



From: Greg Rogers [mailto:rogers@advancedenvironmentaldimensions.com]
Sent: Tuesday, July 01, 2008 12:42 PM
To: Director - FASB
Subject: File Reference No. 1600-100.

Ladies and Gentlemen:

I am pleased to comment on the Exposure Draft, "Disclosure of Certain Loss Contingencies: an amendment of FASB Statements No. 5 and 141(R)." I support the Board's efforts to expand disclosures about certain loss contingencies within the scope of Statement 5 and Statement 141R with the objective of providing adequate information to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies. Consistent with that objective, I want to draw the Board's attention to an important area that is not addressed by the Exposure Draft—the use of indemnification arrangements as surrogates for due diligence in business and asset acquisitions. A particularly striking example of this practice involves the use of so-called "no look" agreements.

In the sale of real estate or a business that carries some degree of environmental risk, a seller can expect the buyer to insist on an indemnity for damages arising from environmental conditions that existed prior to the closing. One problem from the seller's perspective is that after the closing, a buyer with a favorably-structured environmental indemnity may have an incentive to conduct extensive investigations of the acquired assets and operations to determine if there is contamination or compliance violations, secure in the knowledge that the seller will have to foot the bill for any resulting corrective action costs. In response to this problem, it is becoming more common for sophisticated sellers to negotiate provisions in their sales agreements that limit a buyer's ability (or incentive) to go looking for evidence of environmental loss contingencies that could result in an indemnification claim. "No look" provisions—so-called because they impose limitations on the buyer's ability to "look" at subsurface environmental conditions—are commonly employed by sellers to this end. See attached article, "*No Look Provisions Are Opening Eyes*" on page 21.

While "no look" agreements expressly state the intention of the parties to discourage the identification and assessment of suspected loss contingencies, broad environmental indemnities are commonly used as a surrogate for environmental due diligence in mergers and acquisitions. In a current high-profile case, the interpretation of such an indemnity is at the heart of litigation involving a Koch Industries subsidiary (INVISTA) and Dupont. See [DuPont Rejects 'Grossly Exaggerated' Contract Allegations by INVISTA.](#)

Paragraph 7c of the Exposure Draft requires disclosure of the terms of relevant indemnification arrangements that could lead to a recovery of some or all of a possible loss. This paragraph, however, seemingly would not require disclosure of indemnification arrangements relating to *undisclosed* loss contingencies. Thus, disclosure of the indemnification arrangements relating to reasonably suspected contingencies that are subject to a "no look" agreement seemingly would not be required.

The use of indemnification arrangements, including "no look" agreements, to avoid identification and assessment of loss contingencies that might otherwise be subject to

disclosure under the Standard seems inconsistent with the Board's stated disclosure objective. Regardless of the Board's position on the issue, however, a statement of the Board's position would be useful. In the absence of clarification, some preparers may be uncertain how to treat such arrangements in their financial statements, and users will be unsure as to what to expect.

In light of the foregoing, I ask that the Board expressly address the following issues in the final Statement:

1. Does the Statement impose or imply any process/internal control requirement on preparers to undertake commercially reasonable due diligence (e.g., as set forth in various standards adopted by ASTM International) business combinations and asset acquisitions in order to identify and assess potentially material loss contingencies? Alternatively, is willful blindness acceptable?
2. Does the Statement require preparers to disclose the existence and nature of indemnification arrangements, including "no look" agreements, that have been used to avoid identification and assessment of loss contingencies that might otherwise be subject to disclosure?
3. If disclosure of such arrangements is required, what information must be disclosed regarding the indemnification arrangement and the unidentified loss contingencies?

Thank you for your consideration.

Best regards,

Greg

Advanced Environmental Dimensions, LLC
750 N. St. Paul St., Suite 300
Dallas, TX 75201
866.599.0009
rogers@advancedenvironmentaldimensions.com
www.advancedenvironmentaldimensions.com

- 5. First check that the maintenance fees are paid on potential problem patents.
- 6. "Prior art" is all publications and public uses, including grant proposals, sales, offers for sale, and the like, that were published or occurred before the filing date of an application.

- 7. Prior art can be used to invalidate a patent to the extent that it describes the same invention.
- 8. Employees may have a duty of confidentiality and a duty to assign inventions to their employer, but it is still advisable to have these requirements in writing.

"No Look" Provisions Are Opening Eyes

By **Stuart Hammer** and **Kirk D. Lipsey**

In a sale of a business that includes real property or that otherwise carries some degree of environmental risk, a seller can expect the buyer to insist on an indemnity for damages arising from environmental conditions that existed prior to the closing. One problem from the seller's perspective is that after the closing, a buyer with a favorably-structured environmental indemnity may have an incentive to conduct extensive subsurface investigations of the acquired property to determine if there is contamination, secure in the knowledge that the seller will have to foot the bill for any resulting remediation costs. In response to this problem, it is becoming more common for sophisticated sellers to negotiate provisions in their sales agreements that limit a buyer's ability (or incentive) to go looking for evidence of environmental contamination that could result in an indemnification claim. "No look" provisions—so-called because they impose limitations on the buyer's ability to "look" at subsurface conditions—are commonly employed by sellers to this end.

Triggering Cleanup Obligations

Many industrial properties are contaminated as a result of historical releases of hazardous substances. The mere fact that these properties are contaminated, however, does not in itself compel the owner or operator of such site to investigate or remediate contamination—especially if the existence of contamination is undocumented. Contamination generally can remain in place until there is some action or event that obligates the owner or operator, as a matter of law, to investigate or remediate.

One of the most common triggers for such obligations is a subsurface investigation, such as a soil or groundwater investigation, that reveals contamination in excess of regulatory levels. In such instances, companies will frequently be required to report the contamination to environmental regulatory authorities and may thereafter be required to undertake further investigation or remediation of the contamination.

"No look" provisions generally provide that a seller will have no indemnification obligation to the extent the buyer's claim results from an environmental condition that was discovered as a result of the buyer's post-closing subsurface investigation or testing. A typical no look provision provides as follows:

Seller shall have no obligation to defend, indemnify or hold harmless Buyer with respect to any environmental claim if any such claim relates to, arises out of or is triggered by any condition that is discovered or identified as a result of any environmental investigation, testing or sampling conducted by or on behalf of Buyer after the Closing.

[[It is becoming more common for sophisticated sellers to negotiate provisions in their sales agreements that limit a buyer's ability (or incentive) to go looking for evidence of environmental contamination that could result in an indemnification claim.

Until quite recently, most buyers, particularly financial buyers, were unwilling to entertain the inclusion of no look provisions, which they viewed as an unreasonable restriction on the use of their property. Some buyers also objected on the basis that such provisions deprived them of the ability to conduct a subsurface investigation prior to the expiration of the seller's indemnification period in order to determine whether an indemnification claim should be made.

Recently, however, no look provisions have begun to appear more frequently in purchase agreements.

Stuart Hammer (shammer@debevoise.com) is Counsel in the New York office of Debevoise & Plimpton LLP and a member of the firm's Corporate Department and its Environmental Practice Group. **Kirk D. Lipsey** (klipsey@debevoise.com) is an associate in the Corporate Department in the firm's New York office.

Some buyers will be more inclined to accept no look provisions if they are reasonably confident that the business they are buying is “clean”. Buyers may also be willing to acquiesce if their acquiescence can be bartered for a contractual provision that they view as more valuable than a no look provision is adverse. And it is sometimes the case that the economics of the transaction are simply too attractive to the buyer for a no look provision to be a deal-breaker.

Limiting No Look Provisions

While a no look provision may in principle be acceptable, a buyer will want to ensure that it is not unduly restrictive; there are circumstances under which a buyer will have sound legal or commercial reasons to undertake a reasonable subsurface investigation that does not constitute the sort of indemnity-driven “fishing expedition” that sellers worry about in pressing for no look provisions in the first place. With all of the limitations on no look provisions discussed below, the challenge will be to agree on wording that preserves appropriate buyer flexibility while allaying seller concerns that the exceptions could be manipulated to permit a fishing expedition by the buyer.

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Legal Requirements. Buyers should expressly retain the ability to conduct subsurface investigations that are required by law or by a regulatory authority. For example, a regulator may require the buyer to conduct a subsurface investigation in order to determine the impact of a post-closing release of hazardous substances. If a post-closing release has occurred, a buyer that has agreed to an unlimited no look provision may not have any recourse against the seller for any pre-closing contamination discovered during its investigation, since in the absence of a carve-out, the no look provision will eliminate any indemnity recovery for damages identified as a result thereof. A seller worried that an “except as required by regulators” carve-out from the no look provision gives the buyer too much leeway could negotiate for language precluding the buyer from initiating contact with regulators unless required to do so under applicable law.

Third Party Claims. Buyers should carve out exceptions that would permit subsurface investigations

undertaken in connection with third party claims. For example, a subsurface investigation may be needed to refute a claim brought by a neighboring landowner alleging that contamination has migrated to the neighboring property. But if the buyer undertakes a subsurface investigation that reveals pre-existing contamination, it will, by virtue of the no look provision, have waived its right to indemnification and thus may be liable for any such contamination unless the no look provision contains a suitable carve-out.

Construction Activities. When a buyer expands a facility or conducts other construction activities, it may need to conduct a subsurface investigation. From the buyer’s perspective, the no look provision should not prevent subsurface investigations conducted in such circumstances. On the other hand, sellers may take the view that an exception for construction activities could be “gamed” by a crafty buyer looking to undertake a subsurface investigation so as to exploit the seller’s indemnity.

A better approach is to express the no look provision in the form of a limitation on the buyer’s right to an indemnity, so that the buyer would be unable to recover damages under an indemnity if the damages were brought to light by a post-closing subsurface investigation commissioned by the buyer.

Corporate or Real Estate Transactions. Buyers should insist on being able to conduct subsurface investigations in connection with corporate or commercial transactions. For example, when a buyer ultimately decides to dispose of a property, it may be important for the parties to be able to evaluate and quantify the environmental issues that could bear on the transaction by conducting an environmental investigation. Similarly, in connection with financing transactions, lenders may require subsurface investigations in order to appraise the environmental risk associated with their collateral.

Harm to the Environment. Buyers may want to carve out an exception for situations in which it would be prudent to commission a subsurface investigation in light of facts indicating a potentially significant risk to human health or the environment, even in situations in which testing is not required by law.

Ordinary Course of Business. Buyers should negotiate exceptions that let them undertake subsurface investigations that are necessary or appropriate in the ordinary course of the buyer’s business even if not

required by law or in connection with construction activities. For example, a subsurface investigation may be necessary in order to resolve building foundation issues.

Covenant vs. Indemnity Limitation

No look provisions are sometimes drafted in the form of negative covenants that expressly prohibit buyers from conducting subsurface investigations after closing. Depending on how the provision is drafted, however, this approach could pose enforceability issues, because as a matter of public policy courts may be loathe to uphold contractual provisions that could have the effect of exacerbating existing environmental problems or discouraging their remediation.

A better approach is to express the no look provision in the form of a limitation on the buyer's right to an indemnity, so that the buyer would be unable to recover damages under an indemnity if the

damages were brought to light by a post-closing subsurface investigation commissioned by the buyer. While the intended effect is the same—to discourage post-closing subsurface investigations by an indemnified buyer—an indemnity limitation like this is less likely to run afoul of public policy than a negative covenant, since it does not directly or explicitly forbid an action that may be necessary for the protection of human health and the environment.

Conclusion

The use by sellers of no look limitations has in recent years become more common, but a buyer willing to accept them in principle will want to be sure that the form of the limitation leaves enough flexibility for the buyer to undertake environmental investigations on its property as and when reasonable legal or business considerations warrant.

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