

MWCC ENVIRONMENTAL CONFERENCE

Environmental Compliance Audits and Due Diligence in Property Transactions/Mergers and Acquisitions

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Mergers and Acquisitions of Operating Industrial Facilities

Environmental Risks

- Historical/Legacy Risks
- Ongoing Legal or Enforcement Actions
- Mitigation Costs
 - Operations and Plant Capital
 - Delays and Lost Productivity
 - Fines and Legal Fees



Purposes

Identify:

- Past, current, and potential future compliance issues
- Conditions impacting future operations and/or development
- Negative impacts to property and business value
- Legal protections under environmental laws

Regulators Response to Merger/ Acquisition

Can go two very different
directions

The White Knight!



Regulators Response to a Merger/ Acquisition

- **FRESH MEAT!**



Due Diligence Process

- Standard Components
 - Financial
 - Operational
 - Management Systems
 - Personnel
 - Logistics and Communication
 - Corporate Governance



Due Diligence Process

ENVIRONMENTAL COMPONENT

- Nearly always a Phase I ESA
- Sometimes a follow-up 'due diligence' or 'limited' Phase II site investigation
 - Following up on findings from the Phase I

Due Diligence Process

- Ideally a compliance audit
 - Environmental compliance
 - OSHA compliance
- Focused on identifying and quantifying:
 - Compliance risks that will be assumed in the transaction
 - Financial impacts
 - Operational impacts

Due Diligence Process

Once you close the deal, it's all yours!

Phase I Assessments



Standards

- Phase I ESAs – ASTM 1527-13
 - CERCLA Liability Protections
- Transaction Screen – ASTM 1528
 - No CERCLA Protections

Phase I Assessments

- Records review
- Site visit
- Interviews
- Identification of “Recognized Environmental Concerns” (RECs)



Phase I Assessments

What is a REC?

“the presence or likely presence of any hazardous substances or petroleum products in, on, or at a property: (1) due to release to the environment; (2) under conditions indicative of a release to the environment; or (3) under conditions that pose a material threat of a future release to the environment. De minimis conditions are not recognized environmental conditions.”

Phase II Assessments

Sampling and analysis to investigate RECS from Phase I

- Standards
 - State rules
 - Federal guidelines

Phase II Assessments

Additional Components

- Tank contents
- Sumps and collection pits
- Asbestos
- Lead-based paint



**Compliance
Audits**

**Environmental
Health & Safety**

Legal
Considerations
with
Transaction-
Based Due
Diligence

CERCLA Bona Fide Prospective Purchaser Status

- Prior to acquisition, Prospective Purchaser must meet the following criteria:
 - All disposal of hazardous substances occurred prior to acquisition of the facility
 - Purchaser conducted “all appropriate inquiry” prior to acquisition
 - Purchaser is not a PRP or affiliated with a PRP

**Legal
Considerations
with
Transaction-
Based Due
Diligence**

CERCLA Bona Fide Prospective Purchaser Status

After acquiring the property, the BFPP must also:

- Provide legally required notices
- Take reasonable steps to stop/prevent releases or exposure
- Provide full cooperation with response actions
- Comply with land use restrictions and institutional controls
- Comply with CERCLA requests for information or subpoena

Legal Considerations with Transaction- Based Due Diligence

CERCLA Bona Fide Prospective Purchaser Status

USEPA 2003 Interim Guidance:

<https://www.epa.gov/sites/production/files/documents/common-elem-guide.pdf>

- A BFPP who discovers hazardous substance contamination on property during “all appropriate inquiry,” may have an obligation to notify USEPA or other appropriate governmental authorities of the discovery. The Interim Guidance notes that providing notice would be a “reasonable step” to ‘prevent a threatened future release’ or ‘prevent or limit exposure.’
- “Reasonable steps” generally do not include investigating or remediating contaminated groundwater emanating from contiguous or adjacent property, e.g., the historic landfills. The one exception to this is where the subject property contains a groundwater well.

Legal Considerations with Transaction- Based Due Diligence

CERCLA Bona Fide Prospective Purchaser Status

- If a BFPP discovers a previously unknown release of a hazardous substance from a source on its property, the BFPP must “take some affirmative steps to ‘stop the continuing release,’ but EPA would not, absent unusual circumstances, look to her for performance of complete remedial measures.” Notice to governmental authorities and containment or other mitigation measures would be considered appropriate.
- “Q: If a landowner discovers contamination on her property, does the obligation to take reasonable steps require her to investigate the extent of the contamination? A: Generally, where the property owner is the first to discover the contamination, she should take certain very basic actions to assess the extent of contamination. Absent such an assessment, it will be very difficult to determine what reasonable steps will stop a continuing release, prevent a threatened future release, or prevent or limit exposure. While a full environmental investigation may not be required, doing nothing in the face of known or suspected environmental hazard would likely be insufficient.”

Legal Considerations with Transaction- Based Due Diligence

Missouri

- Any person having control over a hazardous substance shall be strictly liable to the state of Missouri for the reasonable cleanup costs incurred by the state as a result of the failure of such person to clean up a hazardous substance involved in a hazardous substance emergency” in accordance with the rules. RSMo 260.530.1.
- The director “may require a person having control over a hazardous substance involved in a hazardous substance emergency to clean up the hazardous substance and take any reasonable actions necessary to end a hazardous substance emergency.” RSMo 260.510.

Legal Considerations with Transaction- Based Due Diligence

Kansas

- Contaminated Property Redevelopment Act (May 9, 2016): KDHE can issue a Certificate of Liability Release (CELR) to certain prospective purchasers

Illinois

- Proportionate share liability (415 ILCS 5/58.9):

Compliance Auditing 101

Internal Compliance Audits

Conducted by the owner or operator on their own facility and operations

- Self-assessments for compliance assurance
- Internal due diligence

Internal Compliance Audits

Internal Audit Purposes:

- Staying ahead of enforcement
- Maintaining a safe and responsible operation
- Satisfying 3rd parties:
 - Customers
 - Financial Institutions
 - Other Stakeholders

Transactional Audits

- Property Transactions
 - No on-going operations
 - Phase I ESA often sufficient
 - Focus on historical contamination and environmental liabilities associated with the real property

Transactional Audits

Mergers and Acquisitions/Operating Facilities

- Compliance Audits in Addition to Phase I and II ESAs
- Environmental and OSHA
- Compliance Risks to be Assumed with the Transaction
- Financial and Operational Impacts

Purposes

Identify:

- Past, current, and potential future compliance issues
- Conditions impacting future operations and/or development
- Negative impacts to property and business value
- Legal protections under environmental laws
- Satisfying 3rd parties:
 - Customers
 - Stakeholders
 - Financial Institutions

Who Conducts the Audits

Internal Audit Team

- Advantages
 - May be less expensive
 - Easier to facilitate
 - Legal privileges in place
 - Familiarity
 - Facility
 - Operations
 - Internal policies and procedures
 - Document management systems

Who Conducts the Audits

Internal Audit Team

- Disadvantages
 - Requires a corporate structure that allows independence of the audit team from operations
 - Familiarity might breed complacency

Who Conducts the Audits

External Audit Team

- A new set of eyes
- Can eliminate internal conflicts of interest

Who Conducts the Audits

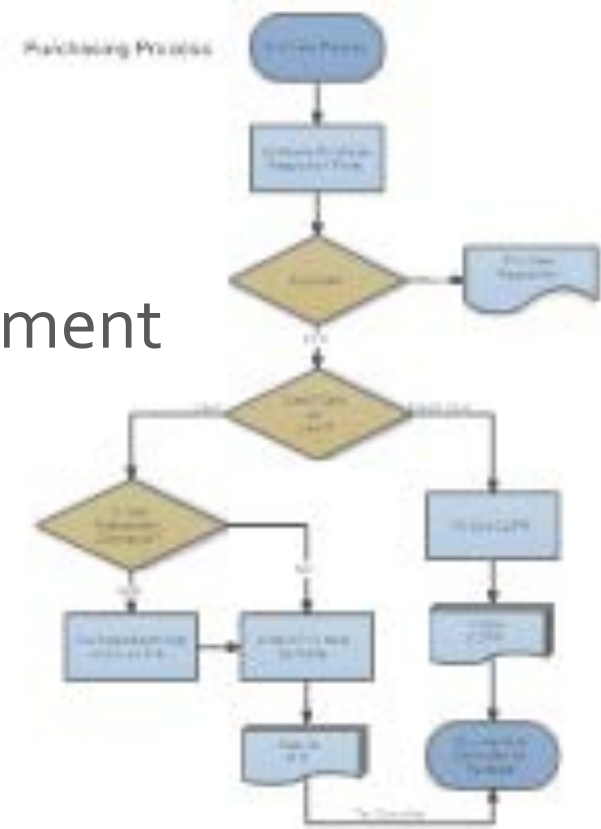
REGARDLESS OF WHO

- No one person is expert in all fields of EH&S.
- Team of experts.



Iterative Process

- Phone interview
- Scope
- Preliminary records and document review
- Site visit



Iterative Process

Site visit

- Pre-meeting
- Walk-through/Photos
- Interviews
- On-site document review
- Exit interview



Iterative Process

Follow Up

- Additional documentation
- Operations clarifications
- Regulatory research
- Final Report
- Response to findings and concerns

Standard Audit Components



- Regulated chemical products management and storage
 - TSCA
 - SARA (Community Right to Know)
 - ASTs and USTs
 - SPCC
- Record keeping and reporting review

Standard Audit Components

- Permit Review
 - Air
 - Industrial waste water
 - Stormwater
 - Solid waste operations
 - US Army Corps of Engineers

Standard Audit Components

- Solid waste management
 - Hazardous waste
 - Non-hazardous waste
 - Universal waste
 - Recycling
 - Medical/Pharmaceutical/Biohazard wastes



Standard Audit Components

- Previous concerns and non-compliances
 - Previous internal audit findings
 - Agency inspections
 - Notices of Violation
 - Enforcement actions
 - Settlement agreements

Standard Audit Components

- OSHA Compliance
 - Written programs
 - Fall protection/Working-walking surfaces
 - Hazard communications (HazCom)
 - Worker exposures
 - Noise
 - Hazardous chemical exposures
 - Employee training



Standard Audit Components

- Employee Training
 - EPA
 - OSHA
- New laws and regulations

Legal Issues with Compliance Audits

- A “gold mine” for regulators
- Evidentiary and statutory privileges

Legal Issues with Compliance Audits

Evidentiary Privileges

1. Attorney-Client: “For the purpose of providing legal advice”; counsel retains consultant
2. Work Product: “In anticipation of litigation”; must include counsel’s mental impressions/opinions

Legal Issues with Compliance Audits

USEPA Audit Policy – 9 Criteria

- a. Systematic discovery
- b. Voluntary disclosure
- c. Prompt disclosure – within 21 days
- d. Independent disclosure and discovery
- e. Correction and remediation
- f. Prevent recurrence of violation
- g. Not applicable to repeat violations
- h. No application to serious actual harm/imminent and substantial endangerment/violation of existing order or agreement
- i. Cooperation by disclosing entity

Legal Issues with Compliance Audits

USEPA Audit Policy

- 100 % reduction of gravity-based penalty if all 9 criteria met
- 75% reduction of gravity-based penalty if no systematic discovery
- USEPA can waive insignificant economic benefit penalty
- No criminal referral
- <https://www.epa.gov/compliance/epas-audit-policy>

Legal Issues with Compliance Audits

eDisclosure (2015)

Category 1 disclosures (EPCRA): Automatic issuance of electronic Notice of Determination and no penalties

Category 2 disclosures (EPCRA/CERCLA chemical release reporting, no systematic discovery/non-EPCRA): Acknowledgement letter

USEPA 5/15/18 "Renewed Emphasis on Self-Disclosed Violation Policies"

(<https://www.epa.gov/sites/production/files/2018-05/documents/refreshannouncementfordisclosures.pdf>)

Legal Issues with Compliance Audits

State Policies

Missouri: No formal self-disclosure policy or audit privilege

Illinois: Section 42(i) of Illinois Environmental Protection Act (415 ILCS 5/42(i), "Voluntary Self-Disclosure Civil Penalty Mitigation"

Kansas: KDHE Environmental Audit Policy, K.S.A. 60-3332

Legal Considerations with M & A

USEPA “New Owner” Policy

- USEPA “Interim Approach to Applying the Audit Policy to New Owners” (2008)
- Must be a “new owner”
 - Prior to acquisition, entity was not responsible for environmental compliance, did not cause violation being reported, and would not have been able to prevent occurrence
 - Violation originated with the prior owner before acquisition
 - Prior to transaction, neither buyer nor seller could have held the largest ownership share of the other or had the same corporate parent

Legal Considerations with M & A

USEPA “New Owner” Policy

- Considered a “new owner” for up to 9 months after closing
- Within 9 month period, must (i) negotiate an audit agreement with USEPA or (ii) disclose violations as they are discovered (21 days or 45 days after closing)
- Waives “systematic discovery”
- Expanded penalty relief: no economic benefit penalties for violations prior to acquisition date (but BEN applicable to O&M costs following closing)
- Penalty forgiveness even if serious harm/imminent and substantial endangerment/violation of existing order or agreement as long as no fatalities, evacuation or catastrophic event

Legal Considerations with M & A

USEPA “New Owner” Policy

- Negotiations with USEPA are outside eDisclosure
- Considerations for M&A transactions:
 - No successor liability
 - ‘Clean slate’ with USEPA
 - Scope of penalty relief – still a potential for BEN and injunctive relief

Legal Considerations with M & A

Negotiated Protections

- Warranties/Representations
- Indemnities
- Remediation/Correction of non-compliance
- Institutional controls/deed restrictions
- Disclosures to state and federal regulatory agencies
- Permit transfers

Questions

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