

The



PRACTICAL GUIDANCE

Journal

CAUTIONS AND LEGAL CONSIDERATIONS OF USING GENERATIVE AI IN HEALTHCARE

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GENERATIVE ARTIFICIAL INTELLIGENCE

(AI) continues to dominate headlines and impact most industries from legal to financial and even healthcare. As its capabilities continue to grow, we are just beginning to understand how AI can impact our professional and personal lives in many ways. In this edition of The Practical Guidance Journal, we bring you insights into advantages AI can bring to medical research and development and data analysis, while also considering the legal implications surrounding the use of AI in healthcare decisions. This article discusses liability concerns as well as regulatory, ethical, and safety oversight considerations.

Having your finger on the pulse of emerging trends gives legal professionals an edge over competitors and other firms. Market intelligence can provide an advantage in decision-making and planning. This edition brings you insights into the unprecedented changes that are reshaping the real estate landscape. We also invite you to participate in our annual Private Market Data Survey of trends across the practice areas of real estate, labor and employment, mergers and acquisitions, healthcare, and life sciences. This edition also offers insights into private credit loan transactions and the potential benefits of private credit compared to public credit offered through commercial banks.

A number of environmental concerns are featured in this edition, including federal regulation of oil and gas exploration and production, and wetlands development considerations. This edition offers guidance for real estate developers contemplating purchasing and building on real property that may contain regulated wetlands, and the additional time and expenses often associated with such projects. For companies concerned about how government controls and regulations of greenhouse gas emissions will impact business, we provide guidance on drafting risk factor disclosures along with links to additional Environmental, Social, and Governance resources including risk factor drafting tips and videos.

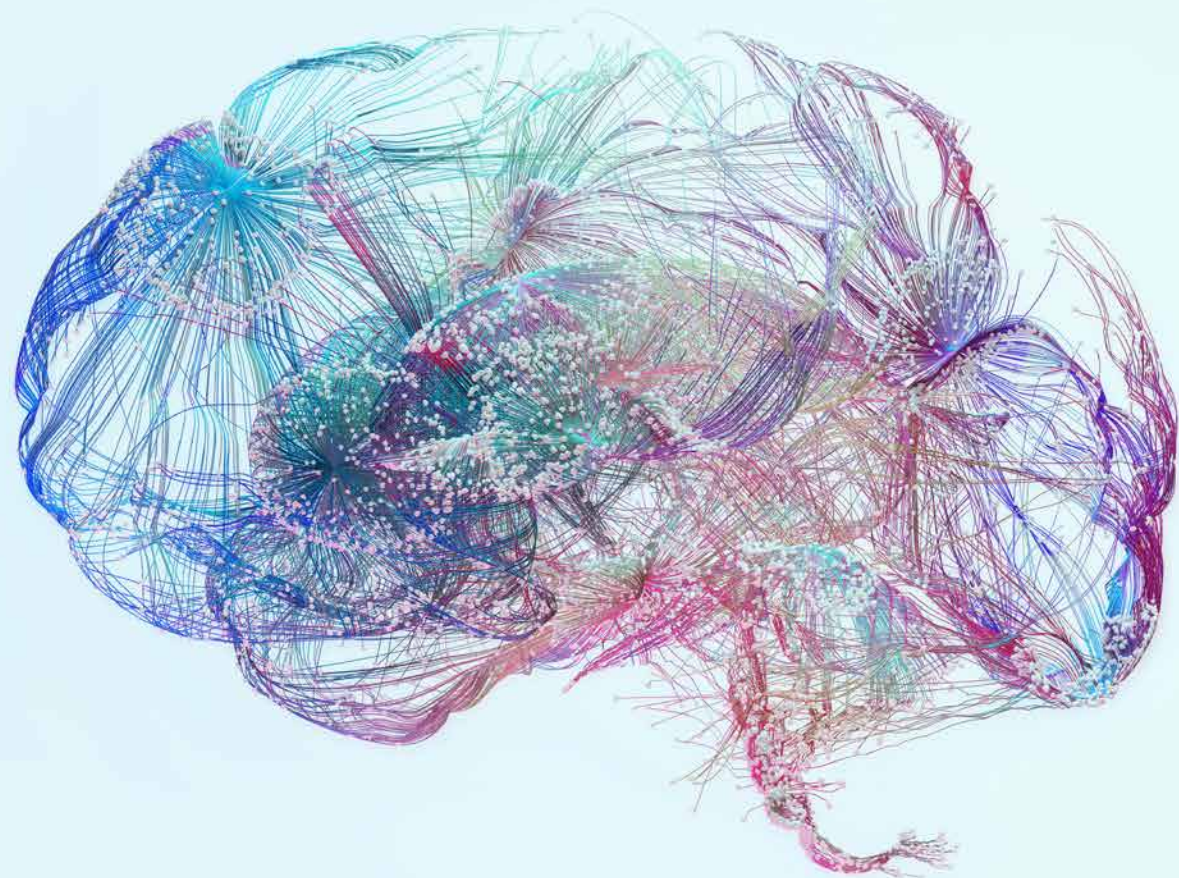
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Sara Shanti, Phil Kim, Christopher Rundell,
Arushi Pandya, and Elfin Noce SHEPPARD MULLIN

Cautions and Legal Considerations of Using Generative AI in Healthcare



The use of generative artificial intelligence (AI) and machine learning (ML) in healthcare is developing at a fanatical and fascinating pace.

BECAUSE THE CONSEQUENCES OF SUCH TECHNOLOGY are yet to be fully understood, thoughtful consideration of its use by industry stakeholders and users is necessary, especially with respect to the legal implications within the healthcare industry. This article discusses AI's development in healthcare and federal and state efforts to regulate its use. It provides health law practitioners with an overview of the legal considerations associated with AI's use in healthcare, including data privacy, corporate practice of medicine, provider licensing, reimbursement, intellectual property, and research. It concludes with a discussion of the ethical considerations involved with AI in healthcare and considerations for protections against potential liability.

AI's Development in the United States and Certain Foreign Jurisdictions

Although AI can be described simply as the engineering and science of making intelligent machines, its effects are much more complex. ML is a subset of AI focused on how to improve computer operations based on informed actions and statistics. While AI programming has been in existence for decades, the recent developments in generative AI have been transformative in mainstream use. Accelerated growth in healthcare can be attributed, at least in part, to the COVID-19 Public Health Emergency (PHE) when digital healthcare, including products driven by AI, emerged as a marketable means to accessible care.

Pre- and post-PHE, the United States has been a premier healthcare leader with breakthrough innovations and research, and this continues to be the case with AI's evolution. However, the current barren regulatory landscape has cast a unique shadow over AI's potential, which is particularly significant in light of an aging population, high Medicaid and Children's Health Insurance Program enrollment—growing 29.8% from February 2020 to December 2022—and multiple ongoing epidemics in mental health and substance abuse. Considering this healthcare climate, AI as a regulated and tamed tool has an incredible opportunity in history with its unique ability to renovate the health and wellness not only of the nation, but the entire global population, at a pivotal point in human history.

Such optimism stands in stark contrast to warnings about AI's potential to harm or mislead. In fact, the World Health Organization (WHO), which issued the Ethics & Governance of Artificial Intelligence for Health in 2021, recently called for caution to be exercised as "the data used to train AI may be biased, generating misleading or inaccurate information that could pose risks to health, equity and inclusiveness." While international bodies, like the European Union, have been actively monitoring and pushing for

limitations on AI for years, to date, the United States has virtually allowed the industry to regulate itself. Without swift action, de facto legal regimes for AI may be established outside of the United States, most significantly in China, if only due to the size of its population base. This is notable, as is the lack of experience by federally elected officials and staff in the crucial arena of computer science and law, coupled with the fact that Congress has been notoriously averse to imposing sweeping limitations on technology companies. The United States has a tremendous opportunity to grow and lead in this arena. Alternatively, many experts strongly believe the role of governing AI must be a global collaboration with international monitoring, similar to how the nuclear field is regulated. While AI now has legislators' attention and future regulation is ultimately expected, stakeholders are hyper-aware of the implications of further delay.

Deaf to legislation battles, AI/ML in healthcare has advanced in a broad range of applications, from innovations in identifying acute health episodes and improving personalization of care and treatment plans, to pharmaceutical development and isolation and self-harm prevention. Understanding that AI is constantly evolving, this article focuses on the legal considerations of AI in healthcare in the United States that can be applied alongside regulatory developments to support protective and successful implementation.

Existing Legal Framework of AI Regulation in the United States

Currently, no comprehensive federal framework to regulate AI/ML exists. The White House's Blueprint for an AI Bill of Rights does offer high-level direction in the design, deployment, and use of automated systems to prioritize civil rights and democratic values. A number of federal agencies have issued high-level guidance or statements, and Congress is taking steps to educate itself, including through hearings with stakeholders and technology executives. However, material and standardized safeguards have yet to be established. In contrast, certain states are actively developing and implementing laws to oversee the development and deployment of AI that impacts healthcare. For example, the California Consumer Privacy Act (CCPA) provides consumers with rights to opt out of automated decision-making technology. Illinois' proposed Data Privacy and Protection Act would regulate the collection and processing of personal information and the use of so-called covered algorithms, which include computational processes utilizing AI/ML. Approximately half of the country's states already have pending or enacted AI legislation.

Stakeholder and industry groups are also actively releasing guidance, despite the lack of enforceability, which materially limits its implementation. For instance, in order to align on health-related AI



standards in a patient-centric manner, the Coalition for Health AI released a Blueprint For Trustworthy AI Implementation Guidance and Assurance for Healthcare. The American Medical Association (AMA) has similarly published Trustworthy Augmented Intelligence in Health Care, a literature review of existing guidance, in order to develop actionable guardrails for trustworthy AI in healthcare.

AI Regulatory Considerations in U.S. Healthcare

At minimum, industry actors should consider the full array of healthcare regulatory and legal issues when creating or using AI/ML products, including those described herein.

Data Privacy

The privacy rights of patients and users are a tremendous consideration at the crux of AI/ML. Consumer and health information privacy laws may be implicated at both the federal and state level with regard to the access, sharing, and use of protected health information (PHI) and personally identifiable information (PII) with AI/ML. Generally, the Health Insurance Portability and Accountability Act of 1996 (HIPAA)¹ limits the ability of certain health entities to share PHI unless an exception applies, and specifically prohibits the sale and commercialization of PHI. In addition, many state data privacy laws are broader and more comprehensive than HIPAA, including CCPA and Washington's recently enacted My Health My Data Act². Such laws may necessitate authorization, consent, notice, or proper anonymization

of data prior to its transfer or use. Further, certain sensitive data, such as mental health, reproductive health, and substance use disorder information; genetic information; and healthcare records of minors are subject to more aggressive restrictions. As such, in assessing AI/ML models or algorithms, it is critical to determine whether PHI, PII, or other sensitive data is regulated and whether consent, notice, and/or other preconditions must be met prior to accessing, disclosing, or transmitting data in AI/ML products.

Data Assets and Rights

With the development of AI/ML, data already collected by healthcare providers becomes a valuable asset that can be used to improve the quality of care for patient populations, and it can also be monetized with further use cases. In order for AI/ML to provide quality results, relevant and high-quality data tailored to the task at hand is imperative. Quality patient data collected at the provider level can be used to improve AI/ML, ultimately resulting in higher-quality outputs. This data can also be monetized through licensure to other companies looking for quality data to train their own AI/ML models. There should be a disciplined approach when allowing third parties or vendors access to this data, as these third parties often request broad rights to use the data to improve their services. Agreements should be carefully crafted to clearly retain all ownership rights in its data for its users, while also providing the relevant third party a limited license to use such data as desired.

Although some generative AI models have shown the capability to pass the United States Medical Licensing Exam, those models cannot be independently licensed to practice medicine at this time. Whether healthcare-related AI/ML products could be interpreted to be practicing or purporting to practice a profession for which a license is required should be considered.

Data Commercialization

Relatedly, caution should be exercised where an AI/ML health product does not have a monetary cost for its use. In some instances, developers of allegedly free AI/ML products are compensated via the use of valuable client data entered into the product. Essentially, a user may be trading data holding value and, in effect, privacy of the data subjects, for the use of the product. The terms of use and privacy policies associated with such products should be closely reviewed to determine the data rights that may be exchanged for the use of an AI/ML product.

The commercial and legal stakes are specifically high with regard to the use of data in AI/ML training. Use of data in a manner that violates federal or state data privacy laws can be potentially catastrophic for an AI/ML product and patient welfare. The developer of the AI/ML model or algorithm could be required to unwind the improperly used data from the AI/ML, which is a complex, near-impossible task, or else destroy the AI/ML models or algorithms that were trained with data that was not properly licensed or obtained, as the FTC has required for certain algorithms trained with improperly used data.

Corporate Practice of Medicine

Generally, the corporate practice of medicine doctrine (CPOM) prohibits the practice of medicine by a corporation, including by employment of licensed healthcare providers (physicians, and in some states other licensed healthcare providers), other than by a professional corporation owned by individuals duly licensed to practice the profession. The public policy rationale behind CPOM is that clinical decision-making should be left to duly licensed professionals, and not be unduly influenced by unlicensed persons or corporations. Not all states have CPOM restrictions, and CPOM laws vary widely state-to-state.

Under existing doctrines, CPOM could impact or outright prohibit generative AI models from being used for clinical decision-making, and in more restrictive states, could prohibit generative AI-related tasks even where a licensed provider supervises the AI. Developments related to the application of CPOM to generative AI in healthcare should be monitored, especially as they are expected to evolve with the proliferation of AI.

Professional Licensing

The type and nature of services supported through AI/ML technology should also be carefully considered.

Practice of Licensed Professions

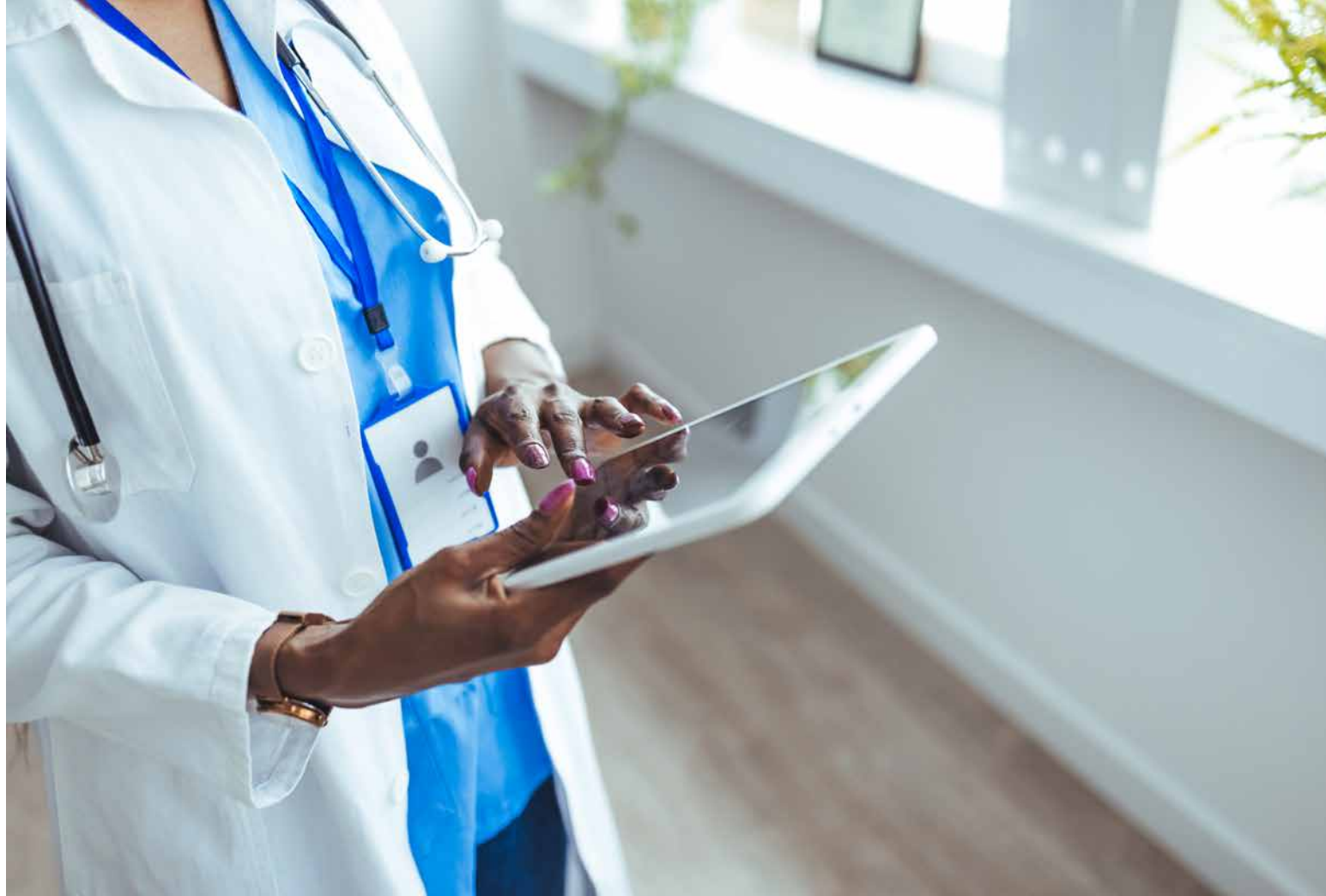
AI/ML technologies could potentially constitute the practice of different types of healthcare professions, including, without limitation, medicine or psychology, which could implicate state laws regulating the scope of practice and licensure of a healthcare practitioner. Industry actors should consider, among other things, the scope of practice, licensure, and marketing laws (e.g., the white coat rule) of the states where AI/ML technology could be used.

Although some generative AI models have shown the capability to pass the United States Medical Licensing Exam, those models cannot be independently licensed to practice medicine at this time. Whether healthcare-related AI/ML products could be interpreted to be practicing or purporting to practice a profession for which a license is required should be considered. At this time, an AI/ML product should be warned against representing or holding itself out as offering services and/or including the name of a licensed profession in its product name, such as therapy or counseling, as these can be defined as licensed professions, with board or other requirements.

Informed Consent

Because the unlicensed practice of a licensed profession can result in penalties for the owner and/or developer of the AI and various types of civil liability, such as tort claims and class actions, the following considerations should be carefully evaluated: (1) whether the descriptive language of the AI services could be interpreted to fall within the scope of the practice of healthcare professions; (2) whether informed consent should include additional descriptions of AI interplay or other disclaimer language for services using AI; and (3) what guardrails should be implemented to enhance transparency and patient trust. For example, if an AI-enabled software or application queries patients on their symptoms to triage them for next steps, such as whether to call a physician or go to an emergency room, and subsequently provides health advice, such actions could constitute the practice of medicine and run afoul of a state's medical licensure laws.

¹ Pub. L. No. 104-191, 110 Stat. 1936 (Aug. 21, 1996). ² 2023 Wash. Advance Legis. Serv., ch. 191.



Professional Decision-Making and Reliance on AI/ML

Providers are likely to ultimately remain responsible for their own medical decision-making within the applicable standard of care (subject to any delegation, collaboration, or supervision requirements in the case of some providers), regardless of the tools they rely upon to inform those decisions. Where provider use of generative AI tools to assist in patient treatment and diagnosis is not prohibited, providers must not substitute the AI's determination for their own judgment or wholly rely on such determination. Prohibitions on provider use of generative AI in patient treatment under federal or state law or state medical board rules should be monitored. As explained further below, AI/ML requires human oversight and monitoring, including of AI output and calibration. Accreditation organizations, malpractice insurers, and oversight agencies are expected to inquire and scrutinize the use of AI and risk to healthcare performance and services.

Compensation and Payment

Obtaining reimbursement for products and services in healthcare is paramount to the industry, and AI/ML's role requires special considerations.

Coverage and Reimbursement

Currently, government and commercial healthcare payors do not cover or reimburse for generative AI solutions used in healthcare, outside of a number of narrow exceptions. Industry actors should be mindful of coverage updates by federal and state healthcare programs and parity laws for governmental payors, such as regulations issued by the Centers for Medicare & Medicaid Services or state Medicaid agencies, commercial insurer policies, and provider participation or network agreements. Submitting reimbursement of items or services provided by generative AI may violate payor coverage and reimbursement rules.

Fraud, Waste, and Abuse

Traditional healthcare fraud, waste, and abuse risks must continue to be considered with regard to various uses of AI/ML in healthcare, as well as non-traditional risks unique to the use of AI/ML. Federal laws, such as the False Claims Act (which prohibits the submission of false claims for reimbursement to the federal government) and state analogues, such as all-payor statutes, false claims laws, and insurance fraud laws, apply to AI/ML products, including to the promotion of purportedly free products, including as mentioned above, those that may be trading data or other technical assets in exchange for AI product access.

Risks related to these laws and the use of AI/ML include, but are not limited to (1) whether the use of AI/ML may lead to, is causing, or is contributing to overutilization or inappropriate utilization of healthcare items and services; (2) whether professional services provided with the assistance of AI must be billed under a different billing code or for fewer units of time; and (3) whether AI/ML-

powered billing and reimbursement software may create inaccurate, erroneous, or up-coded claims.

For example, if a physician utilizes an AI diagnosis tool to diagnose a patient, and the tool results in the physician either not performing the same diagnostic or treatment professional services that the physician normally would perform absent the use of the AI, or spending less time to do the same, how such activity affects the preparation of a related claim, including appropriate billing codes and time units, should be considered. Another important example is determining whether the use of the same billing codes by a physician without the assistance of an AI tool in performing the same services with an AI tool would be considered up-coding.

Intellectual Property

In creating and developing AI/ML, intellectual property is a quickly evolving area and an important legal consideration. Litigation is ongoing around the unlicensed use of source material to train AI/ML. For example, artists have sued AI companies claiming that the services violate copyright and unfair competition laws. Understanding from where the data to train the model originates and, if appropriate, whether rights to use the data have been obtained is critical to the successful commercialization of an AI product.

In creating and developing AI/ML, intellectual property is a quickly evolving area and an important legal consideration. Litigation is ongoing around the unlicensed use of source material to train AI/ML.

guidance documents, including guidance on AI/ML-based software as a medical device, frameworks for risk categorization, quality management systems, and clinical evaluation. The research and development of AI technologies may also require informed consent or institutional review board approval in certain situations involving safety and efficacy evaluations. Notable activity by the FDA in this space includes providing breakthrough device status to certain AI/ML products that address a significant public health need, such as mental health services.

The Federal Trade Commission (FTC)

The FTC oversees, and may impose limitations on, claims of AI/ML under its enforcement of consumer protection laws to prevent deceptive and unfair business practices. The FTC has released guidance on AI advertising claims, and the FTC commissioner has provided public statements reinforcing FTC's purview over potentially deceptive claims involving AI. The FTC's broad enforcement powers allow it to take actions that can be business model-breaking to AI/ML developers, including requiring the destruction of AI/ML algorithms and models that were developed in violation of law. As detailed above, deceptive practices may be based on data collection or use that is inconsistent with its terms of use, privacy policies, or representations to the public.

Medical Research and Development

AI/ML can analyze massive sets of raw data in the healthcare industry quickly and efficiently to identify patterns and make predictive conclusions. It can also assist with customized care and real-time individual or public health needs. While such analysis allows providers and researchers to avoid data overload, it is important to review the characteristics of the data itself and relevance in what it is applied to. In addition to the preceding data privacy considerations, agency guidance, such as the FDA's discussion paper Using AI/ML in the Development of Drug & Biological Products, should be considered, as well as the data's representativeness of the targeted population, data quality, algorithm validation, and transparency in sharing algorithms.

There are also challenges to obtaining a copyright or patent for work created by AI. For example, the U.S. Copyright Office has issued guidance³ that requires copyright registration applicants to disclose the inclusion of AI-generated content. The U.S. Copyright Office states in its guidance that any works submitted that are entirely created by AI cannot be copyrighted, but that, on the other hand, AI-generated content with sufficient human authorship may support a copyright claim. Similarly, under recent case law⁴, AI cannot be an inventor of a patent—only a natural person may be. This is another area that will continue to develop, and as it does, guidance from the U.S. Copyright Office or the U.S. Patent and Trademark Office should be tracked.

U.S. Food and Drug Administration (FDA)

The use or assistance of AI/ML algorithms in making clinical decisions may bring the technology within the purview of FDA regulatory authority if it meets the definition of a medical device. Medical devices are categorized into class levels with increasing levels of regulatory controls. AI/ML technologies that fall into the categories of software as a medical device and AI/ML-enabled medical devices are FDA-regulated. The FDA has released multiple

³ 88 Fed. Reg. 16,190 (Mar. 16, 2023). ⁴ Thaler v. Vidal, 43 F.4th 1207 (Fed. Cir. 2022).

Related Content

For an overview of current practical guidance on generative AI, ChatGPT, and similar tools, see

 [GENERATIVE ARTIFICIAL INTELLIGENCE \(AI\) RESOURCE KIT](#)

For a guide to the key concepts and considerations related to clinical trials of drugs and medical devices, see

 [CLINICAL TRIALS RESOURCE KIT](#)

For practical guidance about health information privacy and security laws, see

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For a discussion of the legal issues involved in healthcare management contracts, see

 [CORPORATE PRACTICE OF MEDICINE AND OTHER KEY HEALTHCARE MANAGEMENT CONTRACT LEGAL ISSUES](#)

For an analysis of rules promulgated under HIPAA, see

 [HIPAA PRIVACY, SECURITY, BREACH NOTIFICATION, AND OTHER ADMINISTRATIVE SIMPLIFICATION RULES](#)

For information on the statutes and regulations governing privacy of patient information in clinical trials, see

 [PRIVACY AND CONFIDENTIALITY IN CLINICAL RESEARCH](#)

Careful consideration of the data can mitigate the material risk of under-representative data sets, which can magnify preexisting biases in the healthcare system, as well as reduce risks of poor generalizability of an algorithm to new settings or circumstances, the lack of alignment with informed consent, and failure to follow research protocol requirements. For example, while AI can enhance efficiency in clinical research, such as through improving patient

recruitment and protocol design, algorithms may not properly account for differences in patient populations, complex protocol design, or inconsistent language in eligibility criteria.

The use of AI in research and development can be significant to IP rights and competitive markets. Failure to obtain the appropriate consents or licensure to data used for research or development can impact IP rights to the underlying AI product or service. Disclosing confidential information or relying on AI output for development can undermine the ability to obtain or retain exclusive rights to products or services.

Ethical Considerations of AI Use in Healthcare

AI/ML has the potential to both improve and exacerbate concerns of health inequity, especially as caused by the social determinants of health (SDOH). The incorporation of SDOH into AI/ML technologies may provide higher quality of care. However, human review and oversight is a key mechanism to promote ethical deployment of AI and to monitor AI's potential harms. The possibility of AI/ML inflicting harm in healthcare encompasses a broad range of malicious and unintended consequences, including to the tremendous detriment of whole societies, such as biohacking and the creation and use of bioweapons.

Bias and Discrimination

While the utilization and development of AI implicate a variety of ethical concerns, these issues are exacerbated and extrapolated within the healthcare industry. Ethical frameworks have been developed by a variety of stakeholders, including the AMA, WHO, and academia. Ethical risks of AI in healthcare include that the source and integrity of data underpinning AI/ML technologies can greatly impact their accuracy and consistency and, ultimately, cause bias and discrimination. Biases can be further perpetuated in data sets as a result of the inaccuracies in data resulting from its human-annotated nature. Algorithms may incorporate biases at multiple stages of their development and can consequently compound and perpetuate preexisting inequities in the healthcare system.

Integrity of Healthcare Delivery

The risk at the forefront of using AI/ML technologies in healthcare is that these systems can sometimes be inaccurate, which could result in patient harm. Generative AI systems have been known to hallucinate and create false information. Inaccuracies can also be caused by algorithmic biases. Security is another risk that comes with the very sensitive and large data sets necessary to produce quality AI/ML models for healthcare use cases. Hallucination and false information are examples of how AI, by its very nature, can extrapolate any bias, discrimination, or misinformation quickly and extensively if it is not mitigated or caught.



Protecting against Potential Healthcare AI Liabilities

Because U.S. regulation of AI/ML in healthcare remains in flux, how to safeguard AI/ML product users against harm, as well as how to allocate responsibility, should harm occur, should be considered.

Adverse Events

Adverse events and damages caused by AI/ML products will likely be difficult to prove due to the black box nature of complex AI/ML products. Where an injury or other harm has occurred, it may be difficult to prove that an AI/ML product caused such harm, as there may be little-to-no transparency or insight into how the AI/ML product operates. Appropriate and clear terms of use and performance standards should be in place to ensure liability and indemnification are provided for AI/ML product arrangements. In addition, consideration should be given to which, if any, oversight and safety mechanisms should be implemented to monitor and test the outputs of AI/ML products. Further, as mentioned above, patient education and informed consent are important considerations to allow patient autonomy and transparency in treatment.

Oversight and Safety

Although AI/ML models and algorithms themselves are often black box systems of which the end user (and sometimes the developer) has little-to-no insight, users can put in place oversight and safety mechanisms to test and audit the outcomes of such systems. Questions such as whether certain oversight and safety mechanisms should be implemented to mitigate risk while preserving the utility of the AI/ML product should be consistently evaluated. Industry actors utilizing AI/ML products could consider extracting random output samples for review. For example, in the case of an AI/ML product that outputs diagnosis or treatment-related information, healthcare providers could create a randomly selected set of outputs to subject to peer review and auditing to confirm whether the outputs are satisfactory. Again, accreditation organizations, insurers, and oversight agencies are expected to grow scrutiny and look to risk assessments on the implementation of these products and services in healthcare operations.



Product and User Liabilities, and the Importance of Terms of Use

Product liability and medical malpractice law are two areas that bring potential liability risk for AI/ML products. Product liability can occur with design defects, manufacturing defects, and a failure to warn. Medical malpractice may arise with the healthcare provider interpreting and taking actions based upon AI/ML tools. Carefully drafting the terms of use for AI/ML is critical to properly assign risk between the developer of the AI/ML tool and the healthcare provider. As with informed consent documentation, whether appropriate terms of use are in place, along with the terms of use themselves, should be evaluated to ensure whether there are

sufficient protections against all potential liabilities attributable to AI/ML and developer.

While the federal and state governments have yet to directly regulate AI/ML product liability, European countries are already promulgating AI product liability policies. For instance, the European Commission has proposed an AI Liability Directive, which would put in place evidentiary disclosure requirements for stakeholders of high-risk AI systems, and a rebuttable presumption of a causal link between the AI system and the alleged harm. Although these rules are not currently applicable in the United States, the evolution of these European policies should be monitored, as federal and state governments may look to these policies as models for domestic policies.

Conclusion—Successful AI Requires Sophisticated Regulation and Regulatory Counsel

The healthcare regulatory framework surrounding AI/ML is unsettled and still developing, yet there are far-reaching implications. Unless the federal government adopts wide-ranging, preemptive rules for the creation and use of AI/ML products, the rise of a patchwork of varying state laws, with overreaching global standards, is likely to govern this arena. As a result, legal developments require careful monitoring, and industry actors should proceed with caution and thoughtful citizenship when developing AI/ML products or entering into arrangements to use AI/ML products. It is key to build flexibility into AI/ML products and arrangements to ensure they can adjust and pivot as needed to accommodate legal developments to come.

The revolutionary nature of AI/ML catalyzes healthcare's age-old oath to care for patients and to do no harm. This oath, in using AI, must be applied in a broader and more deliberate manner to encompass the many, and society at large, to ensure that the benefits of AI in healthcare are not reaped at the cost of individual or public rights and safety. **L**

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Sara has deep experience advising clients on data use and protection under Part 2, HIPAA, GINA, and state privacy laws, such as BIPA and CCPA, and multinational border transmissions. She also assists clients in implementing compliance programs, launching health innovations and investments, and responding to governmental investigations. Her experience extends to consumer and patient rights, including under the American with Disabilities Act and Section 1557 of the Affordable Care Act, medical staff relationships, and navigating the evolving regulatory landscapes for next-generation technology.

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centers, physician groups (including non-profit health organizations), home health providers, and other healthcare companies on the buy- and sell-side of mergers and acquisitions, joint ventures, and operational matters, which include regulatory, licensure, contractual, and administrative issues.

Phil has a particular interest in digital health. He has assisted a number of multinational technology companies entering the digital health space with various service and collaboration agreements for their wearable technology. He also assists public medical device, biotechnology, and pharmaceutical companies, as well as the investment banks that serve as underwriters involved in the public securities offerings for such healthcare companies.

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Elfin Noce is an associate in the Intellectual Property Practice Group in the firm's Washington, D.C. office. He also is a member of the Privacy and Cybersecurity Team. Elfin counsels his clients on a wide range of data privacy and cybersecurity matters. Elfin's practice includes managing cyber breach response, drafting incident response plans, breach simulations, drafting privacy policies, negotiating and drafting complex technology agreements, and defending companies in cybersecurity litigation.

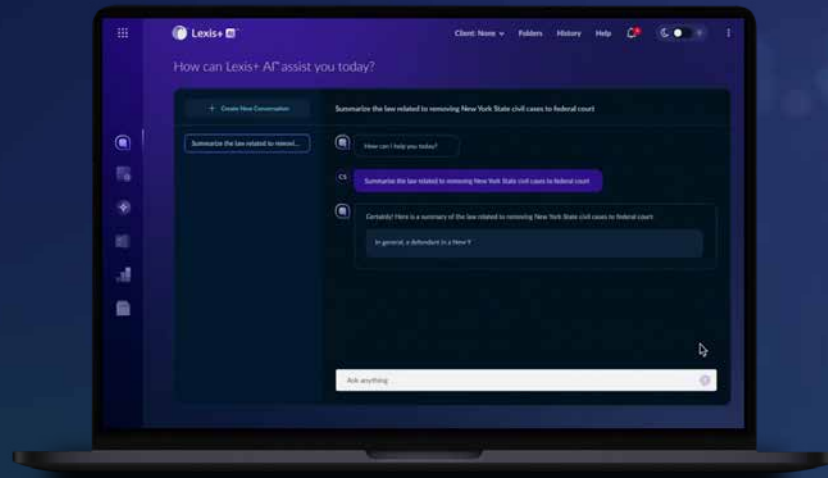


RESEARCH PATH: [Healthcare > Health Information Privacy and Security > Practice Notes](#)

Generative Artificial Intelligence Moves to Transform the Legal World

For an overview of current practical guidance on generative AI, ChatGPT, and similar tools, see [Generative Artificial Intelligence \(AI\) Resource Kit](#)

LexisNexis is pioneering the use of generative AI with Lexis+ AI™, focusing on reliability, consistency, and data security while enabling legal professionals to achieve better outcomes.



Lexis+ AI is built and trained on the largest repository of accurate and exclusive legal content, backed by verifiable, citable authority. “We’re thrilled to bring this transformative technology to customers,” said Mike Walsh, CEO of LexisNexis Legal & Professional. “The Lexis+ AI platform provides first-of-its-kind tools for lawyers to dramatically improve the speed, quality, and effectiveness of their practice and business.”

Lexis+ AI

Lexis+ AI is a generative AI platform designed to transform legal work. It pairs the unsurpassed Lexis legal content with breakthrough generative AI technology in a way that could redefine how legal research is conducted and legal work product is created. Lexis Nexis Chief Product Officer Jeff Pfeifer explained that Lexis+ AI begins by focusing on the top use cases discovered through interaction with clients, which are drafting, search, and summarization.

Practical Guidance on Generative AI

Lexis Practical Guidance includes practice notes, articles, and analysis concerning the impacts of generative AI throughout

the legal profession. The Generative Artificial Intelligence (AI) Resource Kit is a collection of comprehensive cross practice area guidance in the areas of Intellectual Property & Technology, Data Security & Privacy, Civil Litigation, Commercial Transactions, Labor & Employment, Healthcare, and Employee Benefits & Executive Compensation. It includes practice notes and articles covering AI’s legal applications, addresses what lawyers need to know about legal ethics, and offers a Judge’s View of Generative AI. To review enacted state and notable local legislation relating to AI, see Artificial Intelligence Legislation State Law Survey. To follow federal, state, and notable municipal legislation related to the use of AI, see Artificial Intelligence Legislation Tracker.

Ethical, Responsible AI

LexisNexis is responsibly developing legal AI solutions with human oversight. LexisNexis, part of RELX, follows the RELX Responsible AI Principles, considering the real-world impact of the company’s solutions on people and taking action to prevent the creation or reinforcement of unfair bias. Walsh notes that “Customers want

ethically developed solutions with human oversight that seamlessly integrate with and protect their data.” The company’s commitment to data security and privacy in the legal industry spans more than 50 years. LexisNexis employs thousands of technologists, data scientists, and subject matter experts to develop, test, and validate solutions while delivering comprehensive, accurate information.

Generative AI Insights

As the use of generative AI continues to evolve, we want to understand how it will impact your practice and the future of work. That’s why we’re conducting our LexisNexis 2023 How Generative AI is Shaping the Future of Work Survey. Your insights and opinions will be invaluable to this research. By participating in this survey, you will help us gain a better understanding of the current state of the industry and what the future may hold. Please share your insights anonymously by taking this survey. You may also view previous survey results from the 2023 Generative AI & the Legal Profession survey.

For additional information about LexisNexis AI programs and resources, please review the following:

-  [GENERATIVE ARTIFICIAL INTELLIGENCE \(AI\) RESOURCE KIT](#)
-  [JOIN THE COMPLIMENTARY AI INSIDER PROGRAM](#)
-  [SHARE YOUR INSIGHTS IN THE LEXISNEXIS® 2023 HOW GENERATIVE AI IS SHAPING THE FUTURE OF WORK SURVEY](#)
-  [LEXIS+ AI™ WEBPAGE](#)
-  [RESPONSIBLE ARTIFICIAL INTELLIGENCE PRINCIPLES AT RELX](#)



S.H. Spencer Compton COMMONWEALTH LAND TITLE INSURANCE COMPANY

Market Intelligence: What Commercial Real Estate Owners, Tenants, and Lenders Need to Know Now

Interested in access to private market intelligence? Private Market Data offers attorneys private information about highly negotiated agreements not otherwise available or provided in public sources. This valuable market information offers access to protected insights that reveal a higher level of previously hard-to-obtain terms and data points. Take part in this year's Private Market Data surveys. See the full details on how to participate on pages 23 through 25.

CLIMATE CHANGE AND THE NEED FOR AFFORDABLE HOUSING

are looming concerns in most U.S. cities. The impact of COVID-19 is still being felt as remote and hybrid work reshape the real estate landscape. Substantial rises in interest rates have dampened investor appetites for commercial real estate buying and lending. Commercial real estate owners, tenants, and lenders are facing unprecedented challenges and raising novel issues for their attorneys to address. Market intelligence has a crucial role to play in helping industry players navigate this rapidly changing environment. It is important for real estate attorneys to keep up to date with market data to maintain a competitive edge in deal negotiations, thereby producing additional value for their clients beyond the traditional legal realm.

This article discusses the important role market data plays in helping attorneys provide practical and effective counsel to clients, using the New York City real estate market as an example.



Climate Change Legislation

Buildings generate the largest share of greenhouse gas emissions in many U.S. cities. In New York City, for example, buildings account for about two-thirds of greenhouse gas emissions. It is no surprise, then, that cities like New York are focusing their climate change legislation on reducing

Local laws governing building inspections can impact the cost of owning, operating, and maintaining real property. These laws often require the building owner to hire professionals to conduct inspections and impose fines for failure to comply.

building emissions. In 2019, New York City enacted Local Law 97 as part of the Climate Mobilization Act, which commits the city to reducing its emissions 40% below a 2005 baseline by 2030 and 80% by 2050.¹ The law establishes carbon emission limits for New York City buildings over 25,000 gross square feet. Buildings that exceed annual emissions limits will face an annual financial penalty of \$268 per ton of carbon dioxide equivalent over the limit based on 2024 energy usage and emissions. Most buildings have until 2024 to meet Local Law 97 emission targets. Annual fines for buildings that fail to meet the 2024 deadline will begin in 2025. These emission caps will become more stringent over time.

It is critical for developers, owners, tenants, lenders, and their attorneys to be mindful of how climate legislation across the country affects the commercial real estate market. Market data can offer unparalleled insight into how deal terms are evolving against this legislative backdrop.

Building Condition and Inspection Requirements

Local laws governing building inspections can impact the cost of owning, operating, and maintaining real property. These laws often require the building owner to hire professionals to conduct inspections and impose fines for failure to comply. Real estate owners and lenders should be aware of how laws that increase the cost of ownership can interact with, and potentially drive, market trends in their geographic region.

For example, last year New York City implemented new inspection requirements for parking garages.² Real estate owners must hire a professional engineer registered with the Department of Buildings (DOB) as a Qualified Parking Structure Inspector (QPSI) to survey the condition of their parking structures every six years and file a compliance report with the DOB. After conducting the condition assessment, the QPSI then files the compliance report with the DOB, classifying the parking structure as one of the following:

- **Safe.** No repair work is needed. The garage is safe until the next inspection cycle.
- **Safe with repairs and/or engineering monitoring.** There is minor damage to the garage framing elements. The QPSI will set a timeline for repairs, and the DOB will require a follow-up inspection and subsequent compliance report filing. If repairs are not completed prior to the next filing cycle, the parking structure automatically will be classified as unsafe.
- **Unsafe.** There is severe damage to the garage framing elements which is a hazard to people or property. Repairs must be performed within one year of completing the condition assessment, and unsafe conditions must be remedied within 90 days after the date of the compliance report. Within two weeks after completing repairs, the QPSI must perform a subsequent inspection and promptly file an amended compliance report with the DOB.

As another example, look to New York City's Facade Inspection & Safety Program, a set of regulations addressing the condition of buildings' exterior walls and appurtenances.³ The purpose of the regulations is to protect the aesthetic quality and structural integrity of all buildings in New York City, particularly those located on busy streets or other high-traffic areas. Every five years, facades of all New York City buildings over six stories must be examined by a Qualified Exterior Wall Inspector (QEWI) and a report filed with the DOB. A QEWI must be a licensed architect or professional engineer with at least seven years of relevant experience. In addition to substantial fees paid to QEWIs and other professionals, the DOB charges filing fees, amended filing fees, late filing fees, failure to file penalties, and failure to repair penalties.

Similar inspection requirements can be found in cities across the country and may impact owners' capital repair obligations. Real estate owners and lenders should watch how the market responds to increasing costs of ownership, and their attorneys should keep these market considerations in mind during deal negotiations to get the best results for their clients.

1. 2019 NYC Local Law No. 97. 2. See 2021 NYC Local Law No. 126. 3. See 1998 NYC Local Law No. 11.



To review previous editions of the Practical Guidance Journal, follow [this link to the archive](#).

Rent and Eviction Considerations

Building owners, tenants, and lenders should pay particular attention to market trends around rent and eviction.

Housing Stability and Tenant Protection Act

In New York, the Housing Stability and Tenant Protection Act of 2019 (HSTPA)⁴ increased protections for residential tenants. Among the law's expanded tenant rights, landlords should be aware of the following:

- HSTPA sharply curtailed opportunities for regulated rents to rise at rates higher than the Rent Guidelines Board's annual limits. Rent-stabilized tenants can no longer lose their preferential rents during their tenancies.

- Before the HSTPA was passed, property owners could remove apartments from regulation by performing renovations to vacant apartments, but loopholes in the law have now been closed, and rent increases from renovations have been curtailed.
- Owners are now limited to taking only one month's rent for security and are prohibited from asking for first and last month's rent in any rental unit. If the broker was hired by the landlord to rent the apartment, the broker may not charge the tenant a broker's fee. The broker's fee regulation is being challenged in the courts, so stay tuned for the outcome of this litigation. Application fees which could often add up to a hundred dollars or more are now capped at twenty dollars.

- Unregulated apartment owners may charge whatever rate of rent increase they wish when it comes time to renew a lease, and they need not offer a lease renewal at all. Tenants in market rate apartments, however, now must be given the following advance notice for any rent increases over 5% or if the landlord plans not to offer a renewal:
 - 30 days for those who have been tenants for less than a year
 - 60 days for those who have been tenants for more than a year but less than two years
 - 90 days for those who have been tenants for more than two years
- Late fees may not exceed the lesser of 5% of the monthly rent or fifty dollars.

Related Content

For an overview on commercial real estate purchase and sale transactions, see

 [PURCHASING AND SELLING COMMERCIAL REAL ESTATE RESOURCE KIT](#)

To learn more about the retail leasing process, see

 [RETAIL LEASING RESOURCE KIT](#)

For information on the subleasing process, see

 [SUBLEASING RESOURCE KIT](#)

For links to Practical Guidance content on residential tenant representation, including evictions, in New York, see

 [RESIDENTIAL TENANT REPRESENTATION RESOURCE KIT \(NY\)](#)

For guidance on acquisition financing transactions, see

 [COMMERCIAL REAL ESTATE ACQUISITION LOAN RESOURCE KIT](#)

For a guide to the HSTPA and representing a residential tenant in a nonpayment proceeding, see

 [TENANT REPRESENTATION IN A RESIDENTIAL NONPAYMENT PROCEEDING \(NY\)](#)

- The HSTPA outlaws the selling of the names of tenants who appear on a so-called blacklist and prohibits landlords from denying tenant applicants an apartment based exclusively on their status as a respondent in an eviction proceeding.
- Finally, the HSTPA includes changes to the way eviction cases are processed in housing court. The HSTPA increases the time tenants are given to be notified and respond, strengthens available tenant defenses, and broadens opportunities to avoid or lessen the impact of eviction.

Good Cause Eviction

Under New York State law, a residential tenant may be evicted only if a landlord has brought a court proceeding and secured a judgment of possession from the court. Only a sheriff, marshal, or constable can carry out a court ordered eviction. A landlord may not evict a residential tenant by use of force or unlawful means.

⁴ 2019 N.Y. Laws 36.

Not surprisingly, good cause eviction legislation is opposed by most landlords and, if past is prologue, likely will be sponsored in one or both houses again. Residential building owners will want to follow the progress of any proposed housing legislation closely.

First proposed in 2019, a good cause eviction statute would apply to residential premises and would amend the existing law to provide that a landlord cannot evict a residential tenant who pays rent on time, except under specific circumstances. Although there are already eviction regulations, current New York law allows landlords to raise rents at their discretion and deny a lease renewal to any tenant who does not inhabit a rent-controlled or rent-stabilized apartment.

A good cause eviction law would effectively cap residential rent increases in New York State at 3% per year regardless of

the percentage increase in real estate taxes or other operating expenses and give judges the power to decide if repairs and improvements are necessary in privately owned real estate. Such a law would also mandate renewal leases and limit landlords from being able to regain apartments they own. Proposed good cause eviction legislation seemingly is premised on the belief that landlords can subsidize their tenants indefinitely while slowly working through the courts to be able to operate their properties.

Under a good cause eviction regime, building owners would be unable to evict a squatter without demonstrating to the

satisfaction of a judge (and then most likely an appellate court) that they have good cause in wanting to reclaim the apartment in order to demolish it even after the lease requires the tenant to vacate. In addition, an employee who is provided housing (e.g., a superintendent) cannot be evicted after being terminated until the landlord demonstrates that the employment was lawfully terminated. Note that the HSTPA already permits judges to allow tenants to remain in occupancy for a year after a default in the event of a hardship, while the landlord has to continue making payments for real estate taxes, heat, insurance, repairs, etc.

Not surprisingly, good cause eviction legislation is opposed by most landlords and, if past is prologue, likely will be sponsored in one or both houses again. Residential building owners will want to follow the progress of any proposed housing legislation closely.

Other Costs of Building Ownership in a Changing Market

In addition to legislative compliance costs, a building owner must also pay real property taxes, debt service on its mortgage and other financing, insurance premiums, and utilities and other operating expenses, all of which historically increase every year whether or not the property's rental income rises or falls.

Some building owners today have the financial resources to withstand a down real estate market because either the building they own is in a desirable location, recently constructed with strong tenancies and vibrant amenities, or they have deep pockets.

Other owners have buildings where leases are gradually expiring with many tenants not opting to renew, resulting in diminishing available cash flow to pay for improvements or the cost of refinancing their mortgage at today's substantially higher interest rates. What can these owners do to protect their real estate investments in today's changing market?

Let's look at a worst-case scenario: An urban commercial building owner is faced with diminishing tenancies and increasing property taxes, utilities, and maintenance costs, as well as interest rates significantly higher than when the property was last financed. When the owner offers the building for sale at a reduced price, there are no takers and so it elects to default on its mortgage and walk away from its asset. Not wanting to own this abandoned collateral, the mortgagee writes off the loan, preferring to take a loss on its balance sheet rather than become a real estate operator in a distressed market. The abandoned property reverts to the city. Real property taxes go unpaid, weeds grow, and windows and doors are smashed. The values of neighboring properties go down.



Potentially, entire commercial neighborhoods could shrivel and lie fallow for decades.

What should owners, buyers, tenants, lenders, and their counsel be paying attention to in the months and years ahead? What can a commercial building owner do to maximize the value of its property? Here are some suggestions:

- Analyze your existing rent roll. Diagram lease expiration dates. Gather the best possible information about each tenant's financial condition. What are your tenants' financial disclosure obligations under their leases? Can they afford to pay rent for the rest of their lease term on what now may be barely occupied office space? Does the lease give the landlord any rights to updated tenant financial information?
- Consider existing floorplates. Is it feasible to offer premises with less square footage going forward? How flexible can you be?
- What amenities does your building offer? Consider a cost-benefit analysis of adding, for example, a tenant cafeteria, conference rooms rentable by the hour or day, on-site pet or child daycare facilities, or a shared roof deck. Think: what will attract people to come to work in your building?
- Determine whether climate regulations like Local Law 97 are applicable to your building, and, if so, commission an energy survey and a carbon emission abatement plan. Even if your building does not fall under the regulation's requirements, an energy survey can help you reduce annual energy costs by investing in better insulated windows, dimmable lights, and more efficient air conditioners and heating systems. The more energy efficient the building, the less costly it is to operate.
- If garage, facade, or other inspection requirements apply to your building, determine when inspections are due and how much compliance will cost.
- When must your underlying mortgage be refinanced? What is the debt service differential between your existing interest rate and today's rate? Will your current rent roll support these new payments? Considering the points listed above, how likely will a refinance lender be to offer favorable terms or any terms at all? Is it viable to take out a short-term bridge loan in the hopes that rates will be lower after a year or two?

In all cases, data on market trends can be a critical resource for real estate owners, tenants, and lenders. By knowing where the market stands and where it's headed, real estate players can develop practical strategies to deal with rising ownership and compliance costs. It is important for real estate attorneys



to stay on top of market intelligence to best advise their clients and protect their interests in deal negotiations and beyond.

Conclusion

With climate change, hybrid work patterns, and changing market trends, today's commercial building owners are faced with more costly regulatory compliance and marketplace considerations than ever before. New York and other U.S. cities have insufficient affordable housing at too high a cost. Many legislative solutions have been proposed but few enacted. Although the recent good cause eviction bill did not become law in New York, as the urban housing crisis persists, bills to address housing concerns likely will be passed. Owners, lenders, tenants, and their lawyers must pay attention to market intelligence to navigate these increasingly challenging real estate trends. ■

S.H. Spencer Compton is Senior Vice-President and Senior Counsel, Commonwealth Land Title Insurance Company.

 [RESEARCH PATH: Real Estate > Trends & Insights > Articles](#)



Private Market Data: Pull Back the Curtain with Access to Private Insights

In today's competitive environment, experience isn't enough to provide client with the best representation. Attorneys need **concrete data** to understand how the winds are shifting so that their clients can get ahead of the trends.

Private market data provides that crucial information. With Private Market Data, LexisNexis Practical Guidance's annual survey of private data trends, attorneys can leverage real data from an anonymous survey of their peers to understand how private agreements are being negotiated across multiple data points, **and survey participants will receive a \$25 gift card.*** This year's surveys encompass topics in real estate, labor & employment, mergers & acquisitions, healthcare, and life sciences.

Once the surveys close, Practical Guidance will provide an analysis of how private data terms in these practice areas are currently being negotiated.

- These survey results will be available in an upcoming edition of the Practical Guidance Journal, and in Practical Guidance, providing attorneys with actionable insights into how to best serve their clients when negotiating private agreements.
- Each survey takes less than 10 minutes to complete. No confidential or client information is requested in any survey, and your participation is confidential and will not be shared.
- The survey will be open for four weeks from **August 25, 2023 until September 30, 2023.**
- Survey participants will receive a \$25 gift card in exchange for participation.



INTERESTED IN PRIVATE DATA?

Let us hear your thoughts.

LexisNexis is conducting a short survey aimed at identifying legal trends across various private agreements. Each survey takes less than 10 minutes, and results will reveal how private data terms are being negotiated today. Survey participants will receive a \$25 gift card for participating.*

These surveys will close on 9/30/2023.

FOLLOW THE LINKS BELOW FOR EACH SURVEY

[REAL ESTATE SURVEY](#)

[M&A SURVEY](#)

[LABOR & EMPLOYMENT SURVEY](#)

[LIFE SCIENCES SURVEY](#)

[HEALTHCARE SURVEY](#)



The real estate industry has experienced dramatic changes recently due to economic factors, COVID-19 impacts, climate change and other legislation. **Real Estate** attorneys working through these shifts are encouraged to participate in the Private Market Data Annual **REAL ESTATE SURVEY**.

Labor and Employment attorneys who negotiate employment discrimination settlements may take the Private Market Data – **EMPLOYMENT DISCRIMINATION SETTLEMENTS SURVEY** related to private employment discrimination, harassment, and/or retaliation settlement agreements.

Mergers & Acquisitions attorneys may participate in the Private Market Data annual **SURVEY – CORPORATE AND MERGERS & ACQUISITIONS**. This questionnaire asks about private deal term trends in recently negotiated M&A transactions, including representations and warranties insurance and regulatory insights.

Healthcare attorneys are encouraged to take the Private Market Data annual **SURVEY – HEALTHCARE**. This questionnaire asks for

key data points regarding recent self-disclosures made to the HHS Office of Inspector General via either the OIG's Health Care Fraud Self-Disclosure Protocol (SDP) or the CMS Voluntary Self-Referral Disclosure Protocol (SRDP). These protocols were developed for individuals and organizations to voluntarily identify, disclose, and resolve instances of potential fraud, waste, and abuse involving federal healthcare programs including, but not limited to, violations of the Stark Law and the Anti-Kickback Statute (AKS), which could potentially result in Civil Monetary Penalties (CMP).

Life Sciences attorneys involved in negotiating clinical trial agreements are eligible to participate in the Private Market Data annual **SURVEY – CLINICAL TRIAL AGREEMENTS (LIFE SCIENCES)**.

Be sure to look for the Practical Guidance Private Market Data survey results later this year in the Practical Guidance Journal and in Lexis Practical Guidance. **L**

*Offer is void where prohibited by law or by your employer's policies. Individual must complete the survey in its entirety and in accordance with all instructions by September 30, 2023, to be eligible for gift card offer. Only one gift card, valued at \$25, will be given per individual while supplies last. Employees of any governmental entity are not eligible to participate in this offer. No returns or exchanges. Offer is valid through September 30, 2023. The questionnaire responses will be reviewed for accuracy and relevancy prior to delivery of the gift card. Other restrictions may apply.

*Offer is void where prohibited by law or by your employer's policies. Individual must complete the survey in its entirety and in accordance with all instructions by September 30, 2023, to be eligible for gift card offer. Only one gift card, valued at \$25, will be given per individual while supplies last. Employees of any governmental entity are not eligible to participate in this offer. No returns or exchanges. Offer is valid through September 30, 2023. The questionnaire responses will be reviewed for accuracy and relevancy prior to delivery of the gift card. Other restrictions may apply.



M. Shams Billah BARNES & THORNBURG LLP, NEW YORK

Private Credit Loan Transactions

This article discusses guidance for borrowers and private equity sponsors entering into private credit loans with nonbank lenders in the middle to lower-middle market space.

THE ARTICLE ALSO DISCUSSES THE BACKGROUND AND benefits of private credit transactions as compared to public credit, as well as best practices for approaching the private credit market, key negotiation points, and recent market trends.

Private Credit vs. Public Credit

Private credit (also known as direct lending) has certain distinct characteristics that enable it to be a strong value proposition compared to public credit for market participants looking to incur loans. Private credit direct loans are provided by nonbank lenders, often on a bilateral basis or in a small club deal, to borrowers directly, rather than through a widely syndicated process run by commercial banks. These types of loans are not publicly traded, although there have been recent efforts to create a platform or exchange to allow for such trading. This is in contrast to public credit syndicated loans and bonds that trade in debt capital markets. The greater reliance of public credit on public markets is part of the reason for the recent exponential growth of private credit and the related benefits that private credit has to offer as further discussed below.

Recent Rise in Private Credit Transactions

The rise in private credit transactions occurred following the financial crises of 2008 when public debt markets tightened and essentially closed up and regulations were introduced through the Dodd-Frank Act that severely hindered the ability of banks to provide leveraged loans to middle-market companies. That is when private credit funds formed to fill the gap created by the shrinkage in traditional bank lending. Portfolio companies of sponsors and founder-owned small to mid-market companies, each of which were squeezed out of the traditional bank debt markets, turned to the private credit market, which was not subject to the same regulatory requirements of traditional banks.

Benefits and Downsides of Direct Lending

The accelerated rise of direct lending is in part due to the following unique features of direct lending transactions.

Benefits of Direct Lending

Certainty and Speed of Execution

As mentioned above, direct loans are either bilateral facilities or closely held by a small club of lenders. This is in contrast to broadly syndicated loans, in particular in the term loan B market where loans are held by hundreds of different funds and lenders. The bilateral or club nature of direct lending transactions allows direct lenders to be more nimble and often faster in closing deals and

providing responsive, flexible, and bespoke solutions to the needs of borrowers and private equity sponsors. This is one of the reasons sponsors and first-time borrowers often turn to and prefer nonbank lenders to finance their transactions.

Non-reliance on Public Markets

As mentioned earlier, private credit is less affected by public market price volatility. The reason for this is that direct loans are usually held for investment through the tenor of the loan and are not traded, unlike broadly syndicated loans and corporate bonds that trade frequently on public markets. This lack of reliance on public markets allows borrowers and sponsors to feel more comfortable that their financing windows are not too affected by macroeconomic shocks, like the COVID-19 pandemic, during which private credit lenders continued to provide credit to the market in a resilient manner. In addition, lenders in the private credit market do not have to consider as heavily what the market may accept for terms and hence are not subject to market flex provisions as much.

Downsides of Direct Lending

The downsides of direct lending are often offset by the benefits noted above. More importantly though, most middle-market companies are not in a position to access public bonds and so the issues noted below are typically not relevant for middle-market companies. Some of the downsides of direct lending compared to public corporate bonds are addressed below.

Floating Rates

Unlike bonds that are primarily fixed interest rate instruments, private credit debt often has an interest rate composed of a floating rate (typically tied to a benchmark such as Secured Overnight Financing Rate (Term SOFR), often with a rate floor) and a fixed margin rate. Many loans also have a variable interest rate grid, which allows the fixed component of the interest rate to change based on pre-defined thresholds such as a leverage ratio. While borrowers may not prefer floating interest rates, this grid methodology can be attractive to borrowers because it allows the interest rate to adjust to positive (but also negative) changes to the credit risk profile of such borrower without the need for renegotiations or amendments in the future.

Covenant Heavy

Unlike unsecured high-yield bonds, private credit loans are typically first lien or second lien facilities secured by substantially all of the assets of the borrower group and have a number of covenants to protect such collateral. In general, these loans have a lot more

covenants, including financial maintenance covenants, that provide strong structural protections to lenders much to the chagrin of borrowers compared to covenant-lite public debt facilities or bonds. The extensive set of covenants in private credit loan transactions typically results in lenders having a greater say in the company's affairs, especially during difficult financial times and restructurings.

Higher Premiums/Fees

Although direct loans have shorter maturities of five to six years compared to long-dated corporate bonds, direct loans are often repaid or refinanced prior to maturity, but at a cost to borrowers. In such situations, nonbank lenders often earn additional returns in the form of call protection or amendment fees (which occur less so with bonds).

Documentation Best Practices

The negotiation process between a borrower and a lender should, in theory, be a relatively cordial experience as both parties are receiving a mutual benefit. The borrower receives an infusion of cash to support their daily operations, refinance existing debt on better terms, or fund an acquisition or investment to expand their business, and the lender receives certain fees and interest. Here are documentation best practices on how to make the process as seamless as possible to both sides and to avoid extensive negotiations:

■ **Term sheet/grid.** Before diving into any private credit facility negotiation, the borrower should typically always either first draft a term sheet or request a term sheet from the lender containing the key economic terms. Term sheets can be as simple as one page listing out such key points as the total amount of the loans being requested, the maturity date of the loans, the interest rate and margin, and fees, or a lengthy document listing out in detail all the expected terms of the credit agreement, like affirmative and negative covenants, prepayment mechanics, and events of default. It may seem obvious, but putting pen to paper to establish prior agreed key terms makes the later negotiation process run much more smoothly with far fewer pain points. You need only refer to the prior agreed points in the term sheet rather than renegotiate items previously agreed to on the phone or via email.

In short, a term sheet level sets for all the parties involved and puts to rest potential issues in the negotiation process. And for borrowers or sponsors that are shopping around different private credit lenders, you should consider drafting a debt grid summarizing your ideal asks and sending it around to each lender to see if they meet your asks. This allows you to receive bids that you can then make an apples-to-apples comparison before making a decision about which lender to proceed with. Large cap sponsors often use this grid or tree methodology, but it can be applied on a smaller scale cost-effectively to the middle to lower-middle market as well.

The market for the first half of 2023 has seen an uptick in activity compared to 2022. With the increase in activity, practitioners have overwhelmingly reported that terms in credit agreements have tightened to become more lender-favorable compared to how borrower-favorable they were in 2021 and the first half of 2022.

■ **Credit agreement precedent.** When negotiating a draft of a credit agreement, and assuming there is no prior credit agreement relationship between the parties, the best place to start is to use a market standard template to compare provisions and terms. An excellent resource is the Loan Syndications and Trading Association (LSTA), which provides its members with standard credit agreement templates for various facility types, like bilateral facilities (where the loan agreement is between a single lender and the borrower(s)) or syndicated facilities (where the loan agreement may be among a group of lenders and the borrower(s)), that are generally accepted in the direct loan market. Having a common template allows for proper expectations in the negotiation process around what is generally a market ask in any given provision or term.

■ **Third-party-related documents.** Outside of the main deal documents, lenders will often require further steps to perfect or otherwise secure their collateral package. Some examples include:

- **Certificates of insurance and endorsements.** These will be provided by your insurance broker and will both list out your existing insurance policies and provide for the lender to be added as an additional insured or lender's loss payee to such policies. Lenders generally have specific insurance requirements that need to be met for these certificates and endorsements.
- **Control agreements.** These forms will be provided by the banks where your existing accounts (whether deposit accounts, securities accounts (including crypto accounts), or commodities accounts) are located and are agreements that grant the lender control over such an account in certain scenarios (generally, after an event of default).
- **Collateral access agreements or landlord waivers.** These forms allow the lender to have access to the collateral located on real estate property that is being leased from a landlord. Similar to the control agreements noted above, these agreements only grant access after a trigger event.

These three items often have a long lead time to complete as they require negotiations with various third parties in addition to the borrower and lender. After the engagement with a lender

has started and a term sheet is agreed upon that requires these three items as conditions precedent to effectiveness of the credit facility, you should consider communicating with the lender and its counsel to request the lender's insurance requirements and form of collateral access agreement in order to start the process with your insurance broker and commercial landlord. Similarly, once you have determined whether a control agreement will be needed for any of your various deposit or securities accounts, it is best to reach out to your depository bank and/or securities intermediary for their forms of control agreement.

While lenders often allow each of these items to be done on a post-closing basis, it is often more cost-effective to get started on these early rather than having it linger on a post-closing checklist as discussed immediately below.

■ **Closing items vs. post-closing items.** While it would be the preference for all parties to have the deal finalized and all documents and requirements met at the initial closing, that is often not feasible given the amount of time required to satisfy certain items and the limited bandwidth of senior management that may be negotiating the credit facility. To the extent possible, you should work to have as many items completed at closing as possible. Once closing has occurred, any of the remaining requirements, which often include mortgages, insurance requirements, landlord waivers, and control agreements as discussed above, can drag on as the impetus to complete those items lessens considerably after the initial loan has funded.

Frequent Negotiation Points

The market for the first half of 2023 has seen an uptick in activity compared to 2022. With the increase in activity, practitioners have overwhelmingly reported that terms in credit agreements have tightened to become more lender-favorable compared to how borrower-favorable they were in 2021 and the first half of 2022. Although strong credits continue to be well received by the market, we have seen lenders attempt to try and reign in the nearly covenant-lite terms that used to give borrowers significant operational flexibility following COVID-19. Outlined here are some of those points that frequently come up in private credit transactions as well as an analysis of how to approach the negotiation around these points:



Usually, a borrower in the direct lending space is not only trying to fund an acquisition at the initial closing of the loan but also will be looking ahead for potential future acquisitions and the ability to upsize their credit facility in such situations.



■ **EBITDA add-backs.** When calculating the company's earnings before interest, taxes, depreciation, and amortization (EBITDA), lenders often allow borrowers to adjust or add-back certain items to their net income as enumerated in the definition of Consolidated Adjusted EBITDA in a loan agreement. These add-backs play a crucial role in builder baskets, ratio-based baskets, and financial covenants, such as a leverage ratio where greater EBITDA often results in a lower leverage ratio, which then allows for lower interest margins under the pricing grid approach described above. For these reasons, adjustments to EBITDA are a hot topic for negotiations. These add-backs can generally be separated out into standard add-backs, like taxes, interest expense, depreciation, and amortization, which are fairly common in any given credit agreement, and more company-specific or one-time add-backs, like transaction costs in connection with a permitted acquisition, costs, or expenses incurred in connection with a specific contract or certain run-rate savings, which will generally require more negotiation.

Recent negotiations involve lenders pushing back against uncapped adjustments to EBITDA (now limited to shared caps in the range between 10% to 35%) and long forward-looking periods for adjustments to apply (which are now typically between 12 to 18 months rather than 18 to 24 months previously). When negotiating these specific add-backs, the best way to approach the issue is to have records reflecting the items being requested to be added back with support from a quality of earnings report, if possible, along with a business reason in the financial model for why such items should be added back.

■ **Call protection.** Call protection remains particularly important for nonbank lenders who face significant risk of refinancing, especially in light of sponsors that are looking to do roll-ups or transformative transactions in the near term. For these reasons, there has been an uptick in lenders requesting a longer call period of up to 36 months at 103/102/101 upon voluntary prepayments, mandatory prepayments from unpermitted debt, yank-a-bank provisions, and acceleration. Borrowers often request an exception at par for a change of control or an initial public offering, but nonbank lenders are even pushing back there and only providing perhaps a 50% discount to the

premium in such situations. In addition, nonbank lenders are denying requests for the list of exceptions to include dividend recapitalizations, transformative acquisitions, and other transformative corporate events. We expect these issues to continue to be heavily negotiated throughout the remainder of 2023 and going forward.

■ **Negative covenant flexibility.** Negative covenants in credit agreements typically have several detailed exceptions and baskets that allow borrowers to operate their businesses while remaining in compliance with the terms of the credit agreement.

The primary negative covenants include restrictions on debt, liens, investments, dispositions, and restricted payments. While borrowers have been able to negotiate a great deal of operational flexibility within and across these negative covenants, lenders have recently been more sensitive to the following situations:

- Borrowers often ask for the ability to redesignate use (not capacity) of their debt, disposition, restricted payments, lien, or investment basket to any other basket available at that time. Lenders typically only allow redesignation of use within the same negative covenant, but almost never

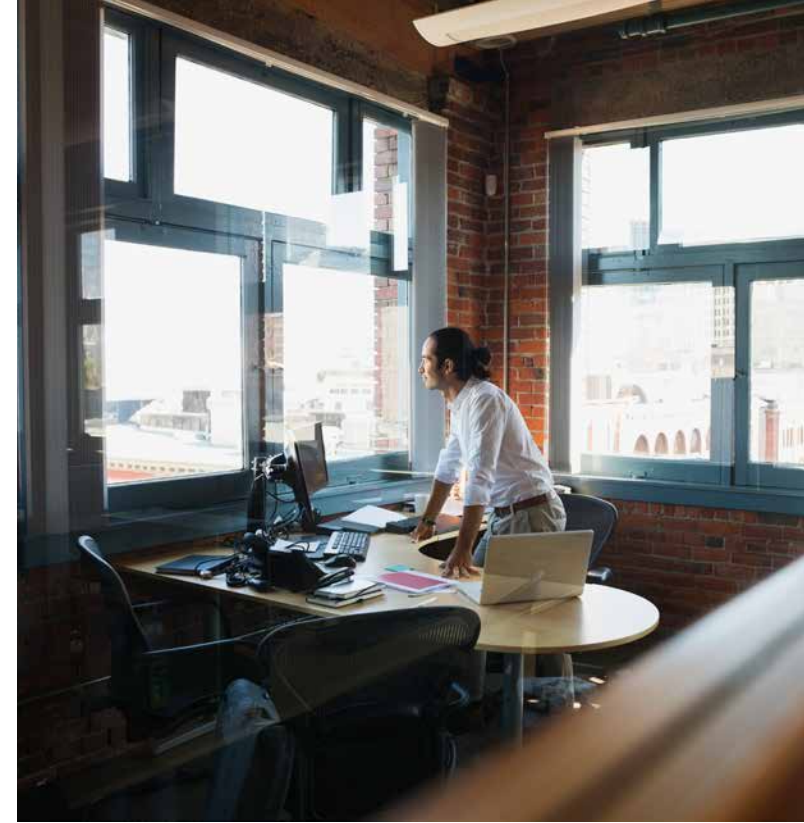
across negative covenants (i.e., lenders typically do not allow redesignation from a restricted payment usage to a debt usage). Furthermore, to prevent leakage, lenders typically do not allow any investment baskets to be added to the basket for investments in unrestricted subsidiaries.

- Borrowers often request and lenders typically allow conversion of restricted payment capacity to permitted investments or debt prepayment capacity and the conversion of debt prepayment capacity to permitted investment capacity. However, lenders typically do not allow such conversion of capacity for lien and debt incurrence.

■ **Incremental debt capacity.** Usually, a borrower in the direct lending space is not only trying to fund an acquisition at the initial closing of the loan but also will be looking ahead for potential future acquisitions and the ability to upsize their credit facility in such situations. Such incremental debt capacity is often highly negotiated and the biggest point of contention here is the most favored nations (MFN) provision. Lenders in the private credit space have recently taken a firmer stance on pricing protection for their initial loans by pushing back against the borrower-friendly MFN provisions seen in 2021 and the first half of 2022 that had higher MFN thresholds, short sunset periods, and certain exclusions.

More recently, the MFN provisions are limited to an MFN threshold of 50 bps with either no sunset or a two-year sunset. Also, lenders typically only allow the MFN not to apply to debt that (1) is not pari passu in right of payment and security with their initial term loans or (2) constitutes customary high-yield bonds issued in an underwritten, bona fide Rule 144A offering to multiple unaffiliated purchasers. The perspective to consider for borrowers when negotiating these provisions is balancing how likely it is that such borrower will use this incremental debt capacity and whether it is worthwhile to fight for the additional flexibility here.

■ **Asset sale mandatory prepayments.** Credit agreements in the private credit market have routinely allowed for several exceptions to the 100% asset sale mandatory prepayment requirement. However, in 2023, lenders have tightened such exceptions. For instance, lenders have attempted to limit reinvestment rights by reducing typical reinvestment periods to about 12 months with only an additional six months if within such 12 months there is a binding commitment to reinvest. In addition, borrowers have often asked for a step-down on the 100% requirement to sweep net asset sale proceeds to perhaps 75% or 50% of such proceeds if the borrower improves its leverage ratio by a full turn of EBITDA. However, consistent with the broader market trend toward less permissive loan terms, lenders have pushed back and not allowed any such step-downs.



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Regulations, Case Law, and Other Market Trends

■ **Transition from LIBOR to Term SOFR.** In the direct lending market in 2023, participants have generally adopted the forward-looking rate based on the Term SOFR as the preferred benchmark replacement for the London interbank offered rate (LIBOR). U.S. dollar LIBOR, the previous benchmark interest rate in the private credit market, for one-, three-, and six-month interest periods is no longer published as of June 30, 2023, and all new credit facility originations should no longer provide for LIBOR. The Term SOFR provisions in new direct lending originations are often based on the latest model LSTA form of credit agreement, which was issued on February 27, 2023, with variations based on the particular lenders' needs and capabilities. The primary three negotiation points here are:

- **Credit spread adjustments.** As a way to reimburse lenders for the traditional difference between LIBOR and SOFR, many SOFR-based credit agreements include a credit spread adjustment (CSA). Some credit agreements include a flat CSA for all tenors, such as 10 basis points (bps) (or 0.10%), while others have an increasing rate for longer interest periods, such as 10 bps (0.10%) for one-month, 15 bps (0.15%) for three-month, and 25 bps (0.25%) for six-month, or the tiers recommended by the Alternative Reference Rates Committee, which is 11.448 bps (0.11448%) for one-month, 26.161 bps (0.26161%) for three-month, and 42.826 bps (0.42826%) for six-month. Some borrowers have even been able to get lenders to agree to no CSA, but in such situations, the lenders have already incorporated the economics of the CSA directly into the margin.
- **Floor.** Borrowers often push for a Term SOFR floor (i.e., the minimum interest rate) of 0%, but most lenders are requiring between 0.75% and 1.00%.
- **Consultation rights.** While the model LSTA form of credit agreement does not provide borrowers with a consultation right for conforming changes necessary to implement a change to the benchmark, most lenders have allowed such consultation rights for borrowers.

■ **Collateral leakage and uptiering.** Lenders continue to be focused on preventing collateral leakage and uptiering transactions that have emerged since the litigation involving Serta, Chewy, J.Crew, Neiman Marcus, and Revlon. These only present an issue in club deals or bilateral deals where there is a high likelihood that future lenders may join. In such situations, middle to lower-middle market borrowers typically accept such provisions as is, especially in light of the fact that courts have upheld these actions. For instance, as recently as June 6, 2023, Judge David R. Jones of the U.S. Bankruptcy Court for the Southern District of Texas ruled that Serta's 2020 uptier exchange transaction was not prohibited by its 2016 credit agreement and that the debtors and first lien participating lenders did not breach duties of good faith and fair dealing under Serta's 2016 credit agreement.¹

■ **Small business lending.** One unique regulatory component to the private credit direct lending market is the ability for direct lenders to utilize the Small Business Investment Company (SBIC) program offered by the U.S. Small Business Administration (SBA). Since direct lenders provide credit to mid-market and smaller companies, they can, depending on the size of the borrower's business, provide funding through an SBIC fund whereby the SBA itself provides dollar-for-dollar matching of the funds provided by the direct lender up to a certain threshold. Since a portion of the funding is provided by the SBA, this increases the available liquidity for the direct lender (and by extension, the borrower).

In order to access the SBIC program, the borrower must meet be below certain size requirements, and the borrower will have to complete certain SBA forms. In the credit agreement, provisions relating to SBIC and SBA regulations will need to be included, often along with an SBIC side letter that address certain regulatory requirements and other matters. This is particularly relevant in the lower-middle market space where many private credit lenders operate as an SBIC fund.

■ **Rising rates and fees.** Due to higher inflation and the continuing increase in the Federal Reserve System's reserve rate, the corresponding rates in the private credit market are also increasing, particularly since interest rates in a direct loan are usually floating rates and can vary not only with the underlying benchmark rate, but also in connection with certain financial metrics of the company as noted above. We have also seen a corresponding increase in lender fees to compensate lenders for trying to keep margins down.

Predictions Looking Forward

Lending activity in the middle market is likely to continue the upward trend we have seen thus far for the first half of 2023. There is ample dry powder to be deployed and lenders are looking for opportunities to put it to good use in the second half of 2023, which would be promising for borrowers and sponsors looking to tap into the private credit direct lending market. However, the previous flexibility afforded to borrowers will likely continue to fade and loan agreements will continue tightening up and be more lender favorable. Lenders will be encouraged to continue this trend because of the increase in distressed situations that they may find in other parts of their portfolio. Anecdotally, the first half of 2023 has seen an uptick in distressed and special situations, which we suspect will likely continue into the second half of 2023. ■

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¹ Serta Simmons Bedding, LLC v. AG Ctr. St. P'ship (In re Serta Simmons Bedding, LLC), 2023 Bankr. LEXIS 1479 (Bankr. S.D. Tex. June 6, 2023).

This article should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult your own lawyer on any specific legal questions you may have concerning your situation.

Sustainability-Linked Loans and Bonds



Sustainability-Linked Loans Overview

Sustainability-linked loans are loans where the economic characteristics can vary depending on whether the borrower achieves ambitious, material, and quantifiable predetermined sustainability performance objectives.

The borrower's sustainability performance is measured using predefined sustainability performance targets as measured by key performance indicators and which measure improvements in the borrower's sustainability profile. Along with other forms of finance, such as green loans and green and sustainability-linked bonds and securitizations, investing in sustainability-linked loans is one way for financial institutions to facilitate and support environmentally and socially sustainable economic activity and growth.

The sustainability-linked loan principles are voluntary recommended guidelines that aim to promote the development and preserve the integrity of sustainability-linked loans by providing a high-level framework for determining what constitutes a sustainability-linked loan. For loans to be labeled

as sustainability-linked loans under the sustainability-linked loan principles, they must adhere to five key components: selection of key performance indicators, calibration of sustainability performance targets, loan characteristics, reporting, and verification.

The borrower's sustainability performance should be measured against one or more ESG-related key performance indicators. Carbon emissions are widely used in sustainability-linked debt transactions, but other common indicators include renewable energy and waste reduction. Others that are less frequently applied include gender initiatives and employee safety.

The borrower should determine with the lender group the targets they are ready to commit to for each key performance indicator. Targets should be ambitious, compared to a benchmark or an external reference, consistent with the borrower's overall ESG strategy, and determined on a pre-agreed timeline set before or at the same time as the loan is originated.

A fundamental characteristic of a sustainability-linked loan is that the economic outcome is tied to the borrower's meeting of or failure to meet certain predetermined targets during the term of the loan. For example, the interest rates under the loan agreement may be stepped up or stepped down based on whether the borrower achieves the relevant targets.

There is no standard methodology for reporting on performance as it depends on the chosen key performance indicator. However, borrowers should maintain up-to-date information concerning their adherence to their targets. Public reporting through annual reports, or sustainability reports, is also encouraged.

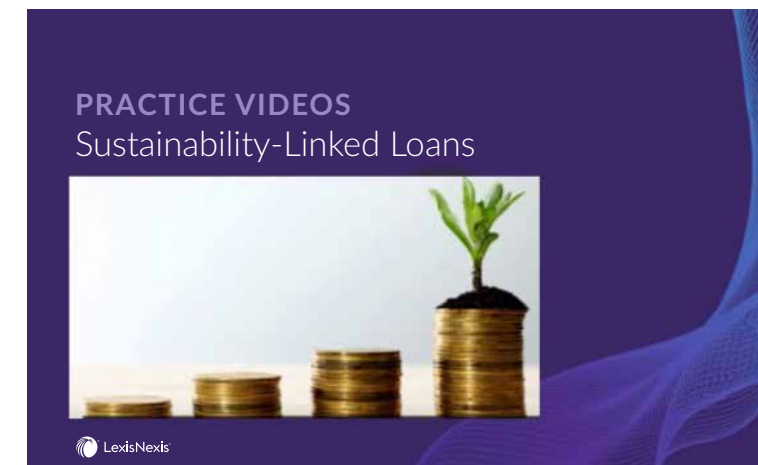
Post-signing verification is mandatory. Borrowers must obtain independent and external verification of their performance

against its sustainability performance targets at least once a year. This can be in the form of an independent audit or assurance statement by a qualified external reviewer with relevant expertise, such as an auditor, environmental consultant, and/or independent ratings agency.

The verification of the performance against the sustainability performance targets must be shared with the lenders in a timely manner, and where appropriate be made publicly available.



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Sustainability-Linked Loans

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Sustainability-Linked Bonds Overview

Sustainability-linked bonds are any type of bond instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability objectives. These objectives are metrics tied to predetermined sustainability performance targets (SPTs) as measured by predefined key performance indicators (KPIs), which may include external ratings and/or equivalent metrics, and which measure improvements in the issuer sustainability profile.

The sustainability-linked bond principles are voluntary guidelines that promote transparency and disclosure of information for the issuance of sustainability-linked bonds with the goal of bolstering integrity in the marketplace. The sustainability-linked bond principles are composed of five core components: selection of KPIs, calibration of SPTs, bond characteristics, reporting, and verification. The sustainability-linked bond principles recommend that any KPI selected by

an issuer be relevant, core and material to that company's business operations and strategy, quantifiable, and verifiable externally.

Any selected KPI should also be able to be benchmarked against some outside reference point or definition so that investors can evaluate the likelihood of achieving the stated targets for that KPI. In conjunction with the KPIs, the issuer will need to identify and quantify the goals for those indicators. These performance targets should be ambitious but they should also be realistic so that the issuer can realize the benefits should these goals be attained. A key component of a sustainability-linked bond is that the bond's financial and/or structural characteristics can vary depending on whether the selected KPIs reach the predefined SPTs. The potential change in the coupon rate is the most common example.

A key goal for the sustainability-linked bond principles is information sharing and transparency. Pre-issuance



reporting may include a second-party opinion letter to confirm conformity with the sustainability-linked bond principles, and to assess the relevance, robustness, and reliability of the identified KPIs and SPTs.

Post-issuance issuers should publish at least annually and keep readily available updated information concerning calculations, of KPIs, changes observed in baseline measurements and benchmarks, external verifications of target level calculations and any changes or updates to the issuer's overall ESG strategy or otherwise to its projected ability to achieve its SPTs.

Verifications by an outside party are a necessary component of the sustainability-linked bond principles as investors need regular updates on measurements of indicators and progress toward target numbers.

After a bond issuance, issuers should, on an annual basis, obtain this external verification, as well as an assurance report confirming their calculations of KPIs and progress toward achievement of SPTs. Issuers may also consider setting interim milestones for SPTs as a show of seriousness in moving toward achievement of a given target level and those levels could be evaluated as part of annual or more frequent verification exercises. **L**

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Cameron Kinvig PRACTICAL GUIDANCE ENERGY & UTILITIES ATTORNEY EDITOR

Federal Environmental Regulations Affecting Oil and Gas Operations

This article provides you and your clients with an overview of the federal environmental regulation affecting the oil and gas exploration and production (E&P) industry.

THERE IS SUBSTANTIAL ENVIRONMENTAL REGULATION of oil and gas E&P at the federal and state levels through the Environmental Protection Agency (EPA) and other agencies. Although it is estimated that states conduct between 80% and 90% of all enforcement actions affecting the E&P industry, these actions are often taken based on federal environmental regulations. For the purposes of providing state examples, we have used Texas as the model here. The practitioner should recognize that the rules do vary by state, as the federal government has left a lot of the enforcement of the federal laws to the states, and the states in turn, have incorporated portions of the federal laws into their own, while adding others as well.

The Need for Environmental Regulation

Environmental regulation is critical to address the environmental impacts of oil and gas E&P, which arise largely because of the methods employed to drill oil and gas wells. As a well is drilled, drill cuttings—rock and mud from the hole—are brought to the surface along with drilling fluids and mud used to lubricate and cool the drill bit, as well as various chemical compounds. Drilling deep and horizontal wells can produce prodigious amounts of this waste, which is generally stored in surface pits or tanks before being disposed of at or near the drilling site (usually by the E&P company).

Environmental regulations ensure that your clients dispose of this waste in an environmentally friendly way, and that complete disposal of waste and rehabilitation of the environment surrounding the well is accomplished by the time drilling is completed.

Environmental regulations also require your client, as the owner, to monitor the entire life cycle of an operating well to guarantee the well is properly plugged and abandoned when it has reached the end of its life.

The Resource Conservation and Recovery Act

The Resource Conservation and Recovery Act (RCRA)¹ regulates solid and hazardous waste and underground storage tanks. Its intention was to aid state governments in creating their own waste disposal schemes.

Exempt and Nonexempt Waste

Drilling waste is exempt from regulation under the RCRA. However, the RCRA does regulate temporary underground hydrocarbon storage tanks located at or near a well site and

other waste associated with drilling operations (e.g., empty drums, solvents used to clean drums or trucks, waste associated with painting and sandblasting, and other solvents, chemicals, and acids used at or around drill sites). In total, hundreds of chemical compounds and other items are listed as nonexempt hazardous waste under the RCRA.²

It is important for you to make your client aware that if they mix exempt and nonexempt waste, this will often cause the entirety of the waste to be deemed nonexempt, which can significantly increase expenses when dealing with large volumes of drilling tailings and mud that may be tainted by only a small amount of nonexempt chemicals or other waste. A listing of exempt waste and a discussion of specific nonexempt waste under the RCRA follows:

Exempt Waste

- Household hazardous waste, such as garbage, sanitary waste, and trash
- Agricultural waste, such as waste from crops or animals that is returned to the soil as fertilizer
- Mining overburden returned to the mine site
- Fossil fuel combustion waste, such as fly ash, bottom ash, slag waste, and flue gas emission control waste generated from the combustion of fossil fuel and/or coal
- Oil, gas, and geothermal waste, such as drilling fluids, produced waters, and other wastes associated with the exploration, development, or production of crude oil, natural gas, or geothermal energy
- Trivalent chromium wastes, as long as it can be proven such waste is not generated through a process that also generates hexavalent chromium
- Mining and mineral processing wastes, including slag from primary copper processing, slag from primary lead processing, red and brown muds from bauxite refining, phosphogypsum from phosphoric acid production, etc.
- Cement kiln dust waste
- Arsenically treated wood
- Petroleum-contaminated media and debris from underground storage tanks

¹ Pub. L. No. 94-580, 90 Stat. 2795 (Oct. 21, 1976). ² A complete listing of nonexempt hazardous waste, and a discussion of the RCRA hazardous waste categories, can be found in 40 C.F.R. Ch. I, Subch. I, Pt. 261. The EPA's exclusions to hazardous waste regulations under the RCRA can be found at A User-Friendly Reference Document for Hazardous Waste Exclusions.



Depending on where a well site is located, and where waste will be discharged, an E&P [exploration and production] operator may be required to obtain as many as four different permits prior to beginning work to drill the well itself.

- Certain types of injected groundwaters that were reinjected as part of a hydrocarbon recovery operation, if those groundwaters were reinjected prior to January 25, 1993
- Spent chlorofluorocarbon refrigerants from totally enclosed heat transfer and air conditioning systems, provided the refrigerant is reclaimed for further use
- Used oil filters, as long as the filter has been drained of oil utilizing one of the four methods approved by the EPA
- Used oil distillation bottoms that are used as feedstock to manufacture asphalt products
- Landfill leachate or gas condensate derived from certain listed wastes, as long as it does not exhibit any characteristic of hazardous waste and meets certain other requirements
- Waste generated by participants in the Project XL Pilot Project

Nonexempt Hazardous Waste

Hazardous waste under the RCRA is categorized into six separate hazard codes: ignitable waste, corrosive waste, reactive waste, toxicity characteristic waste, acute hazardous waste, and toxic waste. Thus, E&P operators must be careful to ensure solvents and other chemicals used at a drill site do not mix with exempt waste from drilling activities.

It should also be noted that the RCRA implements cradle-to-grave requirements for the hazardous wastes it covers. This allows the EPA to establish controls to monitor compliance and cleanup procedures required by the RCRA, and imposes strict recordkeeping and reporting requirements on any party that generates, transports, treats, or disposes of any nonexempt waste.

Although the vast majority of waste at a drill site is exempt from the RCRA requirements, the RCRA remains a powerful tool for the EPA to enforce environmental standards over ancillary activities that occur at or around a drill site.

The Clean Water Act

The Clean Water Act (CWA)³ is the primary federal law governing water pollution, passed in an effort to protect the environmental integrity of the nation's waterways. It is administered by the EPA in conjunction and coordination with state governments. The CWA does not cover drinking water (which is covered primarily by the Safe Drinking Water Act (SDWA)—see the section on the SDWA below) but does strictly regulate what types of waste can be discharged into a waterway—whether that be a wetland, lake, river, estuary, or stream. The CWA also covers the discharge of waste at any shoreline or other land if there is potential for that waste to drain or seep into a waterway or wetland.

Types of Regulated Waste

The CWA regulates two types of waste discharge into waterways: point source and nonpoint source discharge. Point source discharge is a discharge that constitutes a “discernible, confined, and discrete conveyance of pollutants to a water body.” Point source discharge may issue from “any pipe, ditch, channel, tunnel, conduit, well, discrete fissure, container, rolling stock, concentrated animal feeding operation, landfill leachate collection system, vessel or other floating craft from which pollutants are or may be discharged.”

Nonpoint source discharge, on the other hand, generally results from rainwater or other runoff, seepage, or snowmelt moving over and through the ground, which picks up pollutants along the way and eventually deposits those pollutants into lakes, rivers, streams, wetlands, and other waterways. Legally, any water-based pollution that cannot qualify as point source pollution is categorized as nonpoint source pollution.

Permitting Process under the CWA

The CWA requires an E&P operator to obtain all appropriate permits and certifications related to point source and nonpoint source waste before the operator can discharge certain drilling-related E&P waste into or near a waterway or wetland. Different permits and certifications are required for different wastes to be discharged. These include certifications from a state environmental body under Section 401 of the CWA,⁴ permits from the state environmental agency or the National Pollutant Discharge and Elimination System (NPDES) under Section 402 of the CWA,⁵ permits from the NPDES (or its state-run equivalent) under Section 403 of the CWA,⁶ and permits from the U.S. Army Corps of Engineers (USACE) under Section 404 of the CWA.⁷ Depending on where a well site is located, and where waste will be discharged, an E&P operator may be required to obtain as many as four different permits prior to beginning work to drill the well itself.

The permitting process in Texas is somewhat more difficult than in other states, because the Texas Railroad Commission (which regulates all oil and gas activities within the state) is not fully

authorized by the EPA to implement an NPDES permit program. Thus, any discharge of E&P waste in Texas that would require permitting under the CWA requires permitting by both the EPA and the Texas Railroad Commission.

The following sections discuss the permit-related sections of the CWA that relate to Texas.

Section 401

Section 401 of the CWA⁸ requires your E&P operator client to obtain a certification that the planned point source discharge contemplated under a Section 404⁹ permit application (to be approved by the USACE) will meet state environmental and water quality standards. A Section 404¹⁰ permit cannot be issued without this certification.

Generally, a Type I certification is issued to your clients under Section 401¹¹ if your client's project:

- Involves less than 1,500 linear feet of stream
 - Involves less than three acres of waters of the United States
 - Does not affect rare and ecologically significant wetlands
- A Type II certification is issued if your client's project:
- Will affect ecologically significant wetlands of any size
 - Involves greater than 1,500 linear feet of stream
 - Involves greater than three acres of water of the United States
 - Is otherwise not appropriate for Type I certification

For model information on Section 401¹² water quality certifications, please see the Texas Railroad Commission's guidance.¹³

Section 402

Section 402¹⁴ regulates your client's point source discharge of stormwater “associated with industrial activity” through either the NPDES or the relevant state-sponsored equivalent. If your client's E&P facility discharges or has the potential to discharge stormwater into waters of the United States through construction, clearing, grading, and/or excavation activity, then you need to advise your

3. Pub. L. No. 95-217, 91 Stat. 1566 (Dec. 27, 1977).

4. 33 U.S.C.S. § 1341. 5. 33 U.S.C.S. § 1342. 6. 33 U.S.C.S. § 1343. 7. 33 U.S.C.S. § 1344. 8. 33 U.S.C.S. § 1341. 9. 33 U.S.C.S. § 1344. 10. *Id.* 11. 33 U.S.C.S. § 1341. 12. *Id.* 13. State Water Quality Certification. 14. 33 U.S.C.S. § 1342.

client that its facility must receive an authorization permit through the NPDES under Section 402.¹⁵ These permits may be individual or general. Individual permits are issued to individual dischargers and are tailored to your client's facility. General permits are meant to cover several different entities that have the same type of discharge, and they set forth requirements applicable to entire categories of covered discharging entities.

The NPDES permit issued pursuant to Section 402¹⁶ imposes effluent limits for point source discharge that are tied to the technology available to treat the pollutant prior to discharge and the resulting water quality when the effluent is released into the body of water.

The EPA bases the limits, which vary by industry, on the performance of the best available technology that is economically achievable for that industry. Your clients are not required to use the technology considered by the EPA in setting the limit but are required to achieve the pollution control levels set by the EPA with that technology.

The EPA standard for water quality is based on the minimum allowable water quality standards set by the relevant state environmental regulatory agency.¹⁷

It is worth noting that non-contaminated sediment that is released due to uncontrolled stormwater discharge is exempted from CWA regulation, but if such discharge contains oil or other contamination,

you should be aware that your E&P operator client will be liable—even if the discharge was through no fault of its own.

Section 403

If your client is conducting a construction activity that could release potentially contaminated stormwater into a nonmarine body of water, Section 403¹⁸ requires compliance with technology and water quality-based treatment standards before a permit is issued to your client. Specifically, the section requires that your client treat the discharged waters to federal minimum standards and also requires discharged waters to meet state water quality standards.

If the construction activity will or could release potentially contaminated stormwaters directly into territorial seas, a contiguous zone, or the ocean, then additional limitations are imposed before an NPDES permit will be issued. In such cases, there may be requirements placed on your clients in addition to the technology and water quality standards listed above. These may include:

- Ambient monitoring programs designed to determine degradation of marine waters
- Alternative assessments designed to further evaluate the consequences of various disposal options
- Pollution prevention techniques designed to further reduce the quantities of pollutants requiring disposal, thereby reducing the threat to the marine environment

Section 404

Section 404¹⁹ regulates point source discharge of dredging or fill materials into the waters of the United States—including wetlands—through a permit issued by the USACE. A permit will not be issued if it is practicable to dispose of dredging or fill materials in some other way that is less damaging to the environment, or the nation's waters or water system would be seriously degraded if the proposed disposal activity were to take place.

Before a permit can be issued by the USACE, an operator must obtain a Section 401²⁰ state water quality certification from the state entity responsible for enforcement of the CWA, as noted above. Note that although the Section 404²¹ permit is generally issued by the USACE, the EPA retains the right to overrule the USACE's decision to issue a permit.²²

Compliance Monitoring and CWA Jurisdiction

The CWA provides for regular compliance monitoring of waste-generating sites. This is largely accomplished through state agencies, as 46 states have been given authority by the EPA to conduct this monitoring on its behalf. Some states, though, (such as Texas) have only been given partial authority to monitor compliance with the CWA.

In allocating compliance resources, the EPA and the states focus on noncompliance trends and water quality, and shift compliance resources based on the amount and type of state and federal resources available. Resources are allocated based on the type of waste discharged, as well as how long it has been since a site has been inspected.

During an inspection, the EPA or its designate will often request to:

- Review your client's site's spill prevention control and countermeasures plan
- Interview your client's personnel and conduct a walk-through inspection of its site to ensure the site is implementing the spill prevention plan
- Review your client's facility response plan
- Conduct an unannounced exercise at your client's site to ensure implementation of all spill prevention and facility response plans

If the EPA finds that your client violated the CWA during either a desk audit or a site inspection, it will begin an enforcement action. But, before an enforcement action can commence, the EPA must prove that a spill of oil or a discharge of any other covered waste had a significant nexus to traditional navigable waters. This is a relatively new restrictive standard that came into play after the U.S. Supreme Court's decision in the joint *Rapanos* and *Carabell*

In allocating compliance resources, the EPA and the states focus on noncompliance trends and water quality, and shift compliance resources based on the amount and type of state and federal resources available.

cases,²³ where developers wanted to develop real estate projects on wetlands adjacent to, but independent from, waters that fell within EPA CWA jurisdiction. Although the case produced the significant nexus test espoused by Justice Anthony Kennedy in what is viewed as a controlling concurrence, the EPA has issued slightly more aggressive guidance on what water bodies automatically meet this standard. The EPA has stated that the discharge of waste falls within the jurisdiction of the CWA if it is into:

- Waters that are traditionally navigable
- Wetlands adjacent to traditionally navigable waters, including wetlands without a continuous surface connection
- Non-navigable tributaries of traditionally navigable waters, as long as those tributaries are relatively permanent with either a year-round flow or a three-month or longer seasonal flow
- A wetland adjacent to a non-navigable tributary of a traditionally navigable water, as long as such a wetland has a continuous surface connection to that non-navigable tributary

Because of *Rapanos*, the EPA has also issued guidance on the analysis a field officer must conduct before a significant nexus is found. A significant nexus analysis must assess (1) the flow characteristics and functions of the tributary and (2) the functions performed by any wetlands that are adjacent to the tributary. In both cases, the analysis is to “determine if they significantly affect the chemical and biological integrity of downstream traditional navigable waters.”

The EPA has stated that it can consider certain hydrologic factors when making a significant nexus determination, including:

- Volume, duration, and frequency of flow
- Proximity to traditionally navigable water
- Size of the watershed
- Average annual rainfall in the area
- Average annual winter snowpack in the area

^{15.} *Id.* ^{16.} *Id.* ^{17.} More guidance on the EPA's effluent guidelines under Section 402 of the CWA is available at Learn about Effluent Guidelines. ^{18.} 33 U.S.C.S. § 1343. Additional EPA information on the Section 403 NPDES permitting process is available at About NPDES.

^{19.} 33 U.S.C.S. § 1344. ^{20.} 33 U.S.C.S. § 1341. ^{21.} *Id.* ^{22.} More EPA Guidance on Section 404 permitting is available at Permit Program under CWA Section 404. ^{23.} See *Rapanos v. United States*, 547 U.S. 715, 126 S. Ct. 2208, 165 L. Ed. 2d 159 (2006).



A nexus is significant if it is simply more than speculative or insubstantial. The initial determination of whether a significant nexus exists is made by the relevant EPA or USACE district, and the districts are given broad latitude to implement the CWA according to these EPA guidelines.

Civil and Criminal Enforcement Mechanisms

The CWA provides a stringent regulatory regime governing your client's discharge of waste into waters of the United States. The EPA is serious about enforcement of the CWA's provisions and has administrative, civil, criminal, and injunctive enforcement powers at its disposal to effect compliance. In the oil and gas industry especially, the EPA's enforcement of the CWA's provisions can be extensive.

Civil and Administrative Penalties Available to the EPA

The CWA authorizes the EPA to assess a penalty on any person. The definition of person, in this case, covers individuals, corporations, associations, and responsible corporate officers—certainly almost anyone associated with your clients. The following are the civil and administrative penalties that can be assessed against your clients under the CWA:

- Administrative penalties of \$16,000 per violation or per day, up to a total penalty of \$187,500
- Civil penalties of \$37,500 per day per violation for failing to comply with NPDES or Section 404²⁴ permitting programs
- Civil penalties for oil or other hydrocarbon spills of \$37,500 per day, or \$2,100 per barrel of oil discharged
- Civil penalties of \$150,000 minimum, or \$5,300 per barrel for oil or other hydrocarbon spills that resulted from gross negligence or willful misconduct

Criminal Penalties

A variety of criminal penalties can be levied against your clients for violation of the CWA. They include:

- **Violations due to negligence.** Courts have interpreted the negligence standard as only requiring simple or ordinary negligence, rather than gross negligence. Such violations may incur fines of \$25,000 per day for a first conviction and \$50,000 per day for subsequent convictions. A conviction is considered a misdemeanor. A responsible corporate officer faces jail time of up to one year, in addition to the above fines.
- **Violations with knowledge.** These violations incur fines of \$50,000 per day for a first conviction, and \$100,000 per day for subsequent convictions. A conviction is considered a felony and carries a prison sentence of up to three years, in addition to the above fines.



- **Federal Alternative Fines Act.** This act can be utilized by government to impose additional fines in an amount up to double the loss or gain associated with the violation in question.²⁵
- **Disqualification, suspension, and debarment.** Upon criminal conviction, a person or entity is automatically disqualified from conducting work for the federal government until they are reinstated (which may never occur). Suspension and debarment are discretionary actions that can be applied to an entire company, including its affiliates. Suspension is usually in effect for up to 12 months, whereas debarment is often in effect for at least three years and can be extended further. Unlike automatic disqualification, suspension and debarment are only effective if the debarring official issues a negative opinion, notice is given to the violator, and the violator is allowed to protest the decision.

The EPA's enforcement abilities are vast, and fines can reach billions of dollars. For example, BP was assessed a \$5.5 billion civil penalty under the CWA for its part in the 2010 Deepwater Horizon oil spill. This was a negotiated total that was substantially lower than its penalty could have been.

surface reservoir if the fluid leaks out of the formation it is injected into. Thus, the UIC places great importance on the injection of contaminated liquid into proper sealed formations or salt domes so that it does not escape through faults or fissures into a subterranean aquifer or otherwise find its way to the surface to contaminate drinking water.

Enhanced Recovery Wells

Approximately 80% of UIC-qualifying wells are enhanced recovery wells, where the operator consistently injects brine, water, steam, or other fluid into a producing formation to increase pressure and force oil or gas out of a nearby well with greater efficiency. This process is used in older formations where production without an enhanced recovery process would likely not be commercially viable. Although the method has raised environmental concerns related to drinking water, the process can extend the life of a hydrocarbon field by years, or even decades, and is a method of ensuring that all reserves are gathered from a field before its wells are plugged and abandoned.

The enhanced recovery process is markedly different than hydraulic fracturing or fracking, where fluid and proppants are pumped into a well as it is being completed to create and hold open cracks or fractures in the producing formation so that petroleum and natural gas can more easily flow into the wellbore. Instead, enhanced recovery wells make formerly productive wells commercially productive again. Neither the SDWA nor the UIC provides for regulation of the vast majority of fracking operations (see The SDWA and the Regulation of Fracking below).

Saltwater Disposal Wells

Saltwater disposal wells—which inject saltwater brine that occurs naturally as part of the production process—account for the remaining 20% of wells regulated by the UIC. These wells dispose of the saltwater brine byproduct—estimated at 10 barrels for every barrel of oil produced—at a significantly lower cost than would be required to dispose of the saltwater brine in another manner.

Saltwater disposal wells are often formerly productive oil or natural gas wellbores that have stopped producing paying quantities of petroleum or natural gas but are located within productive oil and gas fields and close to other producing wells. Injection into saltwater disposal wells is limited to the amount of fluid that can be absorbed into the formerly productive geologic formation, and each well is rated separately to account for this volume limitation.

If your client is an operator, it has a fiscal inducement to keep the saltwater brine wastewater that is to be injected into disposal wells as free from hydrocarbons and other contaminants as possible, since any hydrocarbons skimmed off the wastewater is

Safe Drinking Water Act

The SDWA²⁶ is the premier piece of legislation allowing the EPA—most commonly through state action—to regulate drinking water within the United States. The SDWA seeks to promote healthy drinking water that is free of harmful amounts of pollutants.

The SDWA created the Underground Injection Control (UIC) program, which regulates wastewater disposal and flowback into old/inactive wells or wastewater disposal wells resulting from the drilling process. Essentially, the SDWA regulates all oil and gas wells that involve injection of liquids or gas, either to enhance recovery or to dispose of drilling waste, brine, or water recovered during production. The SDWA does not, however, regulate wells that are solely used for the production of oil and gas without the aid of any ongoing fluid injection to increase pressure.

It is estimated that there are more than 144,000 wells that qualify for regulation under the UIC, with approximately 2 billion gallons of fluid (mostly saltwater brine) being injected each day. The brine is saltier than ocean water, and a relatively small volume of brine from oil and gas production can contaminate a large freshwater aquifer or

²⁴. 33 U.S.C.S. § 1344. ²⁵. 18 U.S.C.S. § 3571.

²⁶. 42 U.S.C.S. §§ 300f et seq.

In evaluating whether the creation and operation of a well is in the public interest, state regulators evaluate “whether the well will provide needed additional disposal capacity and an economical and safe means of disposing of oil and gas waste, thereby increasing the ultimate recovery of oil and gas and preventing waste.”

their property—rather than the property of the E&P operator that originally produced those hydrocarbons. Thus, many owners of saltwater disposal wells store the wastewater in a series of settling tanks before pumping it into the disposal wells. Any significant solids, as well as oil and other hydrocarbon products, can be skimmed out of the wastewater in the tanks and resold. This helps ensure that the formation receiving the saltwater brine remains as free from serious contamination as possible and helps keep the disposal wellbore clean and able to operate with less maintenance. Additionally, the process may provide a profit motive for your client as well.

Ideal Underground Strata for the Injection of Saltwater and Other Waste

The SDWA attempts to prevent the underground contamination of drinking water by regulating saltwater injection wells. Requiring an operator to inject brine into a formation that is similar to that from which the brine was extracted makes drinking water contamination from the injection activity less likely. In contrast, if sufficient geologic testing is not conducted and brine is injected into an improper formation with faults that allow for leakage, aquifer, and/or groundwater, contamination is quite possible. Thus, the SDWA requires an operator to only inject fluid into strata that is porous and permeable enough to accept the volume of fluid proposed, and which can contain and confine the fluid solely within that formation. If strata is faulted or fractured, it is not acceptable for injection well purposes. Similarly, if strata contains hydrocarbons—even if they are not capable of being produced or are largely depleted—the strata may not qualify, because injection of wastewater may be challenging for the operator. The ideal formation for your client to use for injection purposes is either a porous dry layer of strata, or a porous layer of strata already partially or fully populated with saltwater.

To identify the ideal layer of strata in an area, your client should hire geologists to evaluate core samples and/or records of core samples from when the well was drilled. If quality geologic information is not available, information gathered from geophysical mapping may be used to determine the proper formation for disposal purposes. Depending on where the ideal strata is located, the wellbore may have to be manipulated to ensure that wastewater only travels into

the appropriate formation and does not seep into formations above or below.

The Permitting Process for Disposal and Injection Wells in Texas

Operators of saltwater disposal and enhanced recovery injection wells must obtain a permit. Because the SDWA is largely administered by the states, this is generally done through the state body that regulates the oil and gas industry within that state.

Before a permit is issued, the state authority evaluates the application to determine if:

- Groundwater and surface freshwater can be adequately protected from pollution.
- The use or installation of the well is in the public interest.
- The installation of the well will endanger or injure any oil, gas, or other mineral formation.
- The applicant has made a satisfactory showing of financial responsibility.

In evaluating whether the creation and operation of a well is in the public interest, state regulators evaluate “whether the well will provide needed additional disposal capacity and an economical and safe means of disposing of oil and gas waste, thereby increasing the ultimate recovery of oil and gas and preventing waste.” However, in the seminal case,²⁷ the Texas Supreme Court ruled that the state regulatory agency could not take into account other factors such as increased truck traffic, perceived public safety threats, general community impact, or diminution of local property values when determining whether to grant a saltwater disposal well permit. Additionally, notice must be given to the surface owners, other nearby operators, and local government officials, and the operator must review records for all abandoned wells within a defined radius to ensure there can be no fluid migration into an improperly abandoned well (thereby creating liability for your client as operator of the injection well).

After these standards are met, the state regulatory authority will review the construction plan for the well to ensure that its design will protect drinking water. Depending on various state regulations,



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a saltwater disposal well must generally be constructed with three or four layers of cement and steel casing before it is approved for operation. While different states vary their regulations slightly, best practices for both steel casing, and cementing activities have been promulgated by the American Petroleum Institute and are generally followed by all hydrocarbon-producing states.²⁸

The Casing and Cementing Process

The first casing—the surface casing—is the widest, and is placed downhole, with a concrete encasement that seals the area from the surface to the bottom of the deepest discovered groundwater aquifer. In most cases, a production casing, with full concrete cladding, comes next that travels from the surface to the very bottom of the wellbore. In some cases, an intermediate casing, with concrete encasement, is placed between the surface casing and the production casing, creating an extra layer of protection for the groundwater aquifers the well passes through. Finally, a steel tubing string and packer are lowered into the wellbore. The tubing string has perforations at its bottom, which will allow the saltwater injected to drain into the appropriate formation. The packer is a mechanically or hydraulically set seal that is placed between the tubing string and the production casing—generally at least 50–100 feet above the highest perforation level of the tubing string. The space between the production casing and the tubing string is often

filled with hydraulic fluid before the packer is fully set, thus helping counteract downhole pressure on the bottom of the packer, alerting the operator if the packer begins to leak and saltwater begins to travel up-hole between the production casing and the tubing string. This hydraulic fluid also helps prevent corrosion from attacking the production casing and the outside of the tubing string.

Permitting

If both statutory and mechanical requirements are complied with, the state regulatory authority will issue your operator client a permit for the construction of its saltwater disposal well. However, before the well becomes operational, your client must demonstrate that the well can meet a very strenuous pressure test designed to model the harshest conditions the well might encounter during its lifecycle. If the well passes this pressure test, it may become operational. If it does not, it must either be capped and abandoned, or must be recompleted or repaired. The EPA only requires that this strenuous pressure test be repeated every five years. However, each state differs in this requirement, with some requiring your operator clients to conduct and report an annual pressure test on all saltwater disposal wells within the state. Monthly logs must also be kept of average operating pressure, to ensure the packer or the casing is not slowly failing between pressure tests.

²⁷ R.R. Comm'n of Tex. v. Tex. Citizens for a Safe Future & Clean Water, 336 S.W.3d 619 (Tex. 2011).

²⁸ See U.S. Department of Energy, State Oil and Natural Gas Regulations Designed to Protect Water Resources (3rd Ed. Nov. 2017), at p. 18.

To determine operating volume for the well, many state regulatory agencies will require your clients to perform a step test, in which different and increasing volumes of fluid are pumped down the wellbore while bottom pressure is monitored. Maximum volume/pressure for the well is generally set just below the point at which the fluid injected during the test causes the formation to begin to break down. Pursuant to EPA guidelines, this test must be witnessed personally by state regulatory personnel.



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The permitting process is not a static process. To maintain an active permit to operate a saltwater disposal well, your operator clients must prove that they regularly monitor the well and must keep significant records of disposal volumes and pressures. Your clients must also monitor and report regularly on water quality in the area surrounding the well.

Transportation of Saltwater to an Injection Well Site

The vast majority of saltwater brine is stored temporarily at a well site until a sufficient quantity has been produced to be transported via truck to a disposal well. The cost to transport saltwater brine is generally calculated on a per-barrel-per-hour basis, with the national average being \$1.00 per barrel per hour of transportation time. However, disposal wells are few and far between in oil and gas producing states like Pennsylvania and New York but are plentiful in Texas. The cost of disposing of a barrel of brine on the east coast may be between \$4.00 and \$6.00, whereas the cost may be as little as \$0.50 per barrel in the Barnett Shale in North Texas. Thus, the location of a saltwater disposal well may greatly affect the economics of a productive formation your clients own a part of.

Due to the cost of transportation and, in some cases, the rarity of saltwater disposal wells, some E&P companies have begun to develop systems to filter and reuse produced brine as semi-fresh water for other drilling activities. These efforts are in their infancy and are still relatively uneconomical except in areas where few injection wells are present, but they do present your clients with interesting alternatives to the traditional saltwater injection option.

The SDWA and the Regulation of Fracking

Since 2005, the SDWA has specifically excluded regulating the underground injection of most hydraulic fracturing operations. Some

believe this is because all such fluid eventually works its way out of a well (and therefore does not remain permanently in the ground). Others see it as a specific exclusion brought about by aggressive industry lobbying. Regardless of the cause, most fracking operations remain outside the jurisdiction of the SDWA.

The exception to this rule is that the SDWA does still regulate the injection of diesel fuel as a tool used in fracking, because diesel often contains impurities such as benzene, toluene, ethylbenzene, and zylene that are highly mobile in groundwater and pose a risk to human health. Although diesel is not often used in fracking operations, it can be used as a large or small component of fracking fluid to adjust viscosity and fluidity, or as a solvent for the fractures themselves. If your client wishes to conduct a fracking operation using diesel fuel as a primary base (or carrier) fluid, as a component of its fracking fluid, or as a solvent, then it must seek an additional permit to do so from the EPA. The EPA is given significant discretion when deciding whether to grant such a permit.²⁹

Comprehensive Environmental Response, Compensation, and Liability Act

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)³⁰ is a significant piece of environmental regulation meant to clean up sites contaminated with toxic chemicals. The act creates strict joint and several liability for all present and past property owners and is the act that designates Superfund sites.

CERCLA contains two exclusions affecting the oil and gas industry: the E&P waste exclusion and the petroleum exclusion. The petroleum exclusion is relatively clear cut. If petroleum is spilled, CERCLA liability will not attach, because that spill is regulated under other federal laws, including the SDWA and the CWA.

The E&P waste exclusion is a different matter. Many believe this exclusion was originally meant to fully exclude all drilling-related E&P waste from CERCLA regulation. But early case law on the subject failed to fully recognize that exclusion, if it was indeed the intent.

The EPA has utilized CERCLA to investigate drilling and injection well sites, alleging that E&P waste (such as drilling mud, tailings, injectable fluids, and brine) may be the cause of ground or water contamination. However, this is rare, as the EPA has to find elevated amounts of hazardous substances (e.g., toluene, benzene, zylene, and other hazardous chemical compounds that are associated with either commercial-grade solvents or the use of substantial amounts of diesel fuel during the fracking process) in E&P waste before liability may attach.

CERCLA has recently been used by the EPA to investigate fracking methods in Pennsylvania, Wyoming, and other states. However, no enforcement actions have been taken as a result of these preliminary investigations. In reality, other environmental regulations such as the CWA and the SDWA are more easily tailored to oil and gas regulation and are therefore more often used by the EPA as enforcement tools for fracking operations and within the larger E&P industry.

²⁹ See the EPA's whitepaper regarding the permitting process necessary before diesel can be used in a fracking operation, Unconventional Oil and Natural Gas Development. ³⁰ 42 U.S.C.S. §§ 9601 et seq.



The Clean Air Act

The Clean Air Act (CAA)³¹ regulates major source and minor source entities that emit any of 188 separate air pollutants and is the preeminent federal law regulating toxic pollutants released into the air.

Major source polluters are individual entities that either have the potential to emit at least 10 tons of a single toxic air pollutant per year or have the potential to emit 25 tons of two or more air pollutants during any given year. Major source polluters (such as power plants) are individually regulated and must install emission control devices that drastically reduce the amount of pollutants released into the atmosphere. The standard for these control devices is deemed to be the maximum achievable control technology; each major source facility must install the state-of-the-art air-scrubbing technology to minimize air pollution. Essentially, whatever is the best technology available in the marketplace is the standard.

Minor source polluters emit less than the major source limits on a per-installation basis. These polluters are not required to install emission control devices unless an aggregated number of minor source polluters would, together, produce enough toxic air pollution to qualify as an aggregated major source polluter.

As with many of the federal regulations discussed above, enforcement of the CAA is left first to the states, with oversight from the EPA.

Aggregation and the Historic Oil and Gas Industry

Historically, EPA regulations exempted individual oil and gas wells from being aggregated together for purposes of the CAA, unless they were located within a municipal area with one million inhabitants or more. Thus, the vast majority of the upstream oil and gas industry was historically exempt from CAA standards. This is because individual oil and gas wells do not produce sufficient air pollutants to qualify as a major pollution source under the CAA and were too diverse in location and scope to be aggregated together into a single major source polluter. However, the situation began to change in the mid-2000s.

The Trend toward Aggregation

By the mid-2000s, the nation's oil and gas industry was expanding rapidly. With the discovery of multiple shale gas fields throughout the country, many near or directly under populated residential areas, there was heightened concern about environmental standards for the oil and gas industry under the CAA. There was particular focus on natural gas wells, which are a major source of methane emissions.

In 2007, the Acting Assistant Administrator of the EPA published a memo that stated interconnected oil and gas facilities could be aggregated for the purpose of determining whether they were major source polluters under the CAA if they:

- Have a unity of ownership/control
- Are within the same industrial grouping
- Were located within a quarter-mile of each other

This rule has been adopted by most state agencies tasked with enforcing the CAA. While the EPA concluded that aggregation would not be appropriate in a great majority of cases, the proximity standard allowed for further regulation of the oil and gas industry under the CAA.³²

The Modern Push to Aggregate

In 2009, the Assistant Administrator for the EPA withdrew the above-mentioned memo and published her own guidelines for determining whether aggregation was appropriate within the oil and gas industry. The McCarthy Memo, as it later became known, took the EPA back to a case-by-case analysis for aggregation determinations, with the hope that aggregation could be found for oil and gas facilities that were significantly farther apart than the quarter mile provided for under the previous memo.

Not all state environmental regulatory agencies automatically followed the EPA's lead on this front. As late as 2012, many state agencies were still operating under the quarter-mile guidance. The EPA eventually forcibly reminded each state that this was no longer the standard.

Litigation Shows Limits on Aggregation

In *MacClarence v. EPA*,³³ the U.S. Court of Appeals for the Ninth Circuit upheld a ruling against a private citizen who attempted to force the EPA to aggregate all of BP's wellheads located in Prudhoe Bay, Alaska, even though that field was spread over more than 300 square miles. In its denial of the application for aggregation, it was stated that the request "stretches the concept of proximity" that otherwise defines aggregation determinations within the CAA concept.

In *Summit Petroleum Corp. v. EPA*,³⁴ the EPA decided to take an aggressive stance on aggregation that was ultimately struck down by the U.S. Court of Appeals for the Sixth Circuit. In *Summit*, which began with a 2005 application for an aggregation determination, the EPA initially relied on its early guidance on aggregation to determine that the natural gas wells and a processing facility—which were roughly eight miles from end to end and covered an area of 43 square miles—could not be aggregated. However, a final

determination was not made by the EPA until two weeks before the McCarthy Memo was issued. At that point, the final EPA determination stated that the *Summit* facility should be aggregated under the CAA. *Summit* appealed, and the Sixth Circuit ultimately disagreed with the EPA. The court remanded the case back to the EPA to make a revised determination based on "the proper, plain-meaning application of the requirement that *Summit's* activities be aggregated only if they are located on physically contiguous or adjacent properties."

In response to *Summit*, the EPA instructed its various field regions (outside of the Sixth Circuit) to continue to apply the pre-*Summit* concept of adjacent when making an aggregation determination under the CAA, leaving the field offices located within the Sixth Circuit alone to abide by *Summit*. The U.S. Court of Appeals for the D.C. Circuit patently rejected this approach in *Nat'l Env'tl. Dev. Ass'n Clean Air Project v. EPA*,³⁵ citing the need for a uniform national standard for CAA aggregation policy.³⁶

New Rules to Change Aggregation Standard

While the CAA standards currently in existence still adhere to the McCarthy Memo's aggregation guidelines, the EPA has proposed new rules on aggregation, to clarify regulation of the oil and gas industry under the CAA. These rules propose to bring back the quarter-mile proximity standard, but also propose new stringent standards on methane gas and volatile organic compound emissions. Thus, the oil and gas industry may receive some relief in the proximity standard, but the level of environmental discharge that constitutes an entity being deemed a major polluter may decrease significantly if aggregation is found.

Ultimately, the trend over the past several years has been toward greater regulation of the oil and gas industry under the CAA. Whether this trend continues may be closely tied to the political process. For now, your oil and gas company clients should make plans with more stringent environmental regulations under the CAA in mind.

Oil Pollution Act

The Oil Pollution Act (OPA)³⁷ was passed by Congress largely in response to the Exxon Valdez oil spill in Prince William Sound, Alaska. It imposes liability on responsible parties for discharge of oil into or upon the navigable waters or shorelines of the United States, or within the exclusive economic zone of the United States (which extends up to 200 miles offshore). The OPA requires an E&P company to implement a plan to prevent oil spills, as well as a detailed containment and cleanup plan should an oil spill occur. It also contains certain education requirements and limits the ability of certain vessels that have spilled large amounts of oil from traveling to Prince William Sound, Alaska.

31. 42 U.S.C.S. §§ 7401 et seq.

32. Additional information on this memo is available at Steven H. Lord, Jr., *Aggregation Consternation: Clean Air Act Source Determination Issues in the Oil & Gas Patch*, 29 Pace Env'tl. L. Rev. 645 (2012).
33. 596 F.3d 1123 (9th Cir. 2010). 34. 690 F.3d 733 (6th Cir. 2012). 35. 752 F.3d 999 (D.C. 2014). 36. For a further discussion of the history of aggregation's evolution, see Steven H. Lord, Jr., *supra*. 37. 33 U.S.C.S. § 2701 et seq.



waterways throughout the United States if the responsible party is unwilling or unable to pay to do so.

Toxic Substances Control Act

The Toxic Substances Control Act (TSCA) of 1976³⁸ allows the EPA to regulate chemicals that pose an unreasonable risk to health or to the environment, as well as to regulate new entrants into the chemical marketplace. The TSCA has not traditionally been used to regulate the oil and gas industry. However, the EPA issued an Advance Notice of Proposed Rulemaking on May 9, 2014, that sought public comment on:

The types of chemical information that could be reported and disclosed under [the] TSCA, and the approaches to obtain this information on chemicals and mixtures used in hydraulic fracturing activities, including non-regulatory approaches.

This is clearly an evolving area, but the EPA's efforts indicate a desire to begin the collection of information about the composition and potential health and environmental effects of various chemicals used in the fracking process. This in turn indicates that the EPA may increase regulation in the future. It is reasonable to believe that regulation of the oil and gas industry under the TSCA may be coming in the not-so-distant future.

Endangered Species Act

The Endangered Species Act (ESA) of 1973³⁹ provides for the federal conservation of threatened or endangered species throughout their range and also works to protect the habitat and ecosystem on which they depend. The ESA prohibits any person from taking any endangered or threatened species. The term take includes harassing, harming, pursuing, shooting, wounding, killing, capturing, or collecting any listed species and also includes attempting to engage in any such conduct with a listed species.

The ESA has a significant impact on oil and gas exploration, as a drill site may require the clearing and/or the complete disruption of upwards of five acres of previously undisturbed land, and seismic operations may disturb species on land and underwater. Before any action that may disturb an endangered or threatened species occurs, an operator must determine whether the property is populated by a threatened or endangered species and ensure that it does not inadvertently take an endangered or listed species without government approval.

Section 10 of the ESA⁴⁰ requires any private party undertaking an activity that may result in a taking of a protected species to obtain an incidental take permit prior to beginning the threatening activity. As part of the permitting process, the applicant will be required to develop a habitat conservation plan that details the steps it will take to offset any harmful effects its proposed activity will have on

the protected species. These conservation plans may include such proposals as:

- The development of well sites outside of a species' traditional habitat
- The use of remote monitoring to limit human and vehicular traffic at the production site
- The requirement that a pipeline be run to a well to limit vehicular transportation
- Work to reclaim land surrounding plugged and abandoned wells
- Collaboration with and funding of research organizations in an effort to more fully understand and delineate the endangered species' habitat

Even if your operator client is issued an incidental take permit, it must be very careful. When exploring in an area populated by endangered or threatened species, it is wise for you to advise that your client build such information into the standard lease form, so that it is protected if it cannot drill due to ESA concerns.

As the government is in the process of potentially adding another 251 species to the 1,300+ endangered species list, the ESA will likely become more restrictive to the oil and gas industry. With potential civil and criminal penalties for even small infractions, your E&P operator clients must stay ahead of the curve in this area of regulatory concern.

The Migratory Bird Treaty Act

The federal government does not merely seek civil penalties against your E&P operator clients for violation of environmental laws. It also seeks to assess criminal penalties against them, should their activities cause an environmental impact. Some of the more popular criminal statutes that have been utilized against the oil and gas industry are the Migratory Bird Treaty Act and the National Marine Sanctuaries Act.

The Migratory Bird Treaty Act (MBTA)⁴¹ was originally passed in 1918 to protect birds migrating between the United States and Canada. The MBTA makes it unlawful to hunt, kill, capture, or sell

birds protected by the act. This act has famously been used to restrict the sale of bald eagle feathers, eggs, and nests. Following the Exxon Valdez disaster, the U.S. government chose to pursue criminal penalties against Exxon under the MBTA, arguing that the spill caused the death of a significant number of protected migratory birds.

The government has traditionally stated that any take of a protected migratory bird would result in strict liability and a significant volume of case law has previously agreed. However, certain recent cases have held the opposite. For example, a federal court in North Dakota refused to impose liability on an E&P operator whose open (and lawful) oil reserve pits caused the incidental death of migratory birds. What was once a clearly defined body of law now may be in flux. However, the safest approach for your E&P operator clients is to operate with the same caution as was required in the past. No company or client wants to be the newest test case under the MBTA.

The National Marine Sanctuaries Act

The National Marine Sanctuaries Act (NMSA)⁴² authorizes the U.S. Secretary of Commerce to designate certain areas of the marine environment as national marine sanctuaries if they have special national significance due to their conservation, recreational, ecological, historical, scientific, cultural, archaeological, educational, or aesthetic qualities. Once an area is designated as a sanctuary, the NMSA provides for unlimited liability for any damages occurring to such a designated area, plus a civil penalty of up to \$130,000 per day per violation. In the case of an offshore oil spill, these damages could be significant for your clients, as large areas (such as the entirety of the Florida Keys) are designated as national marine sanctuaries. Largely because there are no damage caps available, the government has threatened or pursued criminal liability against E&P operators under the NMSA in several notable instances, including after the Deepwater Horizon oil spill. This is an area you should certainly monitor on behalf of your clients. ■

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38. 15 U.S.C.S. § 2601 et seq. 39. 16 U.S.C.S. § 1531 et seq. 40. 16 U.S.C.S. § 1539.

41. 16 U.S.C.S. §§ 703 et seq. 42. 16 U.S.C.S. §§ 1431 et seq. on this memo is available at Steven H. Lord, Jr., Aggregation Consternation: Clean Air Act Source Determination Issues in the Oil & Gas Patch, 29 Pace Envtl. L. Rev. 645 (2012).

Drafting an ESG Disclosure Risk Factor Related to Greenhouse Gas Emissions

In recent years, the U.S. federal and state government, as well as governments around the world, have sought to control greenhouse gas emissions by imposing tighter limits on permissible emissions levels for cars, trucks, and other products that use fossil fuels, as well as on the fuels themselves. Companies operating in these markets may face considerable additional costs when complying with these new regulations, or may find their products unable to compete with others in the market that are able to comply more easily.



This risk factor is meant for use in a public company's periodic disclosure, such as a Form 10-K, or a registration statement, such as a Form S-1, to disclose risks relating to regulations relating to greenhouse gas (GHG) emissions regulation. This clause includes practical guidance and drafting notes. Tailor this risk factor to the company's business and the regulatory regime applicable to its industry.

ESG Disclosures Risk Factor (GHG Emissions)

Our business could be adversely impacted by laws, orders or regulations from [U.S. federal, state, or international governments] requiring new or more stringent limits on Greenhouse Gas ("GHG") emissions, "tailpipe" emissions or internal combustion engines.

DRAFTING NOTE TO EFFECTS OF CLIMATE CHANGE AND RELATED REGULATION

Tailoring GHG emissions risks

Each type of business may be affected by GHG emissions rules differently. Companies operating in different markets, such as regional, national, or multinational markets, will need to disclose GHG emissions regulations that are proposed or that exist wherever they operate. Additionally, companies in different industries will be subject to different laws, rules, and regulatory regimes. Replace the examples of regulations provided in this risk factor with examples that are tailored to the company's business, if necessary.

GHG emissions mainly originate from exhaust from combustion engines and heaters, as well as fugitive sources of methane gas. Federal laws, state laws, orders, or regulations [as well as laws, orders, and regulations in markets we serve around the world] have been adopted, and may in the future be adopted, that impose limits on GHG emissions or otherwise require the adoption of zero-emission electric vehicles. Examples include California's AB 32 cap and trade law and the 2021 executive order signed by President Biden directing the federal government to, among other things, purchase only zero-emission vehicles to replace its fleet of more than 600,000 cars and trucks by 2035. GHG emissions regulations continue to evolve and may affect our business based on, among other things, the timing of any new or more stringent requirements; the amount of any required further reduction in emissions levels; the type and implementation of any market-based or tax-based regulatory regime intended to reduce emissions; the relative availability of offsets; the existence of cost-effective, commercial-scale carbon capture and storage technologies, along with supporting regulations and liability-mitigation mechanisms; the breadth, availability, and relative cost of any alternatives to compliance with regulations; and the ability of our [products] to qualify as compliance alternatives under any programs to limit GHG emissions implemented by one or more statutory, regulatory, or standards-based organizations (such as The World Business Council for Sustainable Development). If our [products] are not able to meet compliance standards for GHG emissions, or if they do not perform as well as other alternative fuels and vehicles, our solutions could be less competitive. Moreover, additional federal, state, or foreign taxes could be imposed on

Related Content

For more information relating to ESG disclosure, see

 [THE ENVIRONMENTAL, SOCIAL, AND GOVERNANCE \(ESG\) RESOURCE KIT](#)

For information on drafting risk factors, see

 [RISK FACTOR DRAFTING FOR A REGISTRATION STATEMENT](#) and

 [TOP 10 PRACTICE TIPS: RISK FACTORS](#)


For more ESG-related risk factors, see

 [ESG DISCLOSURES RISK FACTOR \(REPUTATIONAL RISK\)](#) and

 [ESG DISCLOSURES RISK FACTOR \(CLIMATE CHANGE\)](#)

 [CORPORATE ESG DISCLOSURE: RECENT TRENDS AND DEVELOPMENTS](#)

 [5 TIPS ON GETTING STARTED WITH AN ESG STRATEGY VIDEO](#)

tailpipe emissions, which would adversely impact the cost of our [products], as compared to [competing products] that do not generate tailpipe emissions. 

 [RESEARCH PATH: Capital Markets & Corporate Governance > IPOs > Clauses](#)



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Wetlands Regulations: Considerations for Project Developers

Earlier this year, the U.S. Environmental Protection Agency (EPA) and U.S. Army Corps of Engineers published a final rule¹ to revise the definition of waters of the United States.

THIS ARTICLE DISCUSSES THE IMPACT OF THAT REVISION as well as considerations for developers contemplating the purchase or development of real property that contains or is likely to contain regulated wetlands. The presence of regulated wetlands on a site proposed for development can often present complications in terms of time and expense in securing permits as well as restrictions on the type or magnitude of development that regulators will approve. In some circumstances, permits may be denied altogether. Wetlands can be regulated at the federal, state, and municipal levels. This article focuses primarily on the federal regulatory regime, while addressing ways of ascertaining the need for state or local approvals.

Why Regulate Wetlands?

Substantial declines in wetland acreage in the United States have been documented over the past 50 years, as the result of filling for agriculture and other development.² Beginning in the 1970s, recognition arose that wetlands—both freshwater and tidal—perform essential functions in preventing flooding through the retention and slow release of excess water. Wetlands purify storm water runoff by filtering out nutrients, sediments, and pollutants, thereby protecting both surface and ground water. They also provide nesting, wintering, resting, and feeding grounds for numerous species of migratory waterfowl. Estuaries provide critical food sources, spawning grounds, and nurseries for coastal fish and



shellfish on both coasts.³ Therefore, they have become the subject of regulatory efforts to protect them, primarily through permitting standards that are designed to require developers to avoid or minimize incursions on wetlands, and to mitigate any unavoidable loss of wetlands through replacement or restoration projects.

Extent of Federal Jurisdiction over Wetlands

Waters of the United States

The primary basis for the federal regulation of wetlands derives from Section 404 of the Federal Water Pollution Control Act, commonly known as the Clean Water Act (CWA).⁴ CWA Section 404 grants the U.S. Army Corps of Engineers (Corps) the authority to issue permits for discharges of dredged or fill material into navigable waters, which the Act defines as waters of the United States.⁵ This term has been interpreted to include not only traditional navigable waters but also tributaries thereto, tidal waters, lakes and ponds, and impoundments thereof, and wetlands adjacent to any of these waters.⁶

A subject of contention and extensive litigation has been the extent to which the federal government can regulate wetlands that are not in and of themselves traditionally navigable. As described below, a recent decision of the U.S. Supreme Court, *Sackett v. Environmental Protection Agency*,⁷ fundamentally altered the scope of jurisdiction that may be asserted by the federal government. From 2006 until May 2023, under U.S. Supreme Court interpretation, the question was one of the effects of the wetland on the “chemical, physical, or biological integrity” of the navigable water or tributary, or to a wetland adjacent to such a water.⁸ The criterion for determining the presence of such effects was known, from Justice Anthony M. Kennedy’s concurring opinion in *Rapanos*, as the significant nexus standard.

Following attempts between 2015 and 2020 to define the term through regulations that were vacated at the U.S. District Court level, the operative regulatory definition had been governed by prior versions of the rule, as modified by *Rapanos*, and 2008 guidance documents issued by the Corps and EPA based on the *Rapanos* significant nexus inquiry.

On January 28, 2023, EPA and the Corps published a final rule⁹ to revise the definition of waters of the United States. The agencies describe the proposed rule as using the pre-2015 definition of waters of the United States as a foundation while providing “clear rules of the road” to prevent uncertainty. The rule became effective on March 20, 2023.

The 2023 Final Rule revised the regulatory definition of waters of the United States¹⁰ to include:

1. Traditional navigable waters, the territorial seas, and interstate waters (paragraph (a)(1) waters)



2. Impoundments of the above (paragraph (a)(2) impoundments)
3. Tributaries to paragraph (a)(1) waters when the tributaries meet either the relatively permanent standard or significant nexus standard (jurisdictional tributaries)
4. Jurisdictional adjacent wetlands, including:
 - a) Wetlands adjacent to paragraph (a)(1) waters
 - b) Wetlands adjacent to and with a continuous surface connection to relatively permanent paragraph (a)(2) impoundments
 - c) Wetlands adjacent to jurisdictional tributaries that themselves meet the relatively permanent standard
 - d) Wetlands adjacent to paragraph (a)(2) impoundments or jurisdictional tributaries when the wetlands meet the significant nexus standard
5. Intrastate lakes and ponds, streams, or wetlands not identified above that meet either the relatively permanent standard or the significant nexus standard (paragraph (a)(5) waters)

¹ 88 Fed. Reg. 3,004 (Jan. 18, 2023). ² Dahl, T.E., U.S. Dep’t of the Interior, Fish and Wildlife Service, *Status and Trends of Wetlands in the Conterminous United States 2004 to 2009* (2011). ³ See M. Holloway, *High and Dry: New Wetlands Policy Is a Political Quagmire*, *Sci. Am.* 20 (Dec. 1991).

⁴ 33 U.S.C.S. § 1251 et seq. ⁵ 33 U.S.C.S. § 1344(a); 33 U.S.C.S. § 1362(7). See also 33 C.F.R. § 323.1. ⁶ See 33 C.F.R. § 328.3(a). (Traditionally navigable waters are those that “are currently used, were used in the past, or may be susceptible to use in interstate or foreign commerce, including all waters which are subject to the ebb and flow of the tide.” 33 C.F.R. § 328.3(a)(1). ⁷ 143 S. Ct. 1322, 215 L. Ed. 2d 579 (2023). ⁸ *Rapanos v. United States*, 547 U.S. 716, 126 S. Ct. 2208, 165 L. Ed. 2d 159 (2006); see also 33 C.F.R. § 328.3(a), (c). ⁹ 88 Fed. Reg. 3,004 (Jan. 18, 2023). ¹⁰ 33 C.F.R. § 328.3 and 40 C.F.R. § 120.2.



One way of avoiding the lengthy and complex individual permitting process is making use of nationwide permits (NWP), where possible. These are the most common type of general permits issued by the Corps under authority provided by CWA Section 404(e).

Under the 2023 Final Rule, a wetland is deemed adjacent if it satisfies any one of the following three criteria:

1. The wetland has an unbroken surface or shallow subsurface connection to jurisdictional waters.
2. The wetland is physically separated from jurisdictional waters by man-made dikes or barriers, natural river berms, and the like.
3. The wetland is reasonably proximate to a jurisdictional water such that the wetland has significant effects on water quality and the aquatic ecosystem.

The agencies provided some gloss in the 2023 Final Rule's preamble that they "will ordinarily consider all wetlands within a wetland mosaic collectively" and that an entire wetland will be deemed adjacent if any part of it is adjacent.

Unless directly adjacent to a traditional jurisdictional water, under the 2023 Final Rule, adjacent wetlands must meet either the relatively permanent standard or the significant nexus standard. "Relatively permanent, standing, or continuously flowing waters connected to paragraph (a)(1) waters, and waters with a continuous surface connection to such relatively permanent waters or to paragraph (a)(1) waters" satisfy the relatively permanent standard. The significant nexus standard considers whether the adjacent wetland alone or in combination with other similar situated waters in the region "significantly affects the chemical, physical, or biological integrity" of a paragraph (a)(1) water.

The 2023 Final Rule also maintained or codified eight exclusions from regulatory jurisdiction, some of which implicate jurisdiction over arguable wetlands:

- Prior converted cropland (discussed below)
- Waste treatment systems, including treatment ponds or lagoons that are designed to meet the requirements of the CWA
- Ditches (including roadside ditches), excavated wholly in and draining only dry land, and that do not carry a relatively permanent flow of water
- Artificially irrigated areas that would revert to dry land if the irrigation ceased
- Artificial lakes or ponds, created by excavating or diking dry land that are used exclusively for such purposes as stock watering, irrigation, settling basins, or rice growing
- Artificial reflecting pools or swimming pools, and other small ornamental bodies of water created by excavating or diking dry land
- Waterfilled depressions, created in dry land incidental to construction activity and pits excavated in dry land for the purpose of obtaining fill, sand, or gravel unless and until the construction operation is abandoned and the resulting body of water meets the definition of waters of the United States
- Swales and erosional features (e.g., gullies, small washes) that are characterized by low volume, infrequent, or short duration flow

However, the validity of the new rule, as well as the guidance that previously governed jurisdictional determinations, is severely undermined by the Supreme Court's decision in *Sackett*. In that case, a majority of the justices joined an opinion authored by Justice Samuel Alito, which held that to qualify as waters of the United States, water must be a "relatively permanent body of water connected to traditional interstate navigable waters," and wetlands "must be indistinguishably part of a body of water that itself constitutes 'waters' under the CWA" such that there is "no clear demarcation between 'waters' and wetland." A jurisdictional wetland must have a "continuous surface connection with waters of the United States, making it difficult to determine where the 'water' ends and the 'wetland' begins." The Court, including the four justices who concurred in the judgment but not the entirety of the majority opinion, rejected the significant nexus test as a basis for jurisdiction. The Corps and EPA have issued an update stating, "The agencies are interpreting the phrase waters of the United States consistent with the Supreme Court's decision in *Sackett*. The agencies are developing a rule to amend the [2023 Final Rule] . . . The agencies intend to issue a final rule by September 1, 2023."¹¹

For guidance related to delineation of wetlands, jurisdictional determinations, which activities in wetlands are regulated, and the individual permitting process, please review the full practice note in Practical Guidance.

Nationwide Permits

One way of avoiding the lengthy and complex individual permitting process is making use of nationwide permits (NWP), where possible. These are the most common type of general permits issued by the Corps under authority provided by CWA Section 404(e).¹² There are currently 59 nationwide permits that have been issued by the Corps.¹³ NWP are usually renewed (which includes adding or modifying existing NWP)

every five years, consistent with the statutory requirement,¹⁴ with the most recent full set of NWP issued in December 2021.

Thus, an NWP expires at the end of the five-year period, although authorization received pursuant to an unchanged NWP can typically be renewed absent changed circumstances. Before it issues NWP every five years, the Corps conducts an environmental review under the National Environmental Policy Act (NEPA), thereby obviating the need for site-specific NEPA assessments for individual NWP applications.

The Corps may allow different NWP to be used for the same overall project.¹⁵ In certain circumstances, an individual and nationwide permit may be used for components of the same overall project.¹⁶ Thus, where a development site includes regulated wetlands (or potentially regulated wetlands), a first stage of inquiry should be whether NWP could apply to some or all of the proposed activities.

All projects using NWP must comport with certain general conditions, relating primarily to navigation, sedimentation and erosion, and aquatic concerns. In addition, there are specific criteria that apply to particular NWP, as noted below. Most NWP do not require prior notice to the Corps; in these cases, if there is compliance with the general and any specific conditions, the permit is considered to have been already issued. However, confirmation can be sought from the Corps that the proposed activity is eligible for a nationwide permit.¹⁷ This is often a prudent step, given the myriad conditions that must be met. A written confirmation is valid for a time period specified in the verification.¹⁸

A number of NWP, however, do require preconstruction notification and, in some circumstances, there must also be a wetlands delineation. For certain NWP, this procedure entails notification of the proposed discharge to EPA, the Fish and Wildlife Service (FWS), and National Marine Fisheries Service (NMFS) to afford these agencies an opportunity to comment on

¹¹ <https://www.usace.army.mil/Media/Announcements/Article/3440421/27-june-2023-update-supreme-court-ruling-in-sackett-v-environmental-protection/> ¹² 33 U.S.C.S. § 1344(e). ¹³ 86 Fed. Reg. 73,522 (Dec. 27, 2021); see also <https://www.usace.army.mil/Missions/Civil-Works/Regulatory-Program-and-Permits/Nationwide-Permits/> for links to a list of the current NWP and general and NWP-specific conditions. ¹⁴ CWA Section 404(e)(2), 33 U.S.C.S. § 1344(e)(2). ¹⁵ 33 C.F.R. § 330.6(c). ¹⁶ 33 C.F.R. § 330.6(c), (d). ¹⁷ 33 C.F.R. § 330.6. ¹⁸ 33 C.F.R. § 330.6(a)(3)(ii).

whether the activity should be deemed eligible for a nationwide permit or whether an individual permit should be required.

The Corps' nationwide permit provisions provide for the inclusion of mitigation as part of a request for confirmation that a proposed activity meets the applicable criteria.¹⁹ It is not unusual, particularly for activities that necessitate preconstruction notification to the Corps and other federal agencies, to incorporate mitigation at appropriate ratios to diminish the potential that an individual permit would be required.

The individual states must issue water quality certifications for a nationwide permit to be valid in that state.²⁰ Similarly, there must be a state consistency determination for NWP in coastal zone states.²¹ Through the Section 401²² certification or the coastal zone consistency process, states may impose additional conditions upon the issuance of a nationwide permit. If a state denies certification or consistency, an individual certification or consistency determination for the proposed activity is a prerequisite for a valid use of the NWP.²³ In addition, individual Corps districts can add conditions that are based on local circumstances and experience.

The Corps retains the discretion to modify, suspend, or revoke a nationwide permit for a particular activity.²⁴ Individual permits will be required for activities that affect endangered species or their habitat, sites subject to the National Historic Preservation Act, or, with certain exceptions, activities that affect designated wild and scenic rivers.²⁵ On the other hand, the Corps' regulations provide that all individual permit applications should be reviewed for possible eligibility under one or more NWPs.²⁶

Enforcement of Federal Wetlands Regulations

The Corps and EPA possess independent enforcement authority under the CWA. They also have a variety of administrative and judicial enforcement options from which to pick and choose. In an effort to coordinate and achieve more effective enforcement, the agencies entered a memorandum of agreement on enforcement in January 1989 (Enforcement MOA), which allocates enforcement responsibilities.²⁷ In general, the Corps, because of its greater field resources, conducts initial investigations. If a case involves a permit violation, the Corps generally retains the matter. EPA concentrates on unpermitted discharges, as well as problem and special cases. The declination of one agency to enforce does not preclude the other from moving forward. Nor does the Enforcement MOA give any rights or defenses to putative defendants.

Parties Liable for Prohibited Activities

The CWA, like many other environmental statutes, imposes obligations on persons.²⁸ The CWA defines this term broadly, to sweep in, among others, individuals, various business organizations, and governmental entities.²⁹ In addition, EPA regulations include agents or employees of any person.³⁰ Any person responsible for the illegal activity may be the subject of an administrative or judicial enforcement action. The key inquiry is whether a particular person was responsible for, or exercised control over, the illegal activities. Using this standard, the courts have held liable landowners, construction companies, consulting firms, and engineers.³¹

In contracting with partners or contractors that have primary control over a development and obtaining necessary permits, property owners or joint venturers are best advised to include indemnities for violations of law that are expansive enough to include CWA violations.

Administrative Enforcement

Both EPA and the Corps are authorized to issue orders to violators directing them to cease illegal activities and/or undertake remedial action. EPA may issue orders relating to noncompliance with the CWA (i.e., filling without a permit) and violations of a state-issued permit (where the Section 404 program has been delegated to a state).³² The Corps can issue orders with respect to noncompliance with Section 404 and permit violations.³³ EPA issues administrative orders while the Corps issues cease and desist orders; the substantive results are the same.

If the violation involves an ongoing project, the violator is generally ordered to halt the illegal activity. The order not only prohibits work in wetlands but can enjoin work on the entirety of a project, pending final resolution of the matter.³⁴ The initial order will frequently direct removal of the offending fill and restoration of the affected area to the prior status. Removal of a limited amount of fill may be allowed where that would bring the activity within the ambit of a nationwide permit. The Corps sometimes allows the applicant to apply for an after-the-fact permit, while the fill remains in place during the pendency of permit review.³⁵ If the after-the-fact permit is denied, restoration of the illegally filled area may be required.

EPA and Corps enforcement orders are not independently enforceable against the violator; enforcement is through a judicial action. Of course, these orders inform the recipients that they are violating federal law. Hence, EPA has asserted



that when it succeeds in an enforcement action against a violator, it may seek double penalties, both for violation of the law and violation of the administrative compliance order.³⁶

Administrative penalties under Section 309(g) of the CWA³⁷ involve a two-tiered scheme. EPA, as noted above, may impose penalties for unpermitted discharges, while the Corps may impose penalties for violations of permit conditions and administrative orders. A penalty may be assessed after issuance of a complaint and proposed penalty and the opportunity for a hearing. Corps penalties for Class I violations may not exceed \$23,990 per violation, with a maximum penalty of \$59,974.³⁸ EPA penalties may not exceed \$25,847 per violation for either Class I or Class II violations, with maximum total penalties of \$64,618 for Class I violations and \$323,081 for Class II violations.³⁹

EPA has adopted an administrative penalty policy for Section 404 enforcement settlements, which is designed to achieve uniformity and consistency in enforcement of Section 404 violations.⁴⁰ The policy provides for the consideration of a variety of factors in determining the penalty. Like Section 404(s)(4), which governs the Corps' civil penalty criteria, these factors include the nature and gravity of the violation(s), the economic benefit to the violator, prior history of violations, good faith efforts to comply, degree of culpability, and ability to pay.⁴¹ The EPA policy also includes a penalty calculation worksheet that assigns certain values to the various factors to reach a final dollar amount.

The defendant in an administrative proceeding has the right to a formal adjudicatory hearing before an administrative

law judge,⁴² but has no right to a jury trial. As noted by EPA in *Sackett*, penalties imposed under the Section 309 administrative process are subject to judicial review.⁴³ Class I penalties are subject to judicial review in district court, while Class II penalties are reviewable in the court of appeals.⁴⁴

For guidance related to civil judicial and criminal enforcement actions, please review the full practice note in Practical Guidance.

State and Municipal Regulation of Wetlands

EPA may approve delegation of the Section 404 permitting program to individual states for discharges into intrastate waters.⁴⁵ As of this date, only Michigan and New Jersey have assumed that authority for freshwater, but not tidal, wetlands. In such states, EPA retains authority to object to the state's proposed permit. If the state fails to satisfy EPA's concerns, EPA may transfer permitting authority to the Corps.

Of greater importance is determining what nonfederal laws and regulations may govern the activity and require additional approvals. Many states, if not all, have regulations protecting wetlands, including their own permitting processes; other states protect wetlands through more indirect fashion. State jurisdiction, not restricted by the reach of the Commerce Clause,⁴⁶ will usually be more extensive than federal jurisdiction, and include freshwater wetlands not adjacent to any navigable water. Put differently, most states do not have a significant nexus standard or a requirement that the wetlands be indistinguishable from a navigable surface water to limit the extent of wetland jurisdiction. While some states will follow the federal definition of wetlands, others will not limit

¹⁹ 33 C.F.R. § 330.6(a)(3) and Part 332. ²⁰ 33 C.F.R. § 330.4(c). ²¹ 33 C.F.R. § 330.4(d). ²² 33 U.S.C.S. § 1341. ²³ See Regulatory Guidance Letter, 92-04 (Sept. 1992). ²⁴ 33 C.F.R. § 330.4(e). ²⁵ 33 C.F.R. § 330.4(f). ²⁶ 33 C.F.R. § 330.4(g). ²⁷ Memorandum Between the Department of the Army and The Environmental Protection Agency (Jan. 1989) Federal Enforcement for the Section 404 Program of the Clean Water Act. ²⁸ 33 U.S.C.S. § 1362(5). ²⁹ *Id.* ³⁰ 40 C.F.R. § 232.2. ³¹ *United States v. Lambert*, 915 F. Supp. 797, 802 (S.D. W. Va. 1996); *United States v. Van Leuzen*, 816 F. Supp. 1171 (S.D. Tex. 1993); *United States v. Bd. of Trs.*, 531 F. Supp. 267, 274-75 (S.D. Fla. 1981); *United States v. Weisman*, 489 F. Supp. 1331 (M.D. Fla. 1980). ³² 33 U.S.C.S. § 1319(a)(3). ³³ 33 U.S.C.S. § 1344(s)(1). ³⁴ 33 C.F.R. § 326.3(c). ³⁵ 33 C.F.R. § 326.3(e).

³⁶ See *Sackett v. EPA*, 566 U.S. 120, 132 S. Ct. 1367, 182 L. Ed. 2d 367 (2012) (acknowledging EPA's position but not reaching the issue of whether double penalties were authorized). ³⁷ 33 U.S.C.S. § 1319(g). ³⁸ 33 C.F.R. § 326.6. ³⁹ 40 C.F.R. § 19.4. ⁴⁰ Issuance of CWA Section 404 Settlement Penalty Policy (Dec. 2001). ⁴¹ 33 U.S.C.S. § 1344(s)(4). ⁴² 33 U.S.C.S. § 1319(g). ⁴³ 33 U.S.C.S. § 1344(g)-(l). ⁴⁴ 33 U.S.C.S. § 1319(g)(8). ⁴⁵ 33 U.S.C.S. § 1344(g)-(l). ⁴⁶ U.S. Const. Art. I, § 8, Cl. 3.

the definition to areas with typical wetland characteristics (vegetation, hydrology, and hydric soil) and will, for example, include ponds and watercourses lacking such conditions.

Related Content

For a collection of resources addressing climate change, see

 [CLIMATE CHANGE RESOURCE KIT](#)

For complete coverage of wetlands, see

 [ENVIRONMENTAL LAW PRACTICE GUIDE § 19.01 ET SEQ.](#)

For a summary of state laws and regulations governing wetlands protection, see

 [WETLANDS PROTECTION STATE LAW SURVEY](#)

For an analysis of the state role in the federal Clean Water Act Section 404 program, see

 [ENVIRONMENTAL LAW PRACTICE GUIDE § 19.02\[2\]](#)

For a review of the assessment of known, potential, and contingent environmental liabilities and obligations associated with a parcel of property, see

 [ENVIRONMENTAL DUE DILIGENCE IN REAL ESTATE TRANSACTIONS](#)

For more information on state regulation of wetlands generally, see

 [ZONING AND LAND USE CONTROLS § 19.03](#)

For further discussion of nationwide permits, see

 [ENVIRONMENTAL LAW PRACTICE GUIDE § 19.04\[3\]\[B\]](#)

For guidance on federal regulation of stormwater discharges and permitting, as well enforcement actions, see

 [STORMWATER PERMITTING AND MANAGEMENT REQUIREMENTS](#)

For an explanation of Clean Water Act Section 404 jurisdiction and the definition of waters of the United States, see

 [ENVIRONMENTAL LAW PRACTICE GUIDE § 19.03\[3\]](#)



Some states impose a minimum size requirement before an area can be defined as a wetland, while others have no such restriction. Many states include within their jurisdiction not just the actual wetland, but a buffer area—which may range from 50 to 300 feet from the wetland boundary—that is designed to limit disturbance to areas that afford protection to the more sensitive wetlands themselves. Some states map wetlands but most (like the Corps, with a few exceptions) do not. Because states often use different criteria in identifying wetlands, local consultants familiar with state as well as federal practice should be used for delineations.

In addition, wetlands are often regulated at the local level through municipal ordinances. In some states, enforcement of state permitting of wetlands may be delegated to local authorities. In other cases, municipalities have adopted regulations that are more stringent than state regulations (e.g., where a state has a minimum size requirement, local ordinances contain no such provisions).

The type of activities governed by state and municipal wetlands laws are invariably more extensive than the discharges subject to Section 404 permits. In many states, virtually any activity in a wetland and/or buffer area is subject to a permit. For example, while the installation of piles in a federal wetland is typically not considered to be a discharge subject to a Section


404 permit, it is considered subject to most state and/or municipal wetland permit schemes. Similarly, dredging in a federal wetland is often not subject to Section 404 permitting, whereas it is invariably subject to a state and/or municipal permitting scheme.

State or local permitting schemes are likely to differ significantly from the Corps process. An NWP-type process is not available in most states, so there is no short cut to avoid a full-blown permit process. In some states, that process may not be limited to the standard application / public notice / legislative public hearing process but may, in certain circumstances, include an adjudicatory hearing before an administrative law judge—a process that delays permitting. For the 16 states (and Puerto Rico) that have little NEPAs, developments involving wetlands may trigger the preparation of Environmental Impact Statements for not just the wetland portion of the projects, but for all the activities (i.e., many states do not follow the federal small handle doctrine noted above).

Although some states do follow the avoidance, minimization, and mitigation trilogy, the standards to obtain a permit differ from state to state, and locality to locality. In some states, water dependency is critical; in others, it is not. A demonstration that no reasonable alternatives exist is required

in many states. Some states have the rough equivalent of the Corps' public interest standard, but others have different criteria for permitting. Mitigation is treated differently state by state, and even municipality by municipality. Some states simply look at real replacement for lost wetlands, while others apply ratios depending on the type of wetland lost. Some states, as noted above, allow mitigation banking, while others do not.

And, of course, state and local enforcement is likely to be quite different than that under federal law, both in terms of administrative and judicial enforcement.

In short, planning for development on any property containing obvious or potential wetlands requires research into the applicable laws and regulations as well as technical study to determine the existence and/or extent of regulated areas. 

Mark A. Chertok has been active in environmental and land use counseling, permitting, enforcement, and litigation for more than 30 years. He is a principal at Sive, Paget & Riesel, P.C. His experience spans a broad spectrum of substantive areas, including environmental impact statement counseling and litigation under NEPA and the New York State Environmental Quality Review Act; wetlands and water quality permitting, particularly for waterfront projects, under the CWA and state counterparts; major transportation projects; air quality and climate change issues under the Clean Air Act; hazardous substances remediation and litigation under the Comprehensive Environmental Response, Compensation and Liability Act; remediation under the New York State Brownfield Cleanup Program; oil spill remediation under the New York State Navigation Law; compliance review of Phase I and Phase II environmental assessments; land use and zoning; coastal zone management; and historic preservation. A testament to his wetlands experience, Mark served as an expert in freshwater wetland permitting in a condemnation trial in 2012.

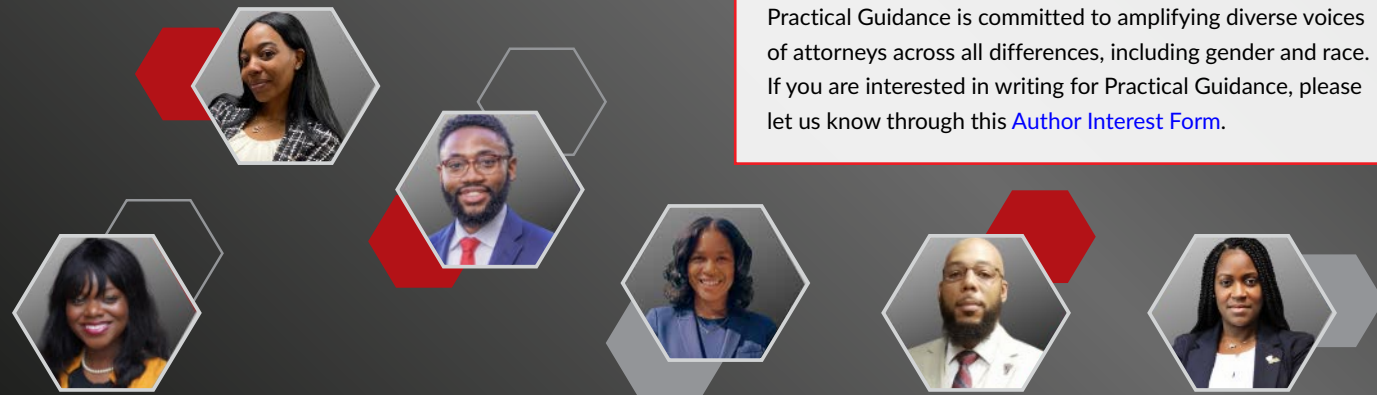
Elizabeth Knauer is a principal at Sive, Paget & Riesel, P.C. Her broad litigation experience includes various matters relating to environmental contamination and claims for recovery of associated costs under the Comprehensive Environmental Response, Compensation and Liability Act, the New York State Navigation Law, and other statutes; environmental permitting standards; administrative law; and contractual provisions. She has litigated at the trial court and appellate level in both state and federal courts for nearly two decades. She frequently defends land use and other determinations made by municipal and state agencies when legal challenges are filed on environmental grounds.

 [RESEARCH PATH: Construction > Planning and Preliminary Considerations > Practice Notes](#)



Third LexisNexis African Ancestry Network Fellowship Projects Address Creation of Greater Equity and Accessibility in the U.S. Legal System

Practical Guidance is committed to amplifying diverse voices of attorneys across all differences, including gender and race. If you are interested in writing for Practical Guidance, please let us know through this [Author Interest Form](#).



THE LEXISNEXIS AFRICAN ANCESTRY NETWORK HAS

announced the third group of 15 law students chosen to participate in the Lexis Nexis African Ancestry Network LexisNexis Rule of Law Foundation Fellowship Program. The Program, launched in 2021, furthers LexisNexis' commitment to building a culture of inclusion and diversity at the company and eliminating systemic racism in legal systems.

The participants, selected from a large applicant pool representing all six law schools in the Historically Black Colleges and Universities Law School Consortium (HBCULSC), are:

- Jai'Ehir Jackson-Hawkins and Veronica Alba, Florida A&M University College of Law
- Morigan Tuggle, Lauren Fleming and Favour Okhuevbie, Howard University School of Law
- Zaria Graham and Larry Futrell, North Carolina Central University School of Law
- Qwantaria Russell, Tatiyana Brown-Harper, Skylar Dean, Jaylon Denkins and Whitney Triplet, Southern University Law Center
- Christian Wolford, Thurgood Marshall School of Law

- Imani Roberson and Paul Campbell, University of the District of Columbia David A. Clarke School of Law

This year, the program is taking a team-based approach, with each team of three students taking on one of five projects aimed at the elimination of systemic racism and the creation of greater equity and accessibility in the U.S. legal system. The topics are:

- The Gavel League: An App Providing Legal Education to Children and Adolescents
- I, Too, Sing America: Uncovering Untold U.S. History Through the Law
- Technology Solutions to Alleviate Racial Bias in Jury Selection
- Pathways to Practice Pipeline: Building Bridges for HBCU Students to Legal Fields Lacking Diversity
- Law Clinic Support Tools & Resources to Combat Systemic Racism in the Legal System

The fellows each receive \$10,000 and spend nine months working on their projects, including participation in the annual Fellowship Innovation Retreat in Raleigh, N.C., where members of LexisNexis' product team assist with their use of LexisNexis products to bolster

their projects. The fellows will present the results of their projects to LexisNexis executives, employees, HBCULSC deans and program sponsors at the annual LexisNexis Equity in the Law Symposium.

"We are striving to increase the representation of diverse legal practitioners in prestigious and lucrative fields of law by providing HBCU law school students with additional professional development, career support, and industry exposure to ensure their access to opportunities," said Adonica Black, Director, Global Diversity and Inclusion at LexisNexis Legal & Professional. "This year our cross-departmental team of LexisNexis employees took a deep dive into the research published by the first two Fellowship cohorts and identified five specific areas of focus in which we believe we can make a meaningful impact."

Also new this year is the availability of corporate sponsorship opportunities, enabling law firms and corporations to demonstrate their commitment to inclusion and diversity, gain access to diverse HBCU law school talent and help increase equity in the legal system. Reed Smith LLP is the first law firm to sponsor the program.

"Supporting talented and deserving law students at HBCUs with the resources to fulfill their potential is critically important in breaking down the systemic barriers that have denied opportunities to far too many," said Reggie McGahee, Reed Smith's global head of diverse recruiting. "Reed Smith's support of the LexisNexis African Ancestry Network & LexisNexis Rule of Law Foundation Fellowship program is one example of how collaboration within the legal industry can provide the resources necessary to move the profession in the direction of inclusion, equality and equity. As a firm, and as members of the larger community, we remain committed to this worthy cause."

The AAN is organized as an official network for employees of African descent at Reed Elsevier Lexis Nexis. The organization embraces corporate diversity initiatives aimed at improving the company's competitiveness by increasing the representation, development, promotion, and retention of Black employees.

The LexisNexis Rule of Law Foundation is a 501(c)(3) non-profit organization aimed at advancing the rule of law around the world. The foundation's efforts focus on the four key elements of the rule of law: transparency of the law, accessible legal remedy, equal treatment under the law, and independent judiciaries.

Practical Guidance Diversity, Equity, and Inclusion Related Content

Corporations across the United States are evaluating how they manage diversity, equity and inclusion (DEI) policies in the workplace in light of the recent Supreme Court decision striking down affirmative action policies on the basis of race in education, (*Students for Fair Admissions, Inc. v. President and Fellows of Harvard Coll.*, 143 S. Ct. 2141, 216 L. Ed. 2d 857 (2023)).



The recent SCOTUS decision does not currently impact corporations, as they are legally prohibited from making employment decisions based solely on race and a broad set of demographic characteristics defined by the EEOC. Regardless, many companies are taking the opportunity to review their programming against legal requirements while restating their commitment to attracting and retaining truly diverse workforces and to creating inclusive cultures.

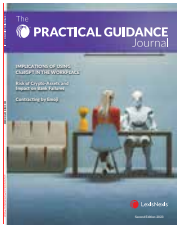
Practical Guidance has resources to help you manage compliance and litigation risk around affirmative action, affinity groups, and DEI policies. Below is a partial listing of such resources.

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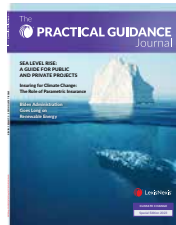
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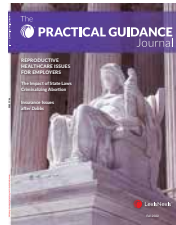
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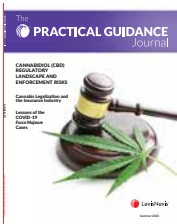
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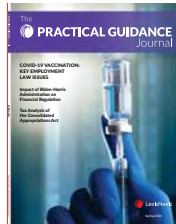
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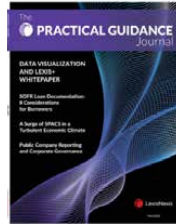
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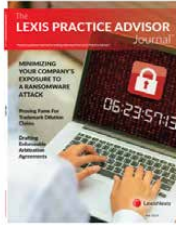
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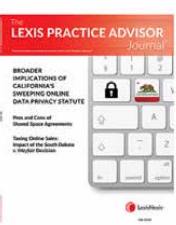
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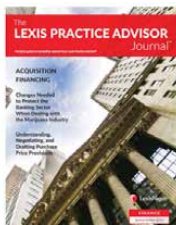
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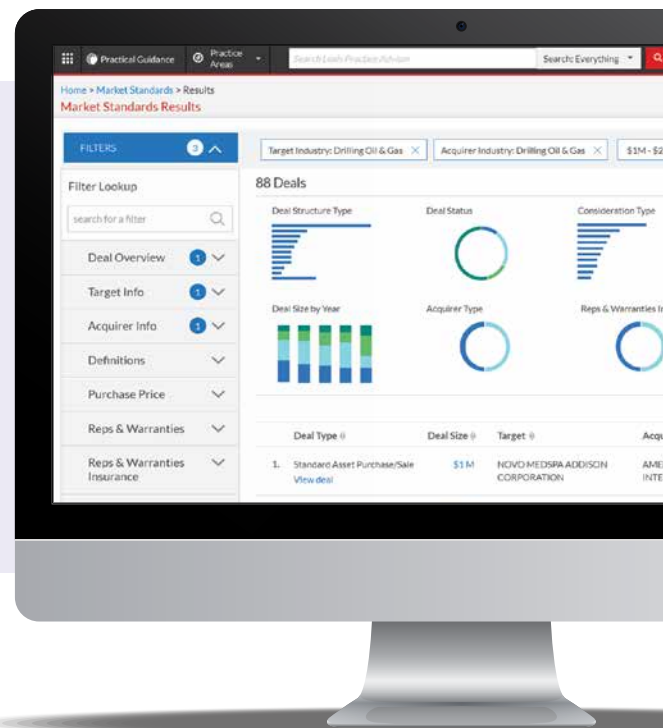


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