Different types of acquisitions need different levels of due diligence: a look at greenfields, brownfields, operating terminals and leases

Assessing environmental liabilities

What does environmental due diligence include? That depends on the nature of the acquisition. In the US, the standards for conducting environmental due diligence are set forth by the Environmental Protection Agency in Title 40 CFR Part 312: Innocent Landowners, Standard for Conducting All Appropriate Inquiry, which references the American Society for Testing and Materials (ASTM) E 1527-05 Standard Practice for Environmental Site Assessments: Phase 1 Environmental Site Assessment Process. But, in both cases, the standards leave it up to the environmental professional to determine the level of assessment that is warranted for an acquisition and consult the client on all the options.

The environmental due diligence process can present significant opportunities. If managed skillfully during a transaction, you can not only save money and avoid environmental liabilities; you can also enough about a property or operation that you can structure your acquisition and future development and use of the property or facility based on that information.

The information obtained during the environmental due diligence process can be a tremendous bargaining tool. You can negotiate on the price and use legal counsel to incorporate protection (indemnifications, warranties, representations, hold backs, or escrows) in the acquisition agreement to cover identified environmental liabilities and costs.

But, you need to identify the environmental liabilities early on during the acquisition process. Discovering environmental liabilities or contamination after an acquisition means you own it, along with all the costs and potential delays and loss of operating revenue.

Terminals continuing to expand without fully assessing the environmental liabilities may learn the hard way.

What constitutes environmental due diligence?

For the acquisition of a greenfield property (property that has never been developed), a Phase I Environmental Site Assessment (ESA) per the ASTM Standards may be an appropriate level of due diligence. A Phase I ESA includes researching the historical use and development of the property, researching the regulated facilities located on or surrounding the property, interviewing persons familiar with the property, conducting a site reconnaissance and preparing a report. A Phase I ESA typically costs $3,000 - $6,000 ($2000-$4000) depending on the size and location of the property, and can be completed within 2 - 3 weeks. If no recognised environmental condition, or potential contamination, is identified, then no further investigation is warranted and the Phase I ESA will satisfy the due diligence requirements and any lending institution requirements.

For the acquisition of a brownfield property (property that has been used for commercial or industrial activity), a Phase I ESA may only be the beginning of the due diligence process.

Conducting a Phase I ESA of a brownfield property will likely uncover recognised environmental conditions (RECs). A REC is defined as the presence or likely presence of hazardous materials or petroleum products on the property that could result in surface water, sediments and/or groundwater contamination and could result in regulatory agency requirements for remediation. In which case, a Phase II ESA is necessary to fulfill the environmental due diligence requirements. A Phase II ESA typically includes surface and/or subsurface sampling and analysis. Depending on the nature and extent of the potential contamination, a Phase II ESA typically costs $15,000 to $60,000 or more and can take two to three months or more to complete. Even when completed, the Phase II ESA may only identify the presence of the contamination, but may not define the total extent of the contamination. At this stage, the environmental due diligence process can be viewed as a major impediment to closing a deal to purchase additional property. However, if you end up saving $250,000 to $750,000 during your acquisition, the environmental due diligence can be viewed as a major strategic element of an acquisition.

The acquisition of an operating terminal entails additional and more complicated environmental due diligence. An ESA is only part of the equation: the other part of the equation includes an assessment of the environmental compliance, permitting and operational conditions of the facility.

Environmental compliance includes a whole host of regulatory programmes (air, water, waste, spill prevention, etc.), each with their own long list of regulatory requirements. And, conducting a detailed environmental compliance audit can be an exhaustive and expensive endeavor. However, some level of environmental compliance auditing needs to be performed and should be focused on the high level issues including, at a minimum, an assessment of the current permits vs. the permits needed for future operations; the regulatory status with respect to violations, penalties and fines; spill control especially in loading/unloading areas; storm water management; management of tank bottoms and wash water; maintenance records related to spills and releases; information on historical operations; along with a site reconnaissance.

Based on these findings, the environmental risks are typically manageable and provisions can be incorporated into the acquisition agreement to account for any environmental costs or potential environmental remediation liabilities.

However, if you are not acquiring property, but leasing from a Port Authority or other entity, there is still an environmental due diligence process that should be followed. In this case, the due diligence should include comprehensive research on the historical use of the property, interviews with persons knowledgeable about the property, and a site reconnaissance to identify obvious environmental conditions. Based on this
information, you can then design a study to establish an environmental baseline, or the current condition on the property. It is almost certain that any lease agreement will include termination provisions with environmental remediation requirements. Therefore, without an environmental baseline, you don’t know what you are agreeing to remediate and this could be a significant financial risk. It may also be possible to negotiate the terms of the environmental remediation requirements to exclude any liabilities for any currently documented environmental contamination.

An example

During a recent acquisition, the environmental due diligence was started as soon as the contract was signed which included a 90 day assessment period. The acquisition included a 12-acre parcel as part of a storage facility expansion. The only known environmental issues that had been identified included some abandoned used tires and a pipeline metering station located on the property. The buyer said the property was clean but during the environmental assessment, an environmental issue was identified, which was going to require mitigation prior to development of the property. The buyer was then very frustrated as this environmental information presented an impediment to his facility expansion. However, he was then convinced to use this information to his benefit. The purchase price of the property was then successfully renegotiated from $750,000 to $400,000, saving $350,000, which more than covered the environmental cost.

Acquiring contaminated property

The environmental due diligence standards in the US have changed since 2005. There are now EPA rules and provisions to afford limitations on environmental liabilities for companies purchasing contaminated properties (bona fide prospective purchasers) and for purchasing property with contamination from an off-site source (contiguous property owners). But, you must meet the statutory criteria to qualify including performing all appropriate inquiry or due diligence. You must also comply with any land use or deed restrictions, prevent any ongoing releases, provide full cooperation to authorities to conduct response actions and provide any legally required notices. These provisions can provide significant advantages for terminal expansions, considering the fact that many expansions may involve industrial properties with high likelihood of historical contamination. But, to be eligible for these limits on liability, you must perform an appropriate level of due diligence.

Environmental due diligence is an opportunity

No one wants to find environmental problems during an acquisition, but the environmental due diligence process is an easy way to save money and avoid/limit liabilities. Most of the time the seller is as anxious as the buyer is to make the deal happen. And, the seller is often very willing to sell at a lower cost to avoid known environmental liabilities or to provide limits on environmental liability when they know there are not any significant environmental problems. Most environmental liabilities are manageable. There are environmental regulatory programmes that can facilitate the acquisition of contaminated property. These programmes can also be used to manage environmental remediation cost-effectively and in a timely manner. The environmental due diligence process should not be ignored, but used as an effective acquisition strategy.

For more information:
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