13] Of course, all this must be done in a business context to balance known or suspected EERs against business objectives, company risk attitudes, and applied risk mitigants. In some cases, there are few mitigants if an EER occurs, and in certain of these situations, and depending on the facts, greater, alternate, and duplicative safeguards may be used to better avoid reaching the EER event in the first place. In other cases, identified or potential EERs, or the unknowns surrounding them, may simply rise beyond a company's comfort level and the transaction will not go through or its structure will be altered (e.g., deal structure changed from a stock to an asset purchase to avoid legacy liability).[14]

This fourth risk review step—arguably the most difficult to perform given expected push-back due to accepted industry norms—is where business-minded, forward-looking outside counsel can distinguish themselves from simply providing typical EHS due diligence legal advice and guidance. To do this, outside counsel must be able to spot EERs as perceived through the eyes of the client. This requires an understanding of a client's operations, risk attitudes, concerns, tolerances, and an awareness of the risks that the client has yet to consider. This also requires the outside counsel, in consultation with the client company, to be able to distinguish between an EER with serious consequences for the company as a whole versus a plant-, site- or sub-business-only EHS risk. A suggested best practice is for outside counsel to arrange a call or series of calls, meetings or site visits, often done on a pro bono basis, with company legal and operational staff. This effort will not only educate the outside counsel on a client's risk attitudes and operations to better spot an EER in a transaction, but also typically helps to build goodwill between the parties and, both optically and practically, better link the outside counsel as a partner of the client company's business success.

Due to today's business environment, often the above layers of suggested review must be performed with a global perspective and proper understanding of how different jurisdictions pose unique challenges to avoiding EERs. For example, it is atypical for today's large industrial portfolio transaction to contain U.S.-only assets. Law firms can provide great value here to companies by helping in-house counsel navigate regional EHS risks. While not every law firm can evaluate the laws of each jurisdiction with the same level or expertise, it is prudent for U.S. law firms conducting international environmental transactional reviews to know the basics of EHS laws and EERs in the emerging markets of the "BRIC" countries (Brazil, Russia, India, China). Further, outside counsel that can provide legal guidance beyond a cursory knowledge of the non-U.S. remedial regimes (e.g., "polluter pays," strict liability, negligence liability—often already understood by in-house counsel from at least a general context) and identify industry or country-specific examples/cases relevant to the client's operations, can help them gauge the potential severity of identified or potential EERs.[15] In dealing with international issues, outside counsel are best positioned when they have a strong sense of the client company, its operations and EHS risk concerns, combined with local assets, or, more commonly, affiliations with local firms in the subject jurisdiction. While many U.S. companies and law firms are focused on the vigorously enforced "alphabet soup" of U.S. and EU EHS laws, in global transactions, counsel should place equal importance on emerging markets with their changing global enforcement, community environmental awareness patterns, and governmental oversight.

In summary, companies may benefit from moving beyond traditional remedial and compliance areas when conducting environmental due diligence, and consider reviewing reputational, social, products liability, corrupt practices, and worst-case scenarios from an EER perspective. These additional layers of review, selectively questioning industry norms, practices and asking "what if . . ." or "why is that . . ." questions, combined with the strategic use of informed outside counsel, may help prevent EERs from negatively impacting a company.

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Endnotes

[1] *See, e.g.*, *Bhopal Trial: Eight Convicted over Indian Gas Disaster*, BBC NEWS, June 7, 2010, http://news.bbc.co.uk/2/hi/south_asia/8725140.stm (discussing what is widely considered one of the worst industrial disasters: the 1984 methyl isocyanate gas leak from a pesticide plant in Bhopal, India, which caused thousands of deaths and injuries to the local community, $470 million in injury compensation, and company employee jail time).

[2] *See generally*, *Executive Summary*, COSO ENTERPRISE RISK MANAGEMENT—INTEGRATED FRAMEWORK, 2, Committee of Sponsoring Organizations of the Treadway Commission (Sept. 2004), *available at* http://www.coso.org/documents/COSO_ERM_ExecutiveSummary.pdf.

[3] *See* ISO 31000, Risk Management—Principles and Guidelines, INT'L ORG. FOR STANDARDIZATION, Geneva, Switzerland (2009).

[4] Consider the March 2008 lawsuit filed by buyer INVISTA against seller DuPont to demonstrate the importance of screening transactions. INVISTA claimed nearly $1 billion in damages for DuPont's alleged noncompliance with environmental health and safety laws and for failing its permit obligations. DuPont disputed the allegations. *See*, INVISTA's original press release at http://www2.invista.com/news_releases/2008/pr_080326_invista_files_lawsuit.html. In April of 2009, INVISTA settled with EPA and DOJ to pay a $1.7 million civil penalty and plans to spend about $500 million to address the self-reported environmental violations. *See*, http://www.justice.gov/opa/pr/2009/April/09-enrd-339.html. The lawsuit against DuPont is still pending, after surviving a motion to dismiss in March 2009. *See*, http://www2.invista.com/news_releases/2009/pr_april_13_09_release.shtml.

[5] *See generally*, Environmental Site Assessments for Commercial Real Estate: Phase I Site Assessment and Transaction Screen Processes and Phase II Environmental Site Assessment Process, ASTM International (2006), *available at* http://www.astm.org.

[6] In the United States, in certain situations, new owners can take advantage of certain federal penalty protections if EHS noncompliance issues are identified, disclosed, and addressed early after acquisition. *See, EPA Self-Policing Audit Policy for New Owners*, U.S. Environmental Protection Agency (2008), *available at* http://www.epa.gov/oecaerth/incentives/auditing/newowners-incentives.html.

[7] For example, consider the historical asbestos tort liability of the major corporations W.R. Grace, Owens Corning, and Babcock & Wilcox related to their U.S. bankruptcy filings. When evaluating EERs, a distinction usually can be made between toxic tort asbestos liability and asbestos premise liability, with the latter typically posing much less of a risk (e.g., with asbestos reconstruction notifications or asbestos roofing shingles or flooring).

[8] For an example of alleged, but later dismissed, supplier reputational issues, see *Doe I v. Wal-Mart Stores, Inc.*, 572 F.3d 677 (9th Cir. 2009) (employees of foreign suppliers brought an action against Wal-Mart for violation of its code of conduct for its foreign suppliers, which required suppliers to comply with local law standards regarding working conditions such as pay, hours, forced labor, child labor, and discrimination. The 9th Circuit upheld the district court's decision to dismiss these claims because the benefits of the code of conduct did not flow to suppliers' employees).

[9] *See* the EQUATOR PRINCIPLES, *available at* http://www.equator-principles.com/index.php/the-eps-and-official-translations.

[10] *See* David Barboza, *After Suicides, Scrutiny of China's Grim Factories*, N.Y. TIMES, June 6, 2010, at A1, *available at* http://www.nytimes.com/2010/06/07/business/global/07suicide.html (reporting on the world's largest contract electronic supplier, which holds a 300,000 employee factory in its portfolio and supplies electronic components to many U.S. and global businesses. The article alleges that poor working conditions including forcing employees to work three

times the legal limit of overtime amidst industrial fumes and suffer verbal abuse has led to 13 work-related suicides or attempted suicides).

[11] As an example of the impact an EER can have from a high-risk operation, consider the April 20, 2010, explosions and fires on the Deepwater Horizon oil rig that killed 11 people and released millions of barrels of oil into the Gulf of Mexico for five months until the well was sealed on September 19, 2010. The impacts on the company were substantial: British Petroleum's (BP) stock price dropped significantly, and BP created a $20B claims fund. Also, the U.S. Department of Justice filed a civil suit against defendants associated with the Deepwater Horizon oil rig and spill. Among the claims made by the government are that the defendants failed to take necessary precautions to keep the well under control, use the best available and safest drilling technology to monitor well conditions, maintain continuous surveillance, use and maintain equipment and material to ensure safety and protection of personnel, equipment, natural resources, and the environment. *See United States v. BP Exploration & Production, Inc. et al.*, Docket 2:10-cv-04536 (E.D. La. 2010) at http://www.justice.gov/usao/lae/news/2010/downloads/complaint_12152010.pdf. This case is one of over 200 similar environmental claims filed in relation to the incident. *See*, Deepwater Horizon Oil Spill Litigation Database, ENVIRONMENTAL LAW INSTITUTE, http://www.eli.org/Program_Areas/deepwater_horizon_oil_spill_litigation_database_results.cfm?case_type=Environmental. *See* note 13 below regarding BP's lessons learned.

[12] E.g., the governments of Brazil and Norway—but not the United States—required, at the time of the Deepwater Horizon spill, blowout preventers to have both electronic and acoustic triggers. *See, e.g.*, Russell Gold, *Leaking Oil Well Lacked Safeguard Device*, WALL ST. J., Apr. 28, 2010, *available at* http://online.wsj.com/article/SB10001424052748704423504575212031417936798.html.

[13] *See*, Lamar McKay, Chairman and President, BP America, Speech at the Offshore Technology Conference (May 3, 2011), *available at* http://www.bp.com/articlelisting.do?taxonomyId=-1&year=2011&contentId=2008132&categoryId=98&mon=&currentPage=2 (providing an interesting perspective on BP's go-forward thinking and lessons from the crisis). *See also BP Donating Oil Spill Revenues to Charity*, MARKETWATCH, June 22, 2010, *available at* http://www.marketwatch.com/story/bp-donating-oil-spill-revenue-to-charity-2010-06-22 (reporting that BP committed to donate revenue from the oil it recovers from the Horizon rig oil spill in the Gulf of Mexico to the National Fish and Wildlife Foundation).

[14] Even changing a transaction from a stock to an asset structure may not avoid the transfer of a company's legacy liabilities. This may occur when it is considered a de facto merger, or when the structure is seen as fraudulent to avoid liability. *See United States v. General Battery Corp.*, 423 F.3d 294 (3d Cir. 2005) (General rule of corporate successor-ship accepted in most states is non-liability for acquiring corporations, with the following exceptions: The purchaser may be liable where: (1) it assumes liability; (2) the transaction amounts to a consolidation or merger; (3) the transaction is fraudulent and intended to provide an escape from liability; or (4) the purchasing corporation is a mere continuation of the selling company.).

[15] Examples such as the following, and how they could impact a client's operations in the BRIC and other emerging markets, may help a company in identifying and addressing EERs in a transaction: (1) does a 2010 Indian cabinet decision to seek additional compensation and extradition related to the 1984 methyl isocyanate release impact an Indian joint venture's officer or director liability analysis; (2) whether the U.S. Alien Tort Act applies to non-U.S. environmental disasters or supplier labor violations; (3) how the arrests in China of 96 people and execution of two people tied to the recent tainted milk scandal may have influenced Chinese environmental enforcement; and (4) how "know your partner/supplier" analyses are affected by the fact that in 2010 a Chinese environmental firm became the first Chinese company listed on the NYSE to be investigated by the U.S. Securities and Exchange Commission for alleged bribery violations under the Foreign Corrupt Practices Act.

U.S. EPA'S AUDIT POLICY: THE BENEFITS OF COMING CLEAN

Benjamin C. Grawe, Natalia Minkel-Dumit, and Edward B. Witte

No matter what a company's procedures are for identifying, correcting and preventing violations of environmental laws and regulations, in-house environmental counsel should be fully familiar with the U.S. Environmental Protection Agency's (US EPA's) Audit Policy.[1] Although many have criticized the US EPA's Audit Policy as being a Catch-22 labyrinth, it helps to hear stories of companies that successfully disclosed violations under the Audit Policy, and to focus on the issues any company should consider in deciding whether to disclose its own violations under the Audit Policy. It also helps to have a clear understanding of when the policy applies and how it operates.[2]

A. The Audit Policy

Under the Audit Policy, companies that voluntarily disclose environmental violations to US EPA and satisfy nine specific conditions are eligible for 100% reduction of all "gravity-based" civil penalties.[3] This means that US EPA will not impose punitive penalties for the severity of the violation, and will seek penalties only based on the amount of money a violator saved by not being in compliance (the so-called "economic-benefit" penalties).[4] Also, if the violation is a criminal violation, in most cases, US EPA will not recommend criminal prosecution if a company satisfies the nine conditions of the Audit Policy.[5]

To be eligible for full gravity-based penalty mitigation under the Audit Policy, the violator must show that it has met nine criteria: (1) the violation must be systematically discovered through an environmental audit or compliance management system; (2) the violation must be discovered voluntarily (*i.e.*, not as a result of a legal requirement – basically, by statute, rule, permit or order); (3) the violation must be disclosed to US EPA within 21 days of discovery; (4) the company must discover and disclose the violation before US EPA likely would have; (5) the company must correct the violation within 60 days; (6) the company must take measures to prevent recurrence of the violation; (7) the violation cannot be a repeat violation that has already occurred at the same facility within the past 3 years, or as part of a pattern of violations at another company facility or facilities within the past 5 years; (8) the violation cannot be one that has resulted in serious actual harm, presents an imminent and substantial endangerment, or is a violation of specific terms of an administrative/judicial order or consent agreement; and (9) the company must cooperate with US EPA in determining the applicability of the Audit Policy.[6] The Audit Policy applies only to settlement proceedings, not adjudicatory proceedings.

Entities that satisfy all but the first condition can still receive a 75% gravity-based penalty mitigation, as well as a recommendation of no criminal prosecution.[7] For companies that have recently acquired a facility or multiple facilities, US EPA uses a slightly modified version of the Audit Policy to address specific issues related to discovery and disclosure of violations caused by previous owners.[8] New owners (*i.e.*, those not involved in previous environmental compliance at the facility) are entitled to penalty mitigation if, within nine months of the transaction closing, they meet all of the conditions of the Audit Policy – some of which are relaxed for new owners, including the requirements of systematic discovery (condition 1), voluntary discovery (condition 2), and the exclusion of some violations that resulted in actual harm or presented an imminent and substantial endangerment (condition 8).[9] If discovery of the violations occurred prior to acquisition of the facility, the company has 45 days after closing to disclose the violations to US EPA.[10] The remaining conditions apply as they would for current owners under the Audit Policy. For small companies, the US EPA's criteria are also slightly relaxed. Those with 100 or fewer employees need not have a systematic compliance program in place (any audit will do) to receive the full penalty mitigation, and instead of the 60 day period to correct the violation, small businesses receive 180 days, or 360 days if correcting the problem involves implementing pollution prevention measures.[11]

B. Successfully Using the Audit Policy

Although certain conditions of the Audit Policy may be difficult to interpret and satisfy, thousands of companies have benefited from disclosing violations under the Audit Policy since it was released in 2000. The largest

self-disclosure case occurred after Koch Industries purchased INVISTA from DuPont in 2004 and subsequently disclosed 680 environmental violations (mostly related to air emissions) at 12 DuPont facilities to US EPA in accordance with the Audit Policy.[12] As a result of the disclosures, US EPA agreed not to seek any gravity-based penalties from Koch, and the company agreed to a $1.7 million economic-benefit penalty to settle the violations. INVISTA also agreed to spend between $240 million and $500 million to correct environmental violations at facilities in 7 states.[13]

In 2006, Johnson Controls, Inc. (JCI) discovered — through a systematic environmental audit — and subsequently disclosed air permitting violations at facilities in 5 states that JCI had recently acquired from York International Corporation and Environmental Technologies, Inc.[14] Following the acquisition, JCI determined that none of the facilities had necessary Clean Air Act (CAA) permits, including Title V and Prevention of Significant Deterioration permits, the most restrictive permitting category under the CAA. JCI timely disclosed the violations to US EPA in accordance with the nine criteria of US EPA's Audit Policy. In 2009, after 3 years of negotiation, JCI and US EPA entered into a Consent Agreement and Final Order (CAFO) to resolve the violations.[15] Under the CAFO, US EPA agreed to a zero-dollar penalty, waiving all gravity-based penalties (estimated in the CAFO at $1.5 million), and did not seek any economic-benefit penalty. US EPA agreed with JCI's analysis, under US EPA's Economic Benefit Model, that JCI had obtained a *de minimis* benefit (or none at all) in connection with the violations. If JCI had not used the Audit Policy to disclose the violations, it could have faced significant penalties (in excess of $1.5 million), and would not have benefited from the goodwill that the voluntary disclosure generated both externally and internally. In addition, as a result of JCI's audit of the facilities and steps to come into compliance, JCI is recognizing substantial, per year, economic savings, due in part to the development of new technology that is not only more environmentally friendly, but cheaper.

These examples highlight successful use of the US EPA's Audit Policy. Similar policies exist in multiple states, including California, New York, Florida and Indiana.[16] However, prior to disclosing any violations, counsel for any company should carefully consider: (1) whether the company fully satisfies all conditions for penalty mitigation; (2) the likelihood of enforcement; (3) the potential costs of non-disclosure if the company faces an enforcement action; and (4) whether the potential benefits of disclosure outweigh the costs. Additionally, to the extent companies have not already done so and wish take advantage of such policies, it is important to make environmental compliance platforms and procedures a priority within the organization. This means devoting resources to the auditing process, developing a budget, ensuring proper documentation, and securing adequate management oversight. Environmental compliance measures often lead to difficult decisions regarding evaluation of the information discovered, the source, whether or not to disclose potential violations, and just how to do so.[17] Still, the benefits of establishing the measures, including improved environmental performance, conservation of resources, and increased overall efficiency, tend to outweigh the costs.[18]

C. Considered Use of the Audit Policy

Possible use of the Audit Policy, including disclosure to a government agency, and implementation of the environmental compliance foundations upon which it derives, should be discussed with members of the company's internal (and external) legal and environmental team. If a company cannot or may not meet all of the Audit Policy conditions (or US EPA determines that it does not), there may still be hope to reduce the overall penalty. The Audit Policy provides that a company which fails to meet any of the conditions and is therefore not eligible for penalty relief may still be eligible for some penalty relief under other media-specific enforcement policies in recognition of "good-faith efforts."[19] For instance, good-faith efforts are a factor to be considered by the US EPA in determining penalties for violations of the CAA.[20] Gravity based penalties may be reduced up to 30% for such "efforts." The company bears the burden of proof, which may consist of prompt reporting of noncompliance and prompt correction of the environmental problems.[21] It should also be noted that the Audit Policy may not be around forever. This was signaled recently by the US EPA in an Office of Enforcement and Compliance Assurance (OECA)

draft National Program Manager Guidance for FY2013, which calls for a reduction in OECA and Regional work on the Audit Policy to a "level of minimal national coverage."[22] OCEA reasons that although the Audit Policy has resulted in a significant number of disclosures, the "environmental benefit from those disclosures is estimated to be significantly less than traditional enforcement, and the disclosure have generally not focused on the highest priority areas."[23]

Penalty relief may also be available under US EPA's Supplemental Environmental Projects ("SEP") Policy,[24] or US EPA's Guidance on Determining a Violator's Ability to Pay a Civil Penalty.[25] Under US EPA's SEP Policy, US EPA may require any alleged violators of environmental statutes and regulations to perform environmentally beneficial projects - such as protection of a wildlife habitat - as part of any civil or administrative settlement agreement with US EPA to resolve the matter. If the SEP satisfies all criteria under the SEP Policy, then the value of the SEP is used to reduce the alleged violator's monetary penalty. Under US EPA's Guidance on Determining a Violator's Ability to Pay a Civil Penalty, US EPA may adjust penalties of for-profit or closely held entities if the alleged violator shows that paying a civil penalty would cause "extreme financial hardship." This type of penalty adjustment is referred to as the "ability to pay factor" and is determined based on a detailed review of the alleged violators financial statements and specified formulas for calculating an adjustment. Companies that are facing environmental penalties should consider the policies discussed in this article and consult with legal counsel to evaluate the applicability of these polices and other penalty policies that may apply.

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Endnotes

[1] *Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations,* 65 Fed. Reg. 19,618 (April 11, 2000) (the "Audit Policy").

[2] This article focuses on the Audit Policy and its application to most medium to large companies, and to a lesser extent its application to small businesses (*see* Note 11, *infra*), but we note that there is also a Voluntary Disclosure Policy issued by the US Coast Guard that is modeled closely after the Audit Policy. More information can be found at: http://www.uscg.mil/foia/docs/CH-4%20Appendix%20V.pdf.

[3] Supra note 1, at 19,620 – 19,623.

[4] *Id*. at 19,625.

[5] *Id*. at 19, 620; although, note that the US Department of Justice has ultimate prosecutorial discretion under its 1991 guidance entitled *Factors on Decision in Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure by the Violator* (http://www.justice.gov/enrd/3058.htm), its 1999 *Guidance on Federal Prosecutions of Corporations* (http://federalevidence.com/pdf/Corp_Prosec/Holder_Memo_6_16_99.pdf), and its 2008 *Principles of Federal Prosecution of Business Organizations* (http://www.justice.gov/dag/readingroom/dag-memo-08282008.pdf).

[6] *Id* at 19,620 – 19,623.

[7] *Id*. at 19,625.

[8] *Interim Approach to Applying the Audit Policy to New Owners,* 73 Fed. Reg. 44,991 (August 1, 2008).

[9] *Id*.

[10] *Id*. at 45001.

[11] 65 Fed. Reg. 19,630 (April 11, 2000).

[12] US EPA, *United States Announces Largest Settlement Under Environmental Protection Agency's Audit Policy* (April 13, 2009), available at http://yosemite.epa.gov/opa/admpress.nsf/d0cf6618525a9efb85257359003fb69d/1e9d18f061b4da818525759700632926!OpenDocument (last visit October 25, 2011).

[13] US EPA, *INVISTA Audit Settlement Information Sheet,* available at http://www.epa.gov/compliance/resources/cases/civil/mm/invista-infosht.html#civil (last visited October 25, 2011).

[14] *In the Matter of Johnson Controls, Inc.*, Consent Decree, Docket #HQ-CAA-2008-6001 (EAB, October 06, 2009); available at http://yosemite.epa.gov/oa/EAB_Web_Docket.nsf/0/f982cfc44c19e48a8525765000618c72?OpenDocument (last visit October 25, 2011); *see also EPA Compliance and Enforcement Annual Results, 2010 Fiscal Year, Additional Compliance Activities*, available at http://www.epa.gov/compliance/resources/reports/endofyear/eoy2010/compliance.html (last visited October 25, 2011).

[15] *Id*.

[16] *See* US EPA, *State Audit Privilege and Immunity Laws & Self-Disclosure Laws and Policies*, available at http://www.epa.gov/region05/enforcement/audit/stateaudit.html (last visited October 25, 2011).

[17] Typically, disclosures are made through written communication with US EPA's Office of Enforcement and Compliance Assurance. The US EPA has a pilot program, however, that allows for electronic disclosure of certain violations under the Audit Policy. More information is available at: http://www.epa.gov/compliance/incentives/auditing/edisclosure.html.

[18] For more on the costs and benefits of an environmental management system, see US EPA's website at: http://www.epa.gov/ems/info/costben.htm; *see also* the International Standards for Organization's 14000 group of environmental management standards, which can be found at: http://www.iso.org/iso/iso_14000_essentials.

[19] 65 Fed. Reg. at 19627.

[20] *See* Kathie A. Stein (EPA), *Clarification of the Use of Appendix I of the Clean Air Act Stationary Source Civil Penalty Policy*, II.B.4.b.

[21] Additional information about the Audit Policy is available on US EPA's website at: http://www.epa.gov/oecaerth/incentives/auditing/auditpolicy.html.

[22] *US EPA Office of Enforcement and Compliance Assurance (OECA) Draft National Program Manager (NPM) Guidance*, Publication No. 305P12001, p. 14 (February 10, 2012).

[23] *Id.*

[24] Additional information about the US EPA's SEP policy can be found at: http://www.epa.gov/compliance/resources/policies/civil/seps/fnlsup-hermn-mem.pdf

[25] See US EPA's *Guidance on Determining a Violator's Ability to Pay a Civil Penalty* (December 16, 1986), which can be found at: http://www.epa.gov/compliance/resources/policies/civil/penalty/civilpenalty-violators.pdf.