EH&S Advisor

Doing the Deal

Part 3: ENHANCED Environmental Due Diligence

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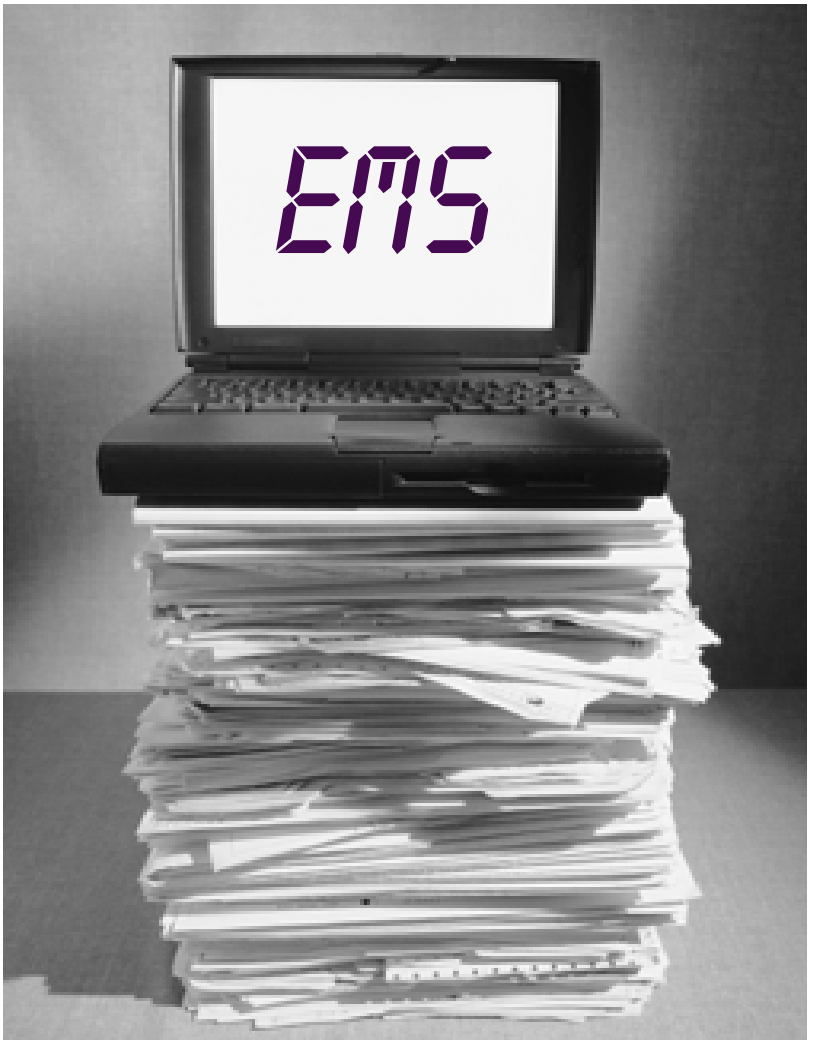
Providing support for major business transactions is arguably the most important strategic responsibility of an EH&S manager. The potential cost savings (if done correctly) or liabilities (if done poorly) can be enormous. A company may bet its future success on a single business acquisition or merger. Even purchases or divestments of plant and equipment can have a profound effect on a company.

This is the final installment of a three-part series on business transactions. In Part 1, we explored the politics of "doing the deal" and some best management practices of leading companies based on a survey by Competitive Environment. In Part 2, we examined specific approaches to business risk assessments. In this column, we analyze the value of environmental management system assessments in merger and acquisition activities.



As noted in Part 1 of the series, many mergers and acquisitions undertaken in the past five years have not achieved their planned business objectives. The record pace of business transactions will in all likelihood continue, so any means to help provide better shareholder return makes good business sense. A promising new approach is to incorporate a review of the environmental management system (EMS) during due diligence activities.

TRADITIONAL DUE DILIGENCE IS NOT ENOUGH

Why assess an EMS? There are two underlying reasons: First, one can minimize future liabilities by gaining an understanding of how the target company maintains environmental compliance; second, one can develop an action plan for successful assimilation of the two companies' operations. A standard Phase I ASTM Standard Practice for Environmental Site Assessments[1] assesses potential property liabilities, but sheds little light on potential future environmental operational liabilities and the resulting impact on business goals. The acquiring company may have higher environmental performance standards than that of the target company. Future resources (human and capital) should be factored into the evaluation of the deal. Dow Chemical, for instance, uses an EMS review during acquisitions to shorten the time needed to bring the acquired company up to Dow's standards.[2] Similarly, PPG Industries focuses on "managing the integration of an acquisition into the existing organization, deciding what will and won't be integrated, and devising a plan to accomplish it."[3]

The EMS review can provide a clear picture of current operations, especially if the EMS has been custom-built and thoughtfully integrated into the business. Basic business intuition tells one that well-managed companies are more likely to succeed. EMS programs can span a broad

spectrum, from a sophisticated system with elaborate data management and software systems to a simple environmental policy statement. Not surprisingly, several studies have shown that companies with successful environmental management systems have also been financially successful.[4,5]

FACTORS FOR ADEQUATELY ASSESSING AN EMS

We recommend that the EMS review and the Phase I due diligence audit be conducted simultaneously, since both activities involve much the same data and personnel. With an integrated approach, even the most sophisticated EMS review requires little additional time or disruption to site activities. On average, a typical EMS evaluation will add one day to the due diligence site visit and anywhere from $1500 to $3000 in costs, depending on the size of the facility and the extent of reporting.

The first step is to determine if an EMS even exists, and to what extent the EMS is integrated into facility operations. Ask for the environmental policy and goals for the target company. Some companies conduct environmental performance reporting that includes descriptions of environmental commitments, mechanisms implemented to ensure that commitments are made, and progress toward those goals; examples of such reports include those prepared by Bristol-Myers Squibb Company (*http://www.bms.com/EH&S*) and International Paper (*http://www.internationalpaper.com/EH&S*).

The EMS format and structure will indicate the level of sophistication of the EMS. Is the EMS a paper system, or is it managed, implemented, and maintained through an electronic medium? Is the EMS tied to a company-wide server? What are employees' responsibilities related to inputting data into the system to track metrics? How are the environmental goals tied to business objectives? How is progress toward those goals measured and evaluated?

Examine how the EMS is communicated. If the company is serious about its EMS, it will be communicated well. Do employees understand the goals of the environmental program? Do employees have specific roles and responsibilities within the EMS process, and to what extent? Are these roles adequately understood? How is information from operations that impact environmental compliance captured by the EMS? For example, a facility may have an air permit condition that requires the tracking of operational data. If this information is not being properly recorded, noncompliances could result in fines. If the systems are weak, then resources will need to be available immediately after the acquisition to correct deficiencies.

External stakeholder communications may give an indication of future issues that will consume resources or limit plant expansions. If existing programs are in place and a track record of open and honest dialogue has been established, this will help support future business objectives that may include new operational permits. If a troubled plant within a group of acquired assets can be identified early in the acquisition process, plans can be made to enhance external stakeholder involvement, such as open houses, community meetings, or working with the local media.

Sometimes resource issues may not be immediately obvious. For example, a global acquisition evaluation reveals that the target company's environmental program is managed by the corporate environmental group. After the acquisition, the plant environmental coordinators will require training and support because the acquiring company's environmental programs will be delegated to the plant level. Had it not been for the information gained during the due diligence assessment, successful assimilation of the two company's environmental cultures would be difficult, costly, and time-consuming.

The final factor to assess is the EMS audit and corrective action process. If identified deficiencies are left unresolved for years, it may indicate a lack of management's commitment to the EMS, or the inadequacy of the infrastructure to make required changes. Knowing this during the negotiation stage can help with the allocation of human and capital resources for use after the merger or acquisition.

EMS ASSESSMENT CANDIDATES

Not all mergers and acquisitions necessitate an EMS assessment. Likely candidates include

- a small privately held company being acquired by a large publicly traded company, because the small company may not have an established system;
- a target company with numerous environmental compliance problems—a good indicator that there is no EMS currently in place, or that the EMS is inadequate and will require attention;
- a target company's product has brand name recognition and customer loyalty worth preserving. A successful EMS can preserve this reputation, minimize negative publicity caused by an environmental mishap, and ensure that external stakeholders are informed through communication efforts (meetings, newsletters, annual reports); and
- a target company with global operations. Eco-Management and Audit Scheme (EMAS) and ISO 14000 techniques have been adopted more readily by companies with European operations, so it is likely that overseas facilities will have existing EMS programs in place. These programs may require integration.

CONCLUSION

Many challenges are present during merger and acquisition activities. Anything that can add value to the post-acquisition success is essential. Environmental managers are beginning to combine assessments of EMS programs during the due diligence process. An integrated approach that incorporates an evaluation beyond the standard Phase I audit allows early identification of resources and costs, resulting in better assessment of potential operational liabilities that could have a profound impact on future business success.

REFERENCES

1. *Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process*; ASTM E-1527-2000; American Society for Testing and Materials: Philadelphia, PA, 2000.
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PLEASE ASK, PLEASE TELL

Is there an EH&S topic you would like to address in *EH&S Advisor*? Do you have information to share with your colleagues, and are you interested in coauthoring a column on the subject? *EM* is very interested in your ideas. Please contact Richard MacLean by phone: (480) 922-1620, or e-mail: *maclean@competitive-e.com*.

EH&S ADVISOR CHECKLIST

Enhanced Environmental Due Diligence

1. Go beyond ASTM Phase I.

- The Phase I ASTM Standard was approved in May 2000 and incorporated business-related issues that can be included in due diligence;
- Include compliance evaluations to ensure that target facilities currently meet regulatory requirements. Also, identify upcoming regulations that may require capital (e.g., MACT standards for air emission sources); and
- Include an assessment of the target company's EMS. It is the link between environmental and business goals and defines facility roles and responsibilities.

2. The EMS evaluation can…

- Provide information to support the acquisition team during negotiations to reduce purchase price and assess potential liabilities;
- Support post-acquisition resource allocation (personnel and money); and
- Help develop a post-acquisition plan of action to address deficiencies.

3. EMS evaluation is best done during due diligence activities.

- Conducted by the same team that does the due diligence assessment, minimizing facility personnel time and disruption;
- Conducted cost-effectively and in a reasonable time frame to support due diligence negotiations; and
- Supporting early planning in the due diligence process, so resources can be defined once the acquisition is complete.

4. Several factors should be considered to adequately assess an EMS:

- EMS format: Is the system paper or electronic? What is the electronic format, and is it available through a company intranet?
- Personnel roles and responsibilities: Who has a role in the EMS, and what are the responsibilities of each person? How do responsible individuals interact with each other and the system, and what roles do operators and/or plant and corporate management have in the EMS?
- Goals and objectives: Are goals and objectives defined? How are they related to business goals? How are they communicated, and how are they measured?
- Training: Is training provided? Who gets trained? Is training adequate?
- Records: Are records maintained, if so where, and what is the records retention policy?
- Communication: Is there a communication policy within the EMS? What constitutes internal communication, and how is the EMS communicated to external stakeholders (community, media, shareholders, regulatory agencies)?
- Evaluation and corrective action: How is the EMS evaluated? How often are deficiencies noted and corrected? How are corrective actions documented?

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