



What Every M&A Advisor Should Know About **Environmental Liabilities**

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An In-Depth Look at Environmental Liability Transfers (ELTs) within M&As

Companies holding environmental liabilities are exposed to far more financial degradation than the estimated cost of the cleanup itself. This is especially true if environmental liabilities become part of a merger and acquisition (M&A) transaction. The mere presence of environmental contamination can produce a virtual quagmire of unquantifiable risk.

Experienced transaction underwriters consider known contamination to be a reliable indicator that unknown issues are nearby. Even known issues that have been well managed are subject to future regulatory reopeners and potential toxic tort claims. Out of an abundance of caution, it isn't uncommon for buy-side underwriters to devalue a targeted company by \$25 million for every \$5 million in environmental liability held on its books. All too often this 5 to 1 environmental devaluation leads to the termination of an otherwise well-crafted M&A transaction.

The Use and Value of Environmental Liability Transfers (ELTs)

Many corporate holders of environmental liabilities are choosing to mitigate these risks through a transaction commonly referred to as an environmental liability transfer (ELT).

During an M&A transaction, ELTs are used to remove environmental liabilities from the pending transaction while providing both the buy-side and sell-side with robust corporate indemnifications from and against all future environmental liability.

Under current environmental regulations, remedial obligations are proactive and retroactive—any entity that has held an environmental liability at any time, regardless of their role in the contamination, is considered a potentially responsible party.

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It is estimated that \$1.2 trillion worth of environmental liabilities exists upon corporate-owned sites within the U.S. Therefore, M&A activity within the industrial sector will contend with the uncertainty of environmental risk for decades to come. That uncertainty can be removed through the use of ELTs.

A well-structured ELT removes environmental issues that are known, unknown, above

grade, at grade, below grade and on- and off-site (originating on-site and naturally migrating off-site), whether the issues occurred or were caused to occur in the past, present or future. In addition, most ELT providers will agree to sign applicable regulatory orders and indemnify transferors from and against potential future regulatory reopeners.

In comparison to the lost opportunity costs of M&A transactions that fail to go through, ELTs provide a relatively inexpensive solution. It isn't uncommon for an ELT to be priced at 50% less than the devaluations proffered by the buy-side underwriters. This is due in large part to the experience of the ELT provider whose sole business model revolves around bringing heavily contaminated sites to regulatory closure in a timely and cost efficient manner.

The following are three case studies that examine the risks environmental liabilities pose to M&A transactions and the benefits ELTs bring to the negotiation table. These transactions were performed by Environmental Liability Transfer Inc. (ELT Inc.), a leading third-party liability assumption firm involved in over \$1 billion USD of environmental liability assumption. Due to the complex nature of mergers & acquisitions, confidentiality has been given to the profiled companies.

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Case Study #1: Negotiations Stall Over Portfolio of Contaminated Properties

A European chemical manufacturing company (Buyer) with a market cap exceeding \$4 billion USD sought to acquire a U.S.-based chemical manufacturing company managed by a large U.S.-based venture capital firm

(Seller) for a transaction valued over \$200 million USD.

In the last stages of deal negotiations, the European Buyer discovered higher-than-expected levels of environmental contamination at four tracks of real estate formerly operated by the chemical manufacturing company. Located throughout the U.S. Midwest, these sites were impacted by years of chemical manufacturing activities.

Environmental liabilities included: three pre-regulated industrial landfills used to dispose chemical waste, soil and groundwater impacted by chlorinated solvents and other chemical contaminants; vacant and distressed facilities containing asbestos; and other environmental concerns. Additionally, two of the four properties were located in close proximity to residential areas, magnifying the Buyer's level of concern. Overall, environmental liability estimates exceeded \$10 million USD.

The Buyer determined the scale of environmental liabilities and unknown risks in the portfolio represented a risk to the Company that outweighed the benefits of the acquisition.

To save the deal, transaction attorneys for both parties approached Environmental Liability Transfer Inc. and requested that ELT Inc. purchase the contaminated real estate, assume all environmental liabilities, and close within 30 days. ELT Inc. was able to work with both parties to structure a transaction that involved taking fee simple title to the full portfolio of contaminated sites, assuming responsibility for the environmental conditions at the sites, indemnifying the Buyer and Seller from future remedial obligations, and planning steps for remediation and redevelopment.

After the environmental liabilities were removed from the transaction, the negotiations resumed and the acquisition progressed to completion.

Following the liability transfer, ELT Inc. commissioned affiliate company EnviroAnalytics Group (EAG) to commence environmental remediation and bring all sites into full regulatory compliance with state and federal agencies. EAG entered into voluntary and required remediation services agreements with the respective state environmental agencies and initiated the following remedial activities: significant soil treatment, soil vapor extraction, In Situ soil treatments and aggressive re-grading cap and cover activities. Three out of the four sites have been remediated fully and brought to regulatory closure; one remains active and is in the final stages of closure activities.

2 Case Study #2: M&A Nearly Collapses as Buyer Learns of Site's Migrating Contaminated Groundwater Plume

A billion-dollar commercial printing company in the U.S. (Buyer) sought to acquire a U.S.-based ink manufacturer (Seller). When the Buyer discovered the scale of the environmental liabilities held by the Seller, negotiations stalled and the transaction was in danger of collapsing.

The Seller owned a 120,000 square foot surplus facility located in Topeka, Kan., that had become an environmental liability. Decades of manufacturing activities resulted in a groundwater plume of chlorinated solvents that had begun migrating off-site, affecting adjacent properties.

Under EPA regulations, the new property

owner would be responsible for all associated environmental liabilities—which included the potential for compensating adjacent property owners for migrating contamination and diminution of value. The Buyer made it clear to the Seller that it wasn't willing to take on the environmental risks associated with this property and wouldn't close unless these environmental liabilities were removed.

The Seller reached out to Environmental Liability Transfer Inc. for liability assumption. ELT Inc. purchased the real estate, extended corporate indemnification to the Seller and Buyer, and assumed all environmental liabilities—both on- and off-site.

With the environmental liabilities and contamination migration no longer a concern, the deal progressed to completion.

ELT Inc. then began working with the Kansas Department of Health and Environment and affiliate consultancy EAG to initiate a plan for containment, remediation and redevelopment of the property. Five years after the transaction, groundwater contamination has been contained and full abatement is expected to be achieved by 2017.

3 Case Study #3: Potential Buyout Candidate Seeks Liability Transfer to Clean its Balance Sheet

In preparation to sell their business, a U.S.-based petroleum company (Company) began taking steps to better position itself as a more attractive buyout candidate by removing environmental liabilities from their balance sheet. Not only would this action improve the Company's valuation, it also would eliminate remedial obligations that would be passed on to a potential buyer.

The Company owned a site totaling over 100 acres site in the U.S. Midwest containing a facility previously used to process and refine crude oil. This facility operated from 1920 through 2003 and subsequently was shuttered for 10 years—resulting in a highly impacted, highly contaminated site restricted from future use.

The cost to remediate the environmental liabilities on this site exceeded the value of the property. As a buyout candidate, the Company wanted to remove all potential barriers that could dissuade a potential buyer.

The Company approached Environmental Liability Transfer Inc. to explore the option of liability transference. ELT Inc. took title to the contaminated site, assumed all associated environmental liabilities and indemnified the Company from future remedial obligations.

Weeks into the liability transfer process, the Company was approached by an interested buyer, a large North American energy infrastructure company. The interested buyer insisted on completion of the liability transfer prior to acquisition. Within 30 days, ELT Inc. acquired the property, assumed the liabilities and indemnified the Buyer and Seller from future remedial obligations—leading to the successful acquisition of the Company.

Following the liability transfer, ELT Inc. again commissioned EAG to commence environmental remediation and bring the site into full compliance with state and federal regulations. EAG entered into a voluntary services agreement with the state environmental agency and commenced a remediation and redevelopment plan.

Checklist for Vetting Liability Transfer Firms

Mergers and acquisitions and environmental liabilities are business elements with high levels of variability and complexity. When combining both into one transaction, a competent environmental liability transfer facilitator is critical to a successful transaction.

While there are many options for liability transference, we suggest vetting potential third-party liability transfer firms under the following criteria:

Financial Strength:

When choosing an environmental liability assumption firm, the financial stability of that firm is critical to a complete and final transfer of liability. A strong facilitator will provide robust corporate indemnification backed by a fully-funded remedial trust and insurance policy. Due to the unique nature of an ELT, which assumes obligations for known and unknown environmental liabilities, a competent ELT facilitator will allocate more than sufficient funds for full regulatory compliance. Be cautious of thinly-capitalized LLCs—before proceeding with a transaction, ask your ELT provider to open their financial documents to ensure required financial capacity.

Transaction Speed:

The terms and conditions of every merger and acquisition are different, but one thing is always valued: transactional speed and efficiency. During M&A transactions, the ability to close a real estate and environmental liability transaction quickly can make or break the deal.

Track Record:

Due to the complex nature of environmental liabilities, ELT facilitators must demonstrate a track record of success. An adept facilitator must demonstrate the ability to manage the entire process lifecycle and effectively turn environmental liabilities into productive community assets.

These case studies demonstrate the value that ELTs bring when environmental concerns occur during the M&A process—through a fixed-cost solution to highly-variable environmental problems, deal barriers can be removed and environmental risks eliminated. However, ELTs also have benefited corporations during divestitures, bankruptcies, crises of public perception, improvement of balance sheets and financial disclosures, PRP disputes and other matters related to corporate environmental sustainability and responsibility. The uses and benefits of an ELT in these situations will be explored in detail in future articles.

About the Author

Randall Jostes founded Environmental Liability Transfer, Inc. (ELT) in 2004 and currently serves as its Chief Executive Officer. Over the past decade, Mr. Jostes has greatly improved the landscape of brownfield remediation and redevelopment in North America by successfully assuming and repositioning over \$1 billion USD in environmental liabilities. His innovative approach has led to win-win solutions for environmentally-impacted real estate, helping clients navigate the complexities of environmental liabilities and improve their bottom line.



About Environmental Liability Transfer, Inc. (ELT)

Environmental Liability Transfer, Inc. (ELT) is a comprehensive environmental liability acquisition company providing its clients complete and final environmental liability transference services. With robust financial backing and a unique blend of expertise – real estate, environmental, legal, and insurance – ELT has successfully assumed over \$1 billion USD in corporate environmental liability for its clients throughout North America.

Contact ELT

If you have an environmental liability that you would like to discuss, or to learn more about the ELT option, please contact us for a confidential call (314) 775-0500 or email at sales@eltransfer.com.

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