



## Environmental Due Diligence in Mergers & Acquisitions: Ten Common Mistakes to Avoid

The high risk nature of environmental liabilities makes it important for companies engaged in business transactions to thoroughly understand these liabilities to avoid adverse and material legal, financial and commercial consequences. Environmental due diligence (EDD) should be an integral component of any due diligence process conducted for business transactions such as mergers and acquisitions (M&As).<sup>1</sup>

EDD can provide a strategic or financial buyer of property, buildings/facilities or other assets, with critical information for:

- Identifying and quantifying the material environmental liabilities and risks;
- Formulating negotiating positions on price and other transaction terms;
- Developing strategies for managing the risks; and
- Implementing a post-transaction management plan and any future exit strategy.

Unfortunately, all too often EDD is not done properly or sufficiently (if it is done at all).<sup>2</sup> There are many reasons why EDD fails to meet the needs and objectives of the parties who require or could use this information. The following list are examples of some of the more common mistakes made when conducting EDD and some suggestions on how to avoid them.<sup>3</sup> The list is not exhaustive but it does illustrate the range and nature of the problems and issues underlying these mistakes.

1. **Reliance on representations and warranties.** A representation is a statement of alleged facts or arguments made to induce a party to enter into a proposed venture or contract. A warranty is an expressed or implied promise that guarantees something by one party in furtherance of a contract. Representations and warranties made by a seller should never be relied on by a buyer in lieu of even cursory due diligence. Because of opposing objectives, there is no language that will meet the needs of both the seller and the buyer; the seller will typically want narrowly-worded representations and warranties while the buyer will typically want broadly-worded representations and warranties. Nonetheless, representations and warranties may be useful in clarifying the starting points for EDD.
2. **Informal or poorly scoped due diligence process.** Ambiguous or ill-defined scopes of work (SOWs) for EDD can lead to incomplete due diligence and unexpected issues arising post-transaction. A comprehensive, formal SOW for conducting EDD should be developed that focuses on the objectives of the transaction, the needs of the buyer, and is consistent with current standards of practice. The SOW does not have to be a lengthy, detailed document; a tabulated summary of the items that need to be addressed, the sources of information and data that are required, the person(s) responsible for each item, and the estimated time and other resources needed to complete each item is a good starting point for an SOW.
3. **Inadequate time.** EDD should commence at the beginning of the overall due diligence period, not just before the closing of the transaction. EDD is often thought of by the business representatives involved as an afterthought or as an add-on to be done if there is sufficient time. It may also be viewed by those trying to close the deal (especially the seller) as a device to hopelessly complicate the deal at best or as a deal-breaker at worst. However, with appropriate planning and management of resources, EDD can usually be completed in a reasonable timeframe (i.e., weeks), concurrently with other financial, legal or commercial due diligence activities, unless more time is needed for multi-site transactions, site inspections, delayed productions of critical documents by the seller, etc.
4. **Reliance on outdated information.** Changes in site or operational conditions, environmental legislation and regulatory agency involvement, and other unforeseen circumstances may make older audit or assessment information obsolete or inaccurate. As a general rule of thumb, any audit or assessment over six months should be updated.

*All too often environmental due diligence is not done properly or sufficiently... if it is done at all*



5. **Reliance on the seller's own due diligence.** Due diligence conducted by a seller and made available to the buyer should not be considered by the buyer as an appropriate level of inquiry and as a substitute for the buyer's own due diligence. At a minimum, the seller's EDD should be vetted for scope (in light of the buyer's own objectives and needs), and for the reasonableness and appropriateness of the methods used, the assumptions relied on, and the conclusions reached.
6. **Failure to compile and evaluate historical information.** Historical information on former operating or disposal/recycling facilities, regulatory non-compliance, corporate succession, etc., is often not readily available from the seller because of the time and expense, and potential disclosure issues involved in compiling this information. Nonetheless, the buyer should make every attempt to compile this information, to the extent it's available, in order to fully understand the past, current and future environmental issues and liabilities.
7. **Reliance on document or data rooms.** Traditionally, a review of documents as part of any EDD effort was conducted by a team of the buyer's specialists sitting in a room at the seller's facilities or at their counsel's offices. In today's computerized world, those documents are more likely to be made available to the buyer in the form of an electronic or virtual data room accessible via the internet. In either case, the seller controls which documents are placed in these repositories. A buyer should prepare a list of documents it would like to review *before* the document review begins. This will serve as a checklist for comparison against the initial document set provided by the seller as well as the basis for making additional requests to the seller for other relevant documents.
8. **Acceptance of unreasonable or inappropriate estimates of liability.** Buyers should be wary of a seller's attempts to "low ball" a liability estimate in order to minimize the potential liability to the buyer. The buyer should derive independent estimates of liability based on current regulatory cleanup standards, best standards of practice, and consistent with the future intended use of the asset.
9. **Reliance on information provided by the seller's representatives.** Buyers should not accept at face value any information provided by the seller's representatives particularly if those representatives have limited knowledge and experience with the seller's environmental issues and liabilities. Thorough EDD will require input from the seller's (and often the buyer's) environmental health and safety managers, business managers, plant operations managers, legal counsel, and outside environmental consultants.
10. **Inadequate communications and insufficient integration of EDD with other assessments.** Failure to communicate and integrate the findings of EDD with the other financial, legal or commercial due diligence findings can result in the inefficient use of resources, or worse, missed material issues. To help prevent this from occurring, an individual within the EDD team, preferably with strong management, interpersonal and communications skills, should be designated as a liaison between the EDD team and the other due diligence teams.

### Summary

Environmental due diligence (EDD) conducted for mergers and acquisitions is often not done properly or sufficiently due to a number of common mistakes. Successful EDD requires: defining clear objectives and a basic scope of work to be conducted; engaging and managing the proper resources to meet time and budget constraints; conducting independent assessments of the information provided and any estimates of the liabilities generated; and ensuring that the findings of EDD are clearly communicated to other due diligence teams and integrated with other due diligence findings.



**Endnotes:**

1. Other business transactions which could benefit from EDD include: joint ventures; commercial or industrial real estate development (“brownfields”); facility closure and sale; refinancing or securitization of commercial and industrial property and facilities; bankruptcy, restructuring and foreclosure proceedings; and smaller transactions such as leases, rights-of-way, etc.
2. A 2004 survey on environmental due diligence practices of 105 European companies found, among other things, poor management and the lack of standard procedures and guidelines, narrow scopes of due diligence, and poor integration of EDD findings with other due diligence teams were major factors contributing to missed material issues. (*Impact – A survey on environmental due diligence*. KPMG LLP. May, 2004. URL: <http://www.kpmg.co.uk/pubs/208251.pdf> ).

A more recent survey of 320 business executives around the world found only 41% of the respondents said they conducted environmental assessments when developing new products or services; 26% when planning geographical expansions, and only 19% when planning mergers and acquisitions. (*Under the spotlight: the transition of environmental risk management*. May, 2008. The Economist Intelligence Unit (EIU); URL: [http://www.eiu.com/site\\_info.asp?info\\_name=eiu\\_Global\\_Risk\\_Briefing&rf=0](http://www.eiu.com/site_info.asp?info_name=eiu_Global_Risk_Briefing&rf=0)).

3. The reader should note that although this article focuses on environmental due diligence for M&As, the mistakes discussed herein are equally applicable to other financial, legal or commercial due diligence efforts conducted for other business transactions (See End Note 1).

**About the Firm:**

**DOUGLAS C. ALLEN, P.A.** provides strategic consulting services to businesses, their legal counsel, insurers and investors to help them define, quantify and manage their high risk exposures so they may mitigate adverse and material consequences to their operations and financial strategies.

**Contact Information:**

Address: 1457 Vermont Route 14N  
East Montpelier, Vermont 05651  
Telephone: 802.229.2129  
Facsimile: 802.229.5030  
Mobile: 617.510.4335  
Email: [info@dcallenpa.com](mailto:info@dcallenpa.com)  
Web: [www.dcallenpa.com](http://www.dcallenpa.com)

**Publication History:**

The original article was published and distributed worldwide via the internet by Mondaq®. September 17, 2008.

Copyright 2008 DOUGLAS C. ALLEN, P.A. All rights reserved.