

Environmental Risk Transfer Solutions for Mergers and Acquisitions



The ARMR Toolkit™

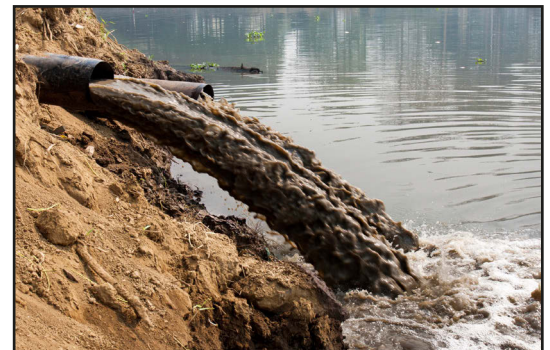
Your Environmental Insurance Resource

In every business transaction, buyers want to be assured of what they are buying. In the context of mergers and acquisitions, environmental liability is an elusive issue to evaluate and quantify. The strict, joint, several *and retroactive* nature of environmental liability for releases of hazardous substances creates uncertainty because it attaches not only to current, but also past operations of a business. Environmental due diligence, although pervasively performed is notoriously inaccurate. Most environmental due diligence studies performed by technical experts are too focused on known issues and pay just cursory attention to potential issues. These studies often fail to evaluate current operational and product-based environmental risks. Undefined and unmanaged environmental risk makes it difficult to successfully purchase or sell an enterprise. Defining what potential financial loss environmental liability poses is essential to properly value and structure a transaction. American Risk Management Resources Network, LLC (ARMR) is an expert at environmental risk identification, evaluation and treatment. We assist in defining environmental risk to aid in the successful transfer of equity and assets.



Benefits of Effective Environmental Risk Management

- Defines the known risks and their cost of treatment so that true deal valuation can occur
- Protects directors and officers from liability
- Protects shareholder value from unexpected costs
- Simplifies the transaction by transferring risk to a well-capitalized insurer
- Reduces post-transaction representations and warranties litigation
- Increases the success rate of transactions with significant environmental issues



The ARMR M&A Process

Risk Identification and Evaluation. There are five categories of a business's operations that need to be evaluated for environmental risk. Each of these is reviewed for both current and past legacy operations.

1. Real Property

Each property that a business owns or owned in the past is evaluated for environmental risk potential. If an environmental release has occurred, its response, regulatory status and estimated cost of closure is evaluated for accuracy. Environmental audits, inspections and technical reports for known releases are reviewed to ensure that they are comprehensive and accurately portray the level of risk at each property.



2. Services

A company that has off-premises operations may have a completed-operations exposure. Current and past services are evaluated for their potential to cause a pollution event.

3. Products

It seems that each year some product is discovered to have a latent toxicity defect. From sulfur in drywall to PFOA in fire suppression foam, a review of a company's current and past products will be reviewed to see whether it contains known or suspected pollutants or has the potential for dispersing them as in the case of tank valves or lining materials.

4. Waste Management

Waste that has been transported from current or past properties can be the source of future liability. Documentation of a company's waste disposal practices including transporters and disposal sites used is necessary to measure the risks they pose.

5. Agreements

Often overlooked, a company's agreements need to be reviewed to see whether risk has been affected by them. From financial guarantees to lenders, contractual indemnities to or from customers or vendors, past insurance contracts and even past retention of liability from sold assets are evaluated to see whether they need to be part of the environmental risk management program.

Risk Treatment

Risk treatment is the handling of risk. You can avoid, mitigate or transfer it. Known contamination still contains several "unknown" risks – How much will it cost to remediate? How long will it take to remediate? Have others been injured by the contamination? For the potential injury liability from known contamination, Environmental Impairment liability insurance is available and is described later. For known pollutant remediation cost, there are multiple solutions for defining its cost:

1. Cost Cap Insurance

Once a vibrant product that receded for 5 years, cost cap insurance is again now available. It provides for insurance against costs that exceed their estimate plus an agreed-upon self-insured "buffer" amount.

2. Third Party Liability Buy-Outs

There is a cottage industry of technically savvy companies that will purchase environmental liability and even the real property associated with it. These transactions require strict scrutiny, but have proven to be successful in offloading idle assets and the liability associated with them.

3. Guaranteed Fixed-Price Remediation Contracts

There is another cottage industry of mainly environmental consulting and contracting firms that will agree to remediate known contamination for a fixed price and absorb unexpected cost escalation.

4. Transfer to a Third Party with Excess of Indemnity Insurance

At times, contractual risk transfer with a non-insurance entity (perhaps to the buyer or retained by the seller) is an efficient disposition of an issue. Excess of indemnity insurance is available to cover gaps in the indemnity or an amount in excess of it if there is a monetary limit.

For each of these risk treatments, ARMR provides support in evaluating their value and security. We have extensive experience in dealing with each treatment and offer advice regarding their effectiveness, value and acceptable terms.

The most cost-effective means of risk transfer is the purchase of liability insurance for unknown occurrences. There is a very active market for both pollution liability and products liability insurance.

1. Environmental Impairment Liability (EIL) insurance

These policies cover both personal injury (bodily injury and property damage) as well as clean-up costs. These claims-made policies can cover legacy issues (i.e. historic releases) as well as future ones. Many enhancements to these policies broaden their scope to cover:

- Non-owned disposal sites
- Transportation liability for waste and product transfer
- Emergency and crisis management costs
- Business interruption costs caused by pollution conditions
- Personal injury for known contamination
- Reopener coverage for remediated contamination
- A lender-specific policy to offset financial guarantees a party may have to its financier.

Currently, you can procure over \$250MM in environmental liability insurance limits for a period up to ten years. There are over 40 insurers that provide EIL insurance although only ten are suitable for the M&A context. Each provider has its own appetite and offerings. As a broker active in this sector, we identify the markets for which successful placement is most likely.

2. Products Liability Insurance

Products liability insurance is a commonly available insurance product. However, most products liability insurance policies exclude pollution liability. A review of the selling business's occurrence-based products liability insurance policies will reveal whether there are gaps in coverage that can be covered with insurance that affirmatively covers the pollution-products liability.



Summary

An analytic approach to defining and treating environmental liability risk inherent in a merger or acquisition will ultimately save time and costs. By effectively identifying risks and converting them into concrete costs of either mitigation efforts or transfer, a company can be more accurately valued. Besides monetizing the risks, the cost-savings in avoiding litigation and increasing the success rate of any transaction reduces the friction costs of conducting the deal.

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Honesty | Integrity | Knowledge | Excellence | Accountability