ENVIRONMENTAL DUE DILIGENCE WITHIN MULTINATIONAL CORPORATIONS

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Superfund and other state and federal regulations that emerged during the 80's dramatically changed the way corporations managed property transactions. At the beginning of that decade there were very few engineers experienced in environmental due diligence. Over the past 15 years a sophisticated consulting industry has emerged to support companies in their effort to minimize liabilities associated with contaminated property. There is now a wealth of published literature on environmental due diligence, including generally accepted standards for investigating property contamination from organizations such as ASTM.

While the technical know-how has risen to meet the challenge, the internal corporate policies and practices typically have not. A recent benchmarking study of a broad array of multinational corporations has found a largely ad hoc approach is used for many transactions. The results of this survey are surprising in light of the heightened awareness by upper management on property contamination issues.

Few corporations have detailed internal guidelines or cross-functional communication networks to cover all transactions. Major acquisitions or divestitures are adequately covered. However, smaller business transactions such as leases, toll productions, and rights-of-way often receive little or no scrutiny, although they are potential multi-million dollar environmental liabilities. Control over international property transactions is especially problematic.

This paper examines the current state of environmental due diligence among multinationals. It presents the underlying reasons for the current ad hoc nature of due diligence investigations and what companies can do to improve their policies and communication networks. A summary is given of the best practices used by industry leaders to minimize liabilities.

INTRODUCTION

In the early 70's there was growing concern by the public over abandoned or poorly run hazardous waste disposal sites. Congress responded by passing RCRA (Resource Conservation and Recovery Act) and TSCA (Toxic Substances Control Act) in 1976. More and more problems were coming to light in the '70's in a piecemeal fashion, culminating with Love Canal being declared federal disaster site in 1978.

Around 1979 the House Commerce Committee's Sub-committee on Oversight and Investigation sent out a waste site questionnaire to the chemical industry. The Sub-committee was chaired by Congressman Eckhart and, thus, the questionnaire became known as the "Eckhart Survey". It was the first systematic survey of hazardous waste disposal at a national level.

Eckhart Survey - Congress Gets Involved

The Eckhart Survey targeted companies above a certain size in the chemical industry (28XX series SIC codes). In spite of its seemingly narrow scope, it captured a majority of waste sites, since the chemical industry contributed to most sites in the United States. The final report was an inch thick.

The questionnaire consisted of a letter requesting information on all current and historical sites used for the disposal of hazardous waste. The hazardous waste categories were very broad (e.g., inorganic, organic, pesticides, etc.) with the exception of one or two specific chemicals (e.g., dioxin and PCB's). Also requested were the locations of the disposal sites (including both on-site and off-site), type of operation (e.g., tank, lagoon, landfill, deep-well, etc.), and waste quantities. Back then companies did not keep very detailed records, so even if more detailed information had been requested, most companies would not have been able to supply the data.

The survey "shook up" industry because: (1) Congress was directly involved; and (2) For most companies it was the first time that management saw in aggregate how much had been disposed and, thus, the magnitude of their potential liability. The results also helped to motivate Congress to pass Superfund legislation (CERCLA) in 1980.

Of all the laws that were passed during the 70's and on into the 80's, Superfund and New Jersey's Environmental Compensation Responsibility Act (ECRA) have had the most far reaching consequences. Superfund is significant because it imposes strict liability (i.e., without regard to fault) and joint and several responsibility for hazardous waste contamination (i.e., collectively & individually responsible, without regard to relative contribution). ECRA is significant because it is the first state law to require actual site assessments before transfer or sale of all industrial or commercial property. Taken together, they focused management's attention on environmental due diligence and dramatically changing how corporations manage their waste and how they buy and sell businesses.

Every bit as important as these environmental laws, surveys and events was a dramatic increase in both the number and size of personal injury awards during the 70's and 80's. There are four factors that contributed to the exponential growth in legal liability costs: punitive damages, jury trials, and adversarial expert witnesses. These civil procedures, by and large, do not exist outside the United States, although some countries are moving in this direction.

This setting of laws, events, public awareness, and politics impacted how corporations in the US not only dealt with real estate when bought, sold or leased, but how wastes were managed on-site or at commercial facilities. For some corporate executives this was their first direct exposure to significant environmental issues. In addition to industry, the banking institutions in the US quickly moved to require "Phase 1 Environmental Assessments" prior to issuing loans. They, in fact, would no longer automatically foreclose on property, for fear of inadvertently taking on environmental liability as an owner.

Benchmarking Sources

The material contained in this paper is based on direct professional experience, published literature, discussions with several senior industry consultants, and interviews with individuals in 25 companies. For the most part, executive level individuals were contacted at corporate headquarters. In some companies environmental professionals were contacted at manufacturing sites to determine if the actual implementation of policy is consistent with the corporate view. Because of the sensitive nature of these interviews, the Competitive Environment may provide detailed contact and background information on a case by case basis, should anyone want to benchmark with these companies directly (Contact the author at 480-922-1620 or e-mail: maclean@competitive-e.com).

CURRENT STATUS

A substantial environmental consulting industry has been built in the United States around due diligence reviews and site remediation. The regulations and technical issues have become so complex that there are even consultants who manage remediation consultants. US-based consulting firms may lead the world in technical expertise in this field. In addition, there is an extensive collection of technical literature available in the US. The **Resources** section at the end of this paper contains a summary of some frequently referenced guidelines.

If there are problems for US corporations during property transactions (and there are), it is not due to a lack of available technical expertise. There is, of course, the omnipresent problem of locating the best consults for the job at hand. This issue was particularly acute in the mid to late 80's when the Phase 1 assessment process swung into high gear. Many consulting firms were getting into the business or expanding, but there were few engineers experienced in due diligence. The development of guidance documents, standards, and checklists has streamlined and simplified the process for "typical" property transactions. It still can be a problem for large, complex business transaction, if qualified consultants are not selected or in-house resources are not available.

While the technical expertise has risen to the challenge, corporate policies and practices have not. In fact, the Strategic Planning Group within a Fortune 100 corporation recently benchmarked the practices of other multi-nationals and were shocked to find the lack of rigid environmental controls on acquisitions and divestitures. The benchmarking conducted by the Competitive Environment confirms this finding.

Executives in corporations have a general awareness of environmental due diligence issues. Management typically utilizes a case-by-case approach, focusing on major acquisitions and divestitures. Most corporations assign a

senior level person(s) responsible for due diligence reviews. Rarely are there hard and fast rules, formal protocols, or sophisticated communications network. Banking institutions have established, however, more conservative and uniformly applied controls. For corporations who may not have to tie an asset to an external source of capitol, environmental due diligence reviews are not always automatic and thorough. Considering the enormous potential liabilities, this is very surprising.

There have been issues, generally of the following origin:

- The policies and the communication network are too informal. Potentially high liability issues do not receive adequate corporate review, because they are perceived by local management as "small business deals".
- The assigned due diligence person is not sufficiently high in the organization to intervene at the onset and/or does not have the power, authority, or will to affect the pending property transaction.
- The person is sufficiently high in the operation, but does not have an environmental background to fully appreciate the potential liabilities.
- Consultants or in-house resources do not have sufficient expertise to fully uncover the issues or utilize the information strategically in the contract negotiations for the business deal. In summary, the underling reason for current due diligence problems are:

    1. **Communications**
    2. **Expertise**
    3. **Authority/Accountability**

The **Table 1** presents a summary of typical program elements and a qualitative assessment of their current degree of implementation in the US. All large corporations perform some level of domestic acquisition and divestiture review of significant business deals. They may originate at corporate or be handled locally within the business groups. What separates the leaders from the others is the formality of the process, the technical competency of the review, and the strategic use of the information in the negotiation. The leaders include reviews of even small leases or joint ventures by competent environmental professionals.

PROGRAM ELEMENTS FOR SUCCESS

The following program concepts are a blend of successful program elements from all of the information sources researched for this paper. No company has all of these elements integrated into their policies and practices, nor should they necessarily attempt to do so. The overall concepts are universally applicable, but the specific approaches described should be customized for company culture and unique requirements. A summary of these best practices is contained in **Table 2**.

1. Executive level commitment

Management commitment is critical for success, probably more so than any single factor. This statement has become a cliché; every textbook on environmental management contains a similar claim. It is mentioned here for a reason that requires some background explanation.

Contaminated property can be very expensive to remediate with little or no positive return on investment. The extent and severity of the contamination are frequently not obvious; even the experts argue over how safe is safe and cost/benefit ratios. Most contaminated sites do not cause acute problems; they are long-term issues.

The issue is confusing, expensive, one sided (i.e., negative), and long-term focused. Major business deals have, however, been immediately killed because of these issues. It's human nature to look the other way and avoid the issue. It takes truly committed, visionary executive leadership to deal with these long-term issues.

Most executives who are willing to take on the challenge have had direct experience in struggling with contaminated sites. They fully appreciate the liability issues. The challenge to environmental professionals is to instill this same level of appreciation in executives without having them go through the expensive "learning curve." Executive briefings, benchmarking among peer executives, and financial analyses help convey these messages to management.

In the absence of any personal involvement or training in property issues there are two other reasons executives take a progressive approach. First, they may have a deep, personal commitment to environmental protection. Mark DeMichele, formerly of Arizona Public Service, is such a CEO. Second, some executives are extremely concerned about the company's environmental image because of the nature of their product line. Large drug and medical products corporations will often have this philosophy.

2. Central control / organization

General Electric is the largest diversified, decentralized corporations in the world. The control over property contamination issues is

one of only a handful of issues where there is strong corporate oversight.

Corporate oversight is usually established for two reasons. First, the issue may represent multi-million dollar liabilities for the company (e.g., In the case of GE, $80 to 110 million average annual expenditure as reported in the 1996 Annual Report). Corporations realize that there is a tension between the need for the business to achieve its financial targets and the need to spend money today to avoid long-term liabilities. Second, the issue is sufficiently complex to require specialized expertise not normally present in the businesses.

All of the benchmarked companies have some degree of corporate review, at least for major acquisition and divestitures. What varies tremendously is the extent to which the smaller transactions are reviewed. The best have rigid controls over all transactions, including leases. Some companies include EHS reviews of used equipment purchases. For large multinationals, it is not usually practical for corporate to be involved in deals as small as leases. The leaders have an established network of reviewers and custom procedures (typically a checklist/questionnaire to complete and forward to corporate or business group headquarters).

Another common feature is a line item sign off on all capitol expenditures. One of the preferred approaches is to link this sign off to the corporation's financial review process. Of course the individual signing for environmental due diligence should either be highly qualified or have specialized resources involved in the sign-off process. Problems may arise if the corporate officer of some other function (e.g., corporate council or manufacturing) signs for environmental. The political reality is such that by the time the project reaches the final sign-off, corporate staffs are reluctant to kill deals.

3. Communications network

It is extremely important that environmental due diligence is performed at the earliest possible stages of a business transaction. First, because the information can be used to better structure the deal to the advantage of the corporation. Even deals involving highly contaminated sites can be winners - - if this is known well enough in advance. Second, if a business deal moves too far forward, so much momentum has already been built behind the deal that the company may accept an unknown or unreasonably high liability risk. It also places the due diligence person in the unenviable position of upsetting a lot of executives backing the deal.

Corporate should be involved at the onset of any major acquisition or divestiture. Establishing communication procedures that draws in the corporate due diligence contact from the onset is not difficult. The best communications links are those established between the environmental department and the finance, business development or legal groups that handle these business transactions. Most routine property transactions, however, originate within the businesses. Corporate may not learn of them until they come up for financial approval. By then it is too late to avoid the issues just mentioned.

Most corporate groups use their network of environmental contacts in the organization to help surface and support due diligence reviews. What separates the leaders from typical companies is the:

- Extent of the reach out into the organization
- Formality of the communications network (i.e., accountability)
- Frequency of the communications up and down these channels
- Integration of the network with other business functions

Most large corporations have decentralized environmental organizations with a relatively small corporate organization. In large, multi-business/division corporations the corporate office is supported by a business/division group that reports directly to the business, not corporate. These business group organizations are supported by plant site representatives who may report directly to plant management, not the business group.

There are endless debates over the benefits of different reporting structures. In general it is better to have a decentralized system, because it places more direct responsibility on plant management for environmental protection. The challenge is to ensure that there are competent individuals all the way down to the site level. These individuals must have the integrity and the "air cover" to raise difficult issues to upper management.

Environmental networks within companies are generally well established, at least for the sites located within the United States. Setting up environmental networks outside the US has been problematic for most US-based multinationals. Some companies have used the approach of establishing designated country or regional contacts. These point contacts may cross business lines. Others use site contacts at their facilities in the countries in which they

operate. Where a group of facilities may be in close proximity to one another, there may be only one contact for all the sites. Establishing and maintaining communications with minority owned joint ventures are especially challenging.

4. Technical expertise

Properly performed due diligence reviews can save a company millions. It's a high stakes game. It is also a specialized one. There are numerous guides that are useful for routine transactions (see the **Resources** section), but these checklists are no substitute for experience. For large, complex international business deals many factors need to be integrated together into an overall assessment. For example, local laws must be evaluated to determined: how they are applied and enforced; how they may change in the future; and how they compare with international environmental laws, best management practices, and trends.

Industry leaders have in-house environmental professionals who are experienced in these issues. What they do not have are large staffs; the work load is too variable. Often it is a single senior level professional at corporate working the issue on an as-needed basis with support from staff professionals within the business groups. The in-house staffs use networks of consultants to handle the overload or any specialized issues.

Specialized expertise and experience is especially important during hostile takeovers or during major business transactions when there may be no time available to conduct even a Phase 1 Environmental Assessment. A hostile takeover may require that consultants conduct anonymous investigations of public records. Experienced professionals can use this information to estimate costs based on remediation costs for similar facilities within the same industry.

The leaders also have customized procedures for the businesses to use in evaluating routine property transactions. These procedures are of little value unless corporate also conducts training, formalizes the communications network, and establishes accountability. To pull the overall program together, it takes an individual with not only technical knowledge, but the interpersonal and leadership skills to work the network and communicate with management.

5. Knowledge of Current Operations

Another extremely sensitive area is the investigation of currently owned property. Ideally, companies should investigate their overall status and remediate the highest risk properties consistent with the business plan and available resources. To take this approach may, however, open a "Pandora's Box" of liability, regulatory and financial reporting issues that the company may be forced to immediately face. Companies are fairly open when describing their due diligence and internal audit practices, however, they are understandably cautious when releasing liability information.

US-based multinationals have a fairly good knowledge of their domestic issues because they were prompted by Congress starting almost a decade ago. Information on foreign operations is less extensive. In general, companies evaluate the relative risk of their foreign operations by benchmarking against known risks at domestic operations with similar processes. The sites with the highest risk potential are audited.

In summary, large multinationals have a general understanding of their property contamination risks due to a combination of:

- Internal surveys
- Government mandated surveys
- Due diligence activities
- Comparisons with similar operations
- Environmental, health and safety audit activities

Sites worth evaluating are those properties that are potential sources of the following significant, ongoing issues:

- Health risk exposure to the community
- Health risk exposure to employees
- Damage to ecosystems

or:

- There is a significant risk of future toxic chemical migration to population centers or environmentally sensitive areas.
- They will be involved in future events/conditions that trigger statutory requirements.
- They may be divested in the future.

In the absence of an established database, the only practical method to determine which properties may fall into the above categories is to conduct a screening evaluation.

Policy - Specific Approaches

Many corporations have thick policy manuals covering scores of topics in excruciating detail. Some companies have these in electronic format available through local area computer networks. The problem is that no one ever reads them. The current trend is to move away from this approach and create relatively few, high level policies that cover the most critical issues.

Typically only a page or two in length, each policy may be a stand alone document or may refer to more detailed implementation guidelines. This approach appears to be more effective because what is ***really*** important to the companies is not lost in all the trivia.

A due diligence policy should be clear and simple: Corporate reviews and approves all property transactions; either directly for all major ones or indirectly through an established network within the business following corporate protocols. No exceptions.

A policy for due diligence could be incorporated into the overall policy for environmental or into the policy for financial practices. The latter approach is superior, because it integrates the concept into the mainstream business practices. The policy for waste management would generally be integrated into the corporate policy for environmental, health and safety. Although the wording may vary from company to company, the essential elements of these policies are:

Due Diligence Policy - Example

All property transactions, including acquisitions, divestitures, joint ventures, and leases, must be reviewed and approved in advance by the [designated office] in accordance with guidelines established by [this office]. Any exceptions must be approved directly by the [Chief Executive Officer or President] of the Corporation.

Corporate attorneys are sometimes uncomfortable with unequivocal environmental policies. First, because they may require a standard of practice higher than local country requirements. Second, because they may add support to punitive damages in a lawsuit, if it can be documented that the company did not follow its own policies. Policy statements that are ambiguous or overly qualified present, however, a greater downside risk: they may allow some managers to focus on short-term goals and possibly, engage in practices that generate long-term liabilities (that hit after they move on to their next promotion).

RECOMMENDATIONS

Taking a proactive approach to managing property transactions and remediation issues can have long term benefits. **Table 3** contains some of these reasons. As an EPA manager in Washington, DC once said "Fix it yourself or get regulated." Here is a suggested plan of attack:

1. Benchmark more extensively

This paper represents, we believe, an accurate snapshot of US-based multinationals. But, it's only a snapshot. Consider establishing an in-depth benchmarking project to add details on specific policy and program elements beneficial to your company's specific industry.

2. Develop guidelines for due diligence reviews

Consistency can be established in due diligence reviews by using only one in-house professional/group or external contractor for all business transactions. This is impractical for large multinationals. The leaders have customized protocols to insure consistency. Consider developing your own.

3. Establish a network of technical expertise for:

a) Site remediation
b) Commercial waste site auditing
c) Manufacturing facility auditing
d) Due diligence reviews

Even the largest multinationals do not attempt to do everything in-house. The field is too specialized. Although each of the four areas listed above are related, they require different skills and approaches. The leaders look beyond "name brand" consulting firms with the most impressive marketing techniques. They target specific individuals and teams within consulting organizations and build long term relationships. Consider doing the same. Find out who are the best people, in addition to the best firms.

4. Establish a baseline assessment protocol

One of the greatest risks for multinationals is to have significant ongoing health, safety and environmental issues and ***not be aware of them***. For just this reason, some multinationals conducted screening assessments in the wake of the Bhopal disaster. Their focus was on the potential for catastrophic accidents.

Conducting a screening assessment of property can be, however, problematic if done improperly Investigations that are not well planned may trigger remediations -- not based on actual health and environmental risk but because of regulatory intervention, politics, management overreaction, and/or public fears. Additionally, discoverable records may be created that later give birth to punitive damages in a lawsuit or negative publicity. There are methods to conduct these investigations, but they require a different protocol than Phase 1 Property Assessments.

About the Author

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RESOURCES

1. Environmental Due Diligence Guide
Subscription Service, Two Volume 3-ring Binder, $674/ yr.
Bureau of National Affairs, Washington, DC,1-800-372-1033
Updated monthly

2. Environmental Liability and Real Property Transactions: Law and Practice
by Joel S. Moskowitz
Hardcover, 1995, $125.00 (includes 1996 supplement)
Wiley Law Publications, Somerset, NJ,1-800-225-5945

3. Environmental Liability Transaction Guide: Forms and Checklists
By John Tarantino
Hardcover, 1992, $125.00 (includes 1996 supplement)
Wiley Law Publications, Somerset, NJ, 1-800-225-5945

4. Environmental Site Assessments for Commercial Real Estate: Standard Practice E1527 &1528
By ASTM Standards
Paperback (2nd Edition), 60 Pgs., 1994, $46
American Society for Testing Materials, Philadelphia, PA, 215-299-5449

5. User's Guide and Software Package for ASTM E 1528-93
by Anthony J. Buonicore
Supports Standard Practice Transaction Screen E1528
Software and user guide, 1995, $99
American Society for Testing Materials, Philadelphia, PA, 215-299-5449

6. Environmental Liability in Commercial Property Transactions: Risk and Responsibilities
By Real Property, Probate and Trust Section
Paperback, 1994, 352 Pgs., $90
Publishes by American Bar Association, Chicago, IL, 312-988-5000

7. International Business Acquisitions: Major Legal Issues and Due Diligence
By Michael Whalley and Thomas Heymann (Editors)
Hardcover, 1996, 392 Pgs., $110
Kluwer Law International, Cambridge, MA, 1-800-577-8118

8. Environmental Site Investigation Guidance Manual Committee Report No. 83
Paperback, 141 pgs., 1995, $27
American Society of Civil Engineers, New York, NY, 212-705-7179

9. Environmental Regulation of Real Property
By Nicholas Robinson
Loose-leaf, 1,000+ Pgs., Updated in 1996, $110
New York Law Publishing Company, New York, NY, 212-779-9200

Program Elements

Table 1

Element	Frequency
Point Contact	
Business Level	Common
Corporate Level	Common
Capitol Sign-off	Common
Communications Network	
Informal/Position Derived	Common
Formal	Not common
Policy	
Informal/word-of-mouth	Common
Formal/written	Often
Technical Expertise	
Consultants Primarily	Common
In-house Contact + Consultants	Often
Internal Teams + Consultants	Often
Guidelines	
Consultant or Available Literature	Common
Custom Developed	Not Common
International Sites	
Reviews of *major* A&D's	Often
Formal Policy	Rare
Formal Network	Rare
Formal Guidelines	Rare

Due Diligence Best Practices

Table 2

Best Practice	Comments
Corporate oversight and leadership	• All of the leaders exercise some degree of central, corporate control over the process. • Oversight is *not* the same as the direct corporate management of all due diligence projects.
Executive backing	• Absolutely essential because of the organizational level at which business transactions occur.
Strong corporate policy direction	• Policies typically are in writing; all are communicated with the intent of changing the culture so practices are automatic and ingrained.
Cross-functional teams conduct reviews	• Teams foster greater communication across functional groups. • Large projects are typically organized and carried out case-by-case. • Smaller projects are typically done by an in-house technical expert plus consultant(s).
In-house technical expertise available	• Larger companies have a small corporate group assigned full time. • Most detailed engineering is contracted out. • Individual company business groups typically use their own technical resources on an as-needed basis supplemented by corporate specialists.
Corporate "Veto power"	• Corporate can veto any deal, however, the level of control varies considerably: Some require an "approval" by a corporate VP; others require a "non-objection" sign-off; others monitor activities and intervene in property transactions that may represent a high risk to the corporation.
Work performed within corporate EHS organization	• It does not seem to matter where the corporate property oversight function resided - Overriding considerations are: executive support, accountability, clarity of process, communications, and technical expertise.
Coverage: Acquisition, Divestitures, Leases, JV's, Toll Production, and Rights-of- Way	• The leaders recognize potential liability and focus on the most significant risks. • The leaders try for 100% capture of **all** categories, but admit difficulties with smaller, especially overseas projects. • Guideline documents and training are important tools to improve coverage.
Corporate understanding of significant risk / liability issues	• The leaders have a fairly good understanding of their significant risk issues through a variety of information sources. • Some have undertaken carefully structured surveys to identify their most significant risks.
Written procedures and guidelines	• A larger centralized group of technical expertise may be required, if no written guidelines exist. • Many leaders are just now moving to formalize their best practices. A few are already there.
Active communications network	• Individual(s) are assigned to geographical regions or business groups to coordinate activities with corporate.
World-wide best practices	• Moving in the direction of functionally equivalent performance standards.

Top 10 Reasons to
Proactively Managing Site Contamination

Table 3

1. Identify and correct environmental problems to reduce the potential for:
    - Civil and criminal liability
    - Litigation
    - Fines
2. Acquire information for financial & strategic planning and prioritize needs in relation to resources.
3. Maximize property value for potential divestitures.
4. Provide accurate cost projections to meet financial accounting standards and disclosure regulations.
5. Identify strategic issues that may preclude facility expansions or diminish the perceived value of businesses.
6. Enhance the company's reputation in the community and with regulators.
7. Increase shareholder value.
8. Gain critical data that will greatly improve the company's negotiating position on acquisition and divestiture business transactions.
9. Allocate responsibility for liability issues between the company and the owners of divested company property
10. Avoid liability problems with toll production, joint ventures, and lease arrangements.