

## Environmental Due Diligence Auditing

Environmental due diligence is the exercise conducted by a purchaser, seller, underwriter or lender (for simplicity only “purchaser” is referred to hereunder) in a wide range of commercial transactions, including a public offering of shares, re-financing, asset purchase, share purchase, divestment or merger. The objective is firstly, to ascertain what environmental liabilities and risks these parties might be transferring in the transaction and, secondly, to quantify any liabilities. In essence it is an external examination of the environmental operations of a company. The emergence of environmental due diligence in business transactions has resulted from two factors, namely the increased risk of inheriting environmental liability, and the limited comfort offered by warranties and indemnities which seek to safeguard against that risk.

Customarily, environmental due diligence is part of the range of surveys and investigations associated with business transfers. It is applicable both to pure property purchases and also to corporate acquisitions. A purchaser must, as a minimum, inform itself as fully as is reasonably practicable of the proper market value of the asset it is considering acquiring, so that it can relate this to the price being asked and what it is prepared to pay. In assessing the value it will need to establish all liabilities that may be associated with the asset. If the deal is to make business sense, the purchaser must then ensure that the purchase contract terms adequately protect it from such liabilities.

Three main categories of potential risk of most concern are:

- Contaminated land with its potential clean up liabilities and costs;
- Regulatory non-compliance - with the potential for fines and the capital costs of technological upgrading of pollution abatement equipment or more substantial process modification to achieve compliance.
- Third party liability for off-site environmental damage caused by contamination leaving the site.

For each of the above areas of risk there are three strands to the work we carry out:

- Identifying the actual and potential risks and liabilities arising from past, current and proposed future activities on the site being acquired and neighbouring sites;
- Quantifying any risks and liabilities identified; and
- Allocating risks between the parties and ensuring that the transaction price properly accounts for this allocation. The purchaser will normally seek to avoid acquiring unknown liabilities, and the vendor will seek to avoid environmental liabilities that may not be attributable to it.

An environmental due diligence exercise must be flexible and will need to be adapted to the business context. However, generally what is required is an understanding of the site; its layout; environmental setting; physical features; and details of past and current processes and working practices. In general terms, there are three phases as follows:

<u>Phase</u>	<u>Purpose</u>	<u>Form</u>
I Site Evaluation	Information Gathering	Documentary Desk-based Study and Visual Evaluation
II Intrusive Studies	Intrusive Scientific Testing	Chemical and Geotechnical Sampling & Analysis
III Remedial Action	Problem Solving – Remediation	Physical and Contractual

In summary, a purchaser must be prepared to conduct a thorough environmental due diligence investigation by establishing a detailed and systematic review of the vendor’s

business so as to define all applicable environmental liabilities and thereafter to establish a policy as regards the acceptance, avoidance or reduction of the risks implicit in those liabilities. Thus a purchaser will seek:

- To identify problems arising from past practice;
- To identify actual and potential future liability flowing from that past practice;
- To identify current problems, such as non-compliance and required future process or system upgrades; and
- To allocate risk according to the above.

#### Due Diligence Audit; Phase 1 Methodology

To gather the information required Cambrensis typically follows a stepwise approach:

1. Issue a Pre-Audit Questionnaire to the management of the subject business, to gather information on the site, its setting, processes and impacts.
2. Supplement the information gathered by a search of commercially available environmental databases and by scrutiny of information held in "physical" or e-data rooms for the express purposes of the transactional process.
3. If allowed by the project circumstances, investigate any files held by local and national regulators on the subject business.
4. Visit the site to examine all environmental documentation held there, walk over the site, and interview management and staff involved in the management of the company's environmental "footprint".
5. Carry out a gap analysis to define the extent of any missing information, and close any gaps by further investigation.
6. Produce a report identifying all environmental liabilities and regulatory non-compliances, and estimating the costs of addressing the liability and compliance issues.

Due Diligence auditing is a dynamic area of our business, needing seasoned consultants who understand a wide range of both business and environmental issues. We typically complete assignments in a matter of days or a small number of weeks, and report in real time on any deal breakers or significant findings. We provide full reports or shorter "table of issues and remedial costs" presentations where required by clients.

#### Phase 2 Methodology

The pace of transactions in today's world frequently ordains that Phase 1 investigations are the limit achievable within the timescale of the transactional framework. However, in cases where there are significant contaminated land or groundwater issues, and time permits, further intrusive investigations may be carried out. These may include geophysical investigations of sub-surface regions of the site and, most frequently, installation of boreholes and trial pits so that samples of soil and groundwater can be removed for chemical analysis. The investigation is scoped by the results of the Phase 1 and aims to delineate liabilities and inform any subsequent remedial work ("Phase 3") required.

#### **Other Audit Offerings**

Cambrensis carries out audits in response to other client drivers eg audits of compliance with legislation and company policy; environmental- or integrated management system audits; carbon management system audits; waste management audits; resource efficiency audits; sustainability audits.

#### **Further Information**

For further information or a confidential discussion on any of the above topics and services contact Dr Alan Fletcher, Managing Director, Cambrensis Ltd on 01584 811134 or 07532 244058 or email him at [alan.fletcher@cambrensis.org](mailto:alan.fletcher@cambrensis.org)