

Purchaser's Guide for Conducting Environmental Due Diligence

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Environmental due diligence plays an important role in corporate transactions. If appropriate environmental due diligence is not done, the parties to a transaction may be faced with unexpected liabilities. Here are a few due diligence tips to help a purchaser avoid liability and effectively negotiate environmental matters.

Negotiate a confidentiality agreement A confidentiality agreement is an effective way for a purchaser to establish the scope, process, and limitations of the due diligence review before documents are exchanged and site visits are scheduled.

- In addition to protecting information provided by the seller, the confidentiality agreement should also protect information generated or prepared by the purchaser as part of its due diligence review.
- The confidentiality agreement should describe a process for the return or destruction of all due diligence documents and reports if the transaction is not completed.
- The confidentiality agreement should establish the procedure for reporting adverse environmental conditions at the property and/or environmental compliance violations that are discovered during the due diligence review so as to best position the parties with respect to governmental disclosures.

Conduct environmental due diligence early There are several reasons why conducting environmental due diligence during the early stages of a transaction is beneficial.

- The innocent purchaser and bona fide prospective purchaser defenses to liability that are available pursuant to federal law require that a new owner complete due diligence before acquisition of the property.
- The earlier the purchaser starts the environmental due diligence process, the more time the purchaser will have to examine all of its options to fairly allocate the liabilities identified during document reviews, site visits, and investigations. The purchaser will be in a better position to draft indemnities, determine appropriate environmental escrow amounts, and negotiate the pricing for the transaction. Starting the due diligence early will also give the purchaser enough time to conduct a Phase II Environmental Site Assessment (ESA) if one is necessary.
- Many lenders have requirements for environmental due diligence that must be met before they will authorize financing for the transaction. For example, some lenders require borrowers to use an environmental consultant pre-approved by the lender.
- The information can be used to apply for federal or state financial assistance that is available to parties that purchase Brownfield properties or properties with contamination from a known source, such as a dry cleaner or gas station. This type of assistance may require significant lead time.
- The information can be used to obtain environmental insurance.

Request a list of environmental documents and information from the seller

- The request should include, but is not limited to, a request for current environmental permits, compliance reports, government notices and violations, prior environmental reports, a description of response actions or remediation projects, a description of claims by any government agency or third party, contingent liabilities, and the company's

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environmental reserves.

- A supplemental list with specific questions or documents may be submitted to the seller following the initial document review.

Engage an environmental consultant to conduct a Phase I ESA and environmental compliance review

- Your attorney should retain a consultant on your behalf so opinions and conclusions in the consultant's reports are protected by the attorney-client and work product privileges. To maintain the privileges, clients should only speak with the environmental consultant when the attorney is present. An attorney should also review the consultant's contract related to the performance of the Phase I ESA and environmental compliance review to ensure the proper scope of work and to negotiate better terms. Many times consultants will try to limit their liability to the cost of the services or \$50,000, even though the consultant has insurance for greater amounts.
- Do not only rely on the seller's previous Phase I ESA(s) or environmental compliance review(s) or any Phase I ESA or compliance review that is more than six months old. Relying on such reports does not constitute sufficient inquiry into the history and current operations at the property and will eliminate any defenses to environmental liability available to the purchaser under federal or state law.
- If a Phase I ESA and/or environmental compliance review has been completed and is less than six months old, ask the environmental consultant who completed the report to grant the purchaser and all related entities the ability to rely on the report(s). A specific reliance letter should be obtained from the environmental consultant.
- Consider using a different environmental consultant than seller used in the past. Deciding which environmental consultant to use and whether to rely on previous reports, depends on the circumstances of the transaction and should be examined closely with the assistance of legal counsel.
- Find a consultant who has experience and resources in the localities where the facilities included in the transaction are located. Generally local consultants will be more efficient and less costly.
- Generally plan to receive verbal results of the Phase I ESA and environmental compliance review within one to two weeks and anticipate another two weeks for the written report.

Negotiate a site access agreement Once the purchaser has completed its initial document review and engages a consultant to conduct a Phase I ESA, environmental compliance review and/or potentially a Phase II ESA, a site visit will likely be necessary.

- The site access agreement should establish the purchaser's reason for accessing the property and should inform the seller about the scope of work and the schedule for completing the work.
- The purchaser should ensure that the consultant has adequate insurance to cover any mishaps during site access and should include related provisions in the access agreement.

Consider how the environmental information can influence the transaction

- The results of the environmental due diligence can influence the structure of the transaction (e.g., stock versus asset purchase).

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- As previously mentioned, appropriate environmental due diligence will help a purchaser draft environmental indemnities, determine if an environmental escrow should be established, or if environmental insurance is necessary.
- Good environmental due diligence will provide the purchaser with information it can use to identify issues and costs associated with post-closing transition and integration matters and factor these issues into the deal.
- The information can be used to evaluate the existing facilities in light of the purchaser's business needs and determine the potential environmental implications and costs associated with retrofitting, streamlining, or closing a facility.

Consider how regulatory and compliance information should be factored into the transaction

- Identify environmental permits or agreements that must be transferred to a new owner prior to the transfer of ownership or control and complete the requirements to transfer the permits in accordance with applicable law. Also identify permits and required timelines for post-closing environmental permit transfers.
- Subject to federal and state audit policy requirements, if environmental violations are discovered during pre-acquisition due diligence, then the seller or purchaser may have the opportunity to voluntarily report the violations and obtain a mitigated penalty and/or reduction of fines. If violations are discovered by the U.S. Environmental Protection Agency or a state environmental agency following the transfer of ownership or control, then the purchaser could be subject to the full enforcement action.
- Further, the environmental due diligence information can be used to assess Securities and Exchange Commission (SEC) disclosure obligations.

No two transactions are alike and the purchaser should develop an approach to environmental due diligence that fits with the facts and circumstances of the particular transaction. These tips will help the purchaser develop an effective strategy for conducting sufficient environmental due diligence that will appropriately allocate environmental liability and add value to negotiations with the seller.

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