Environmental due diligence cannot be left to the last minute

Minimising expansion liabilities

Several options are available for expanding an existing terminal, acquiring or leasing additional property, acquiring another terminal, or developing/redeveloping the existing terminal property.

In all cases if contamination is discovered companies may incur environmental liabilities, along with loss of operating revenues, penalties, compliance costs, permit transfer problems, and local government and public scrutiny.

Yet, in many instances, environmental due diligence is treated as an unwanted stepchild. While the financial and operational due diligence is pursued enthusiastically, the environmental due diligence is often seen as creating only costs, problems and impediments to the deal, and is often left to the end of the transaction.

Environmental issues are often considered immaterial when making a large acquisition that costs multimillions or multibillions of dollars. Some agreements for acquisitions are even negotiated and signed prior to, or subject to subsequent environmental due diligence. Sometimes, companies use their own in-house environmental managers to perform the environmental due diligence, regardless of the fact that they may not have any experience in this area and may not know the current rules and standards.

However, the environmental due diligence process can present significant opportunities during a transaction. The information obtained can be used in price negotiations and to incorporate legal protection (indemnifications, warranties, representations, hold backs, or escrows) in the acquisition agreement to cover identified environmental liabilities and costs. Often, the unidentified or potential environmental liabilities (data gaps), can be even more significant and costly. These issues can also be incorporated into the transaction agreement if identified early in the due diligence process.

In one example a petroleum marketer was expanding its operations by acquiring an existing tank farm facility, and the financial and operational due diligence was completed before even starting the environmental due diligence.

After environmental assessors discovered on-site soil and groundwater contamination the deal was renegotiated to include establishing an escrow account for $250,000 (£175,000) to cover the estimated cleanup cost so that the deal could be finalised.

This required extending the timeframe for the acquisition by four months while additional investigations were performed and required additional legal fees to renegotiate the deal. But, the environmental due diligence paid off and the acquisition was successful.

The clean up was completed within six months, and the facility was operational from day one but the company could have saved more time and money had they started the environmental due diligence earlier on in their acquisition process.

Using the due diligence process to acquire 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 companies must meet the statutory criteria to qualify and comply with the continuing obligations including land use or deed restrictions, preventing ongoing releases, providing full cooperation to authorities to conduct response actions and providing legally required notices.

These provisions, allowing for limitations on liabilities, can provide significant advantages for terminal expansions, considering the fact that many may involve industrial properties with a high likelihood of historical contamination.

But, to be eligible for these limits on liability, companies must perform an appropriate level of due diligence.

As an example, a site for a new facility was selected based on the location and proximity to existing facility operations. During the due diligence process, it was determined that the site was previously used for light industrial and commercial activities since the 1940s included a vehicle dealership, a service station, and several other types of commercial activities.

There was documented soil and groundwater contamination and a documented ongoing unauthorised discharge from an oil/water separator. However, despite these environmental liabilities, the location of the site was so advantageous that the buyer decided to move forward with the acquisition (as a bona fide prospective purchaser), negotiating a reduced purchase price even though the extent of the environmental liabilities was not totally defined.

In order to fulfill the owner’s continuing obligations the environmental regulatory agency inspected the ongoing discharge and implemented actions to prevent any further discharges which included removing the oil/water separator and connection to the sewer system.

The site remediation was then completed within 90 days including asbestos abatement, building demolition, removal of hydraulic lifts, USTs, ASTs, floor drains, sumps, paint booths and associated soil contamination.

The source of the groundwater contamination was determined to be from off-site and this information was submitted to the state agency. Based on current data, the site will be approved for closure with no further action required and no future
Leasing a former terminal site

Groundwater Contamination <0.5 ppm benzene – did not require cleanup after risk-based levels were established.

Soil Contamination <2.6 ppm benzene – did not require cleanup after risk-based levels were established.

Soil Contamination >2.6 ppm benzene – did require cleanup but was reduced by 50% with risk-based assessment.

environmental liability for the previous soil contamination, groundwater contamination, or unauthorised discharges by the previous property owner.

The transaction was successful as the environmental liabilities were managed, the remediation was completed, and the construction of the new facility began on schedule.

Using regulatory programmes to manage environmental remediation and liabilities

While the due diligence process can be used to negotiate prices and limit liabilities, there are also several regulatory programmes that can be used to manage the environmental remediation and liabilities. These can be used in combination with the due diligence process for acquiring property and for developing/redeveloping existing property/facilities.

In the US, these programmes are state-specific, but are similar from state to state. The most advantageous include voluntary cleanup programmes and risk assessment or risk-based cleanup programmes. The voluntary cleanup programs allow companies to complete property acquisitions despite the presence of environmental contamination and can eliminate future environmental liabilities for those problems. The voluntary cleanup programmes also provide a process by which voluntary response actions can be completed in a timely and efficient manner.

The risk-based cleanup programmes include provisions for establishing the cleanup goals based on the future use of the property, with reduced cleanup requirements for industrial use. The risk-based programmes also include provisions for establishing the cleanup goals based on the usability of groundwater, with reduced cleanup requirements for groundwater that is classified as non-potable water. In addition, the risk-based cleanup programmes incorporate provisions for implementing engineering controls to prevent exposures, with reduced and sometimes eliminated requirements for cleanup.

An example of a terminal using these programmes to its advantage is a company that was leasing property from a Port Authority to build a new terminal. The property had been used by a previous terminal and the storage tanks were still present and no investigation or remediation had been performed on the property. The Port Authority’s lease agreement incorporated provisions for the new terminal to complete any required remediation within a one year timeframe or they would be required to post a $1 million bond. The terminal then conducted its environmental due diligence including a Phase I and II Environmental Site Assessment (ESA).

Based on the results, there was minor soil contamination discovered in one area. However, due to the presence of the tanks, no sampling was performed underneath them. The potential presence of contamination under the existing tanks should have been incorporated into the lease with some sort of legal protection, but it was not. This was a risk. During the subsequent removal of the tanks, additional contamination including groundwater contamination was then discovered. The new terminal was then required, under its lease agreement, to perform the remediation.

The State agency’s risk assessment rules were used to reclassify the groundwater as non-useable (groundwater which does not meet the potable water quality standards). The cleanup levels for benzene were then changed from 0.005 to 0.5 ppm in groundwater and no groundwater remediation was required, saving potentially $100,000. The cleanup levels for benzene were also changed, from 0.026 to 2.6 ppm in soils. As a result, the extent of the required soil remediation was reduced by 50%, saving another $100,000. The remediation was completed in less than a year and the agency approved closure with no further action required. The bond was not required by the Port Authority and the new terminal facility was constructed on schedule.

The point of all these cases is that the environmental due diligence process is an opportunity to limit environmental liabilities as well as saving time and money. But it is imperative that terminals start the environmental due diligence as early as practical. In addition, there are environmental regulatory programmes in place that can facilitate the acquisition of contaminated property and regulations that can be used to manage environmental remediation cost-effectively and in a timely manner.

Most environmental problems are manageable and do not become deal-killers, if discovered early on.

For more information:
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