

## Seller's Guide for Environmental Due Diligence

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As a follow-up to the article that appeared in our February 2012 Global Automotive Newsletter, "Purchaser's Guide for Conducting Environmental Due Diligence," this Seller's Guide will discuss several due diligence tips that will help a seller conduct environmental due diligence and negotiate environmental matters.

### **Compile and review key environmental documents.**

Ideally, the seller should gather and review key environmental documents, such as:

- existing Phase I and Phase II Environmental Site Assessments (ESAs)
- environmental permits
- monitoring records
- regulatory records and reports
- description of response actions or remediation projects
- description of claims by any government authority or third party contingent liabilities
- the company's environmental reserves

before commencing the transaction and should review all environmental documents before providing them to a purchaser. Compiling and reviewing key environmental documents before beginning a transaction will allow the seller to:

- Provide a purchaser with the most relevant and up-to-date information about the environmental compliance of the company and environmental condition of each facility.
- Correct inaccurate information, update outdated information and reports, and close open issues such as violations and regulatory or third party audit findings; thereby increasing the efficiency of the transaction and reducing costs.
- Consider the allocation of environmental liabilities associated with previous transfers of the company. Assess whether past owners can still cover their responsibilities and costs related to environmental indemnities.
- Identify and quantify the environmental liabilities so negotiations do not get hung-up on minor issues.
- Understand its environmental liabilities and risks and consider available strategies to deal with these liabilities before entering into negotiations with a purchaser.

### **Consider conducting environmental due diligence before commencing the transaction.**

In a corporate transaction where real property is involved, environmental due diligence may include a Phase I ESA. A Phase I ESA is an initial assessment of the property to identify environmental conditions that denote existing contamination or potential contamination. A Phase I ESA does not include soil or groundwater testing. If the Phase I ESA identifies environmental conditions at the property, then a Phase II ESA, including soil and groundwater testing may be appropriate. An environmental compliance audit is a review of the conditions and practices at the facility in light of applicable environmental laws and requirements. There are several reasons for the seller to perform a Phase I and if

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necessary, a Phase II ESA and an environmental compliance audit prior to commencing the transaction.

- The seller may be able to address environmental conditions and/or environmental compliance issues thereby preserving the desired purchase price.
- The seller's ESAs and environmental compliance audit can provide clarity and certainty to a purchaser and purchaser's potential lenders regarding environmental compliance and the environmental condition of the company and each facility.
- The seller will be in a better position to draft indemnities, determine appropriate environmental escrow amounts, and negotiate the pricing for the transaction.
- With up-to-date information, the seller will be better equipped to make accurate representations and warranties and in so doing can decrease the risk of a breach.
- The seller may be able to limit its liabilities related to environmental issues and benefit financially if it can quantify the environmental risks for the purchaser.
- The seller can conduct additional investigation, remediation, and if applicable, obtain closure or a "no further action" letter to make the purchaser comfortable with the transaction.
- The seller may be able to negotiate terms and conditions that will allow them to conduct remediation activities, which will enable the seller to control costs and limit extended liabilities.
- The seller can use the information to market the company by highlighting certain facilities or property that have already been determined to be eligible for federal or state Brownfield assistance. This type of assistance may require significant lead time and therefore may appeal to a purchaser who is looking for these incentives, but also wants to complete the transaction quickly.

Note that, if the seller completes ESAs and environmental compliance audits prior to commencing the transaction, the environmental consultant should be retained by an attorney in their rendering of legal advice so that the opinions and conclusions in the consultant's reports may be protected by the attorney-client and work product privileges.

### **Negotiate a confidentiality agreement.**

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

- protect the information provided by the seller to the purchaser and should also be agreed to by all of the purchaser's representatives and contractors, including environmental counsel and consultants.
- discuss a process for the return or destruction of all due diligence documents and reports if the transaction is not completed.
- 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.

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### **Designate an environmental information manager and identify key employees with environmental knowledge.**

Select one employee who will be responsible for managing the environmental documents and information during the transaction. This person can be an executive, the corporate environmental health and safety manager, or another individual with sufficient knowledge of the company's environmental documents and requirements. The designated employee should have the following responsibilities during the transaction:

- Compile and review all environmental documents and information before providing it to the purchaser for review.
- Assess, quantify and report all environmental liabilities to executives and seller's counsel who are negotiating the transaction.
- Distribute environmental documents and respond to requests for information and questions from purchaser.
- Participate in conference calls both with company executives and seller's counsel regarding environmental issues and liabilities.
- Oversee all environmental due diligence performed by seller and attend site visits with purchaser's environmental representatives and counsel.
- Work with facility managers and key employees at each facility to obtain environmental documents and information.
- Notify facility managers and key employees regarding the transaction, confidentiality, time commitments and any other significant information.
- Identify key employees with environmental knowledge and information to insure their availability during purchaser's site visits and environmental reviews. Discuss the need for confidentiality and cooperation with the purchaser.

### **Prepare to transfer environmental permits.**

The seller should identify all environmental permits, determine if the permits are transferrable, and identify the requirements to transfer the permits to the purchaser.

- Review legal requirements to determine when environmental permits must be transferred (e.g., an asset sale usually requires the transfer of permits to the purchaser; whereas a stock sale may only require a notification letter to the applicable regulatory authority, or may require no action).
- Review legal requirements to determine if the permits are transferrable. In some cases, the purchaser must obtain a new permit.
- Review legal requirements regarding the procedure to transfer environmental permits. The procedure to transfer environmental permits varies by jurisdiction and regulatory authority. Environmental permit transfers often require the seller to submit a written request to the applicable regulatory authority and a written acknowledgement by the purchaser. In addition, some environmental permits are transferrable, but only within certain time limits before or after closing (e.g., notice must be given to the regulatory authority 30 days prior to the transfer of the permit).
- If environmental permits are not transferred, the seller may remain liable for violations and environmental damages related to a permit.

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### **Negotiate a site access agreement.**

Once the purchaser has completed its initial document review and if the seller has not already performed ESAs and environmental compliance audits, then the purchaser may request that it be allowed to perform these reviews and a site visit will likely be necessary. In this case, the parties should negotiate a site access agreement.

- 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 seller should require that the purchaser's consultant have adequate insurance to cover any mishaps during site access and should include related provisions in the access agreement.
- The site access agreement should require the purchaser to return the property and facility to the same condition that it was in before the purchaser's site visit.
- The site access agreement should make the purchaser responsible for locating all underground utilities.

### **Consider how the environmental due diligence can influence the transaction.**

- The results of the environmental due diligence can influence the structure of the transaction (e.g., stock vs asset purchase).
- As previously mentioned, appropriate environmental due diligence will help a seller draft environmental indemnities and other key environmental provisions such as a termination clause in the event an adverse condition is discovered during the due diligence.
- The environmental due diligence can also help the seller decide if an environmental escrow should be established or if environmental insurance is necessary, and determine if further investigation or remediation is necessary.
- The results of the environmental due diligence may also cause the seller to terminate the transaction so that it can maintain control of the property and facility, if and until, all environmental issues are resolved.
- The results of the environmental due diligence can guide the seller regarding time limits for indemnification for environmental issues, clean-up standards, and limitations on future use to be included in the purchase agreement.
- The seller should consider how long it wants to continue to be responsible for environmental conditions. Does the seller want to be overseeing and conducting environmental remediation ten years after the transaction?

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

- Subject to federal and state audit policy requirements, if environmental violations are discovered during pre-acquisition due diligence, then the seller may have the opportunity to voluntarily report the violations and obtain a mitigated penalty and/or reduction of fines.
- Further, the environmental due diligence information can be used to assess Securities and Exchange Commission (SEC) disclosure obligations.

As we noted in our previous article, no two transactions are the same and the seller needs to understand its environmental liabilities and how those liabilities fit in with the seller's objectives and goals for the transaction. Using these tips will help the seller prepare for the environmental due diligence process in the transaction and conduct

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environmental due diligence that is appropriate to effectively negotiate environmental matters.

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