

Time To Step Up PFAS Due Diligence In Cross-Border M&A

By **Andrew Davis, Alfredo Fernández and Sarah Kettenmann** (January 16, 2024)

A European business contact introduces you to a foreign client interested in an acquisition of a U.S. container packaging company to expand its global business. The deal triggers supply chain considerations, as well as exclusive vendor agreements and supplier contracts.

In addition to the standard mergers and acquisitions legal counsel you would provide, you identify environmental risks — particularly regarding potential per- and polyfluoroalkyl substances contamination — as a relevant environmental issue for this deal.

What are your next steps? Dig deep. PFAS due diligence will be a game changer in 2024 and beyond.

PFAS Background

PFAS are a category of chemical substances that are subject to vastly differing, and rapidly evolving, jurisdictional requirements around the world. Given their abilities to repel liquids and resist heat, PFAS have been commonly used for decades in industrial and consumer products, such as firefighting foam, furniture, cosmetics, clothing and food packaging.

However, PFAS are now understood to biodegrade very slowly — if at all — and are linked to environmental contamination problems and serious human health issues.

As a result, lawsuits have arisen globally with claims and settlements reaching billions of dollars against PFAS manufacturers, drinking water providers, retailers of PFAS-containing products, restaurants using PFAS-containing food packaging and entities that historically used PFAS-containing firefighting foam.

Lawmakers and regulators in some jurisdictions across the globe have responded forcefully. Many global watchdogs have taken steps to rein in PFAS contamination and its effects.

The U.S. and EU are considering and deploying measures that require aggressive soil and groundwater testing, and permit only extremely low maximum contaminant levels in drinking water sources. Global manufacturers and importers will have to identify PFAS and certify the existence of PFAS in their products, whether added intentionally or not — and likely cease the use of PFAS in their industrial and commercial products.

PFAS Considerations for International M&A

The growing list of PFAS bans in packaging across jurisdictions requires manufacturers, importers and distributors to take a close and continuous look at their products, markets and supply chains. The U.S. Environmental Protection Agency has proposed strict regulations limiting PFAS levels in drinking water, and has issued a final rule requiring



Andrew Davis



Alfredo Fernández



Sarah Kettenmann

manufacturers and importers to report PFAS manufactured and used in the U.S.

The EPA has also sought public input for a proposed rulemaking regarding potential future hazardous substance designations of certain PFAS under the federal Comprehensive Environmental Response, Compensation, and Liability Act, or CERCLA, also commonly known as Superfund.

These federal regulatory initiatives overlay and, in certain instances, conflict with, state legislation and state agency rules, creating a patchwork of confusing requirements.

At the beginning of 2023, the European Chemicals Agency published a proposal to create a strict definition of PFAS that may end up eliminating the use of nearly all PFAS in the EU as soon as 2025. These new regulations could evolve to become global standards out of necessity and scale.

Even without global buy-in, the regulations would still be enforceable against U.S. and other non-EU companies under the EU's Directive on Whistleblowers, which allows confidential reporting of noncompliance with EU regulations.

The rapidly evolving legal developments in the U.S., EU and elsewhere around the globe have left attorneys scrambling for answers — particularly for cross-border deals and multijurisdiction transactions.

The Renewed Importance of Due Diligence in International M&A

The recognition of potential PFAS impacts on cross-border M&A transactions is critical for several industries. Traditionally, most risks in M&A could be resolved contractually. Evolving PFAS legal requirements — and legacy liabilities arising from them — in relevant jurisdictions will significantly change that calculus.

For instance, many companies with downstream customers will be asked to certify compliance with new PFAS laws and regulations. In response, those same companies will also request analogous certifications from their upstream suppliers of raw materials and packaging.

With so many entities involved in multinational manufacturing deals, it will be very difficult to certify that every step in the supply chain follows relevant PFAS requirements. The potential impacts of PFAS requirements demand new and evolving due diligence efforts that should be tailored to clients based on their industry and respective positions as buyers, sellers, lenders and investors.

Buyers

A buyer's due diligence may start by considering whether the relevant jurisdiction currently requires, or will soon require, PFAS testing of soil, groundwater, drinking water, raw materials or final products.

In the last decade, timelines for international M&A transactions have shortened, leaving less time for environmental and risk management reviews that could expose critical deal-breakers, such as problematic historical site data that could point to future expensive cleanup obligations and toxic-tort claims.

Through a PFAS lens, international due diligence should include current and historical

operations at the target's site or sites, as well as waste disposal sites utilized by the target. Due diligence would necessarily include analysis and guidance about the risk that the target's previously negotiated and closed consent orders or decrees and other remedial obligations could be reopened in light of aggressive PFAS requirements.

In stock deals, where the buyer generally acquires "the good, the bad and the ugly," a careful due diligence review should always include the target's formerly owned or operated sites, and its former waste disposal sites. As a risk management tool, as noted below, buyers should consider — where available and cost-effective — bespoke environmental insurance products to cover some of the PFAS risks.

Sellers

PFAS requirements will also push new seller trends. Sellers may want to strategically limit a buyer's due diligence, to avoid getting trapped with newly discovered PFAS issues if the transaction crumbles. Limiting due diligence is key, especially where a jurisdiction's PFAS requirements are not yet sufficiently developed or enforceable, such as in China.

As a risk management tool, sellers — in conjunction with buyers, lenders and investors — may consider environmental insurance. The insurance market is global and maintains its own focus on global environmental risks and liabilities, including those that have historically affected transactions.

New environmental insurance policies may carry PFAS exclusions — blanket or partial — for high-risk sites, such as old metal-finishing manufacturing operations or sites that used foam fire-suppression systems. However, legacy occurrence-based insurance policies may not exclude PFAS, and thus retrospective insurance archeology can reveal favorable risk management assets.

If the target company relies on a supply chain, sellers will also need to address PFAS reporting requirements, and work closely with suppliers and vendors before the sale to secure certifications that materials comply with applicable PFAS requirements.

Lenders and Investors

Considering the dynamic and evolving PFAS legal picture in many jurisdictions, lenders and investors should consider risks to themselves, as well as to their borrowers, throughout the full term of a loan or investment.

While all parties should consider creative risk management strategies for managing potential PFAS liabilities, bespoke environmental insurance programs — where available to cover potential PFAS risks — may be most important for lenders and investors.

What Comes Next

As we head into the new year, the new PFAS normal demands holistic risk management, planning and strategy.

Develop tailored risk management plans for transactions and operations that could be affected by PFAS. Understand newer environmental insurance policy exclusions — whether for pollution legal liability, representations and warranties, or secured creditor environmental insurance policies. Draft bespoke PFAS-related contract terms for each class of multinational M&A client: buyers, sellers, and lenders and investors.

In the absence of consistent global PFAS requirements and a patchwork of differing laws and regulations across jurisdictions, parties active in multijurisdictional and international M&A transactions or product manufacturing should be prepared for the specific risks associated with PFAS.

Andrew N. Davis and Alfredo G. Fernández are partners, and Sarah Kettenmann is an associate, at Shipman & Goodwin LLP.

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