

FOREIGN DIRECT INVESTMENT AND ENVIRONMENTAL DUE DILIGENCE IN CENTRAL AND EASTERN EUROPE

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Abstract

Since the political changes there has been steady increase in Foreign Direct Investment into the Central and Eastern Europe. As a standard practice of property transactions within the European Union (EU) and USA, the investment capital companies require environmental due diligence to establish potential environmental risks associated with the transaction. In this region due diligence is not always conducted unless the investing party is EU or USA based, despite the fact that contaminated land regime legislation of the EU membership applying countries is, in principle, aligned with that of EU members. A critical part of any due diligence project is to assess both historical and current site operations and establish if these processes may have resulted in a release into the environment. With pending EU enlargement it is equally important to establish how operating sites fit into the EU EH&S regulatory framework and provide investment companies with cost estimates to meet control standards. This paper presents a rationale behind the due diligence requirements and highlights the differences in conducting such activity within the EU and Central/Eastern European region. It compares sources and availability of necessary historical and regulatory information between the regions and introduces use of GIS tools in such assessments.

Introduction

Between 2001 and 2003 the transition countries have attracted approximately USD 30 billion of Foreign Direct Investment (FDI). It is mainly because the investors see the region as “good value for money” in the current economic climate. To assess potential liability associated with acquisition of a company the investors would conduct a due diligence process. Most investors are likely to undertake due diligence reviewing obligations resulting from the target company financial, contractual and personnel commitments of prior to completion of the deal. However, it will be only be the experienced or multi-national investors who would request an environmental due diligence be conducted at the target company facilities. These companies understand the potential obligations resulting from the subject property environmental conditions as potential liability and seek to limit such a risk. Whether their understanding is driven by their domestic regulatory experience or their desire to understand more the regulatory system in the target country, they certainly are not wasting their efforts. It is less known fact that the principles within the contaminated land regime in the most EU accession countries are no different to those within the EU countries or USA. That is – the polluter pays, and in the event that polluter cannot be found (e.g., no longer exists), such responsibility is transferred onto the current landowner.

In view of the fact that property’s environmental condition is a factor of its historical use, operating practices and underlying geology and hydrogeology, and that a potential contamination may be ongoing for many years before it is realised, the environmental due diligence should be an indispensable part of any transaction that includes real estate property. The reality is that environmental due diligence on property transactions (often incorrectly termed ‘Environmental audit’) is not conducted unless the investor is an EU or US based company.

Methods and Results

Environmental due diligence can have a number of formats. The client would often specify the scope of work to follow a certain standard:

- American Society for Testing and Materials, ASTM E1527-00⁽¹⁾ Standard Practise for Environmental Site Assessment – very prescriptive in stipulating what public databases (US

specific) have to be reviewed during the Phase 1 process and therefore not possible to comply with on projects outside of USA.

- International Organisation for Standardization, ISO 14015⁽²⁾ Environmental Assessment of Sites and Organisations – Although it could be termed as an international equivalent of the above ASTM standard, it is broader and less prescriptive.
- Client Specific Standards

Environmental due diligence, in RSK ENSR's experience, is not routinely conducted on property transactions in Central and Eastern Europe, unless the client is EU or US based. Need for environmental due diligence is often excused by stating that there is not sufficient information to conduct such a study and/or that the time necessary to complete it would exceed the available transaction deadlines, and being expensive. When conducted, the environmental due diligence is often undertaken by non-native consultants, who may not understand the complexity of environmental regulations within the target country.

On projects within EU the consultants will often have restricted access to property-specific data and would therefore rely on data within public domain - regulatory databases. However, the uniformity of available public domain data makes the assessment and interpretation easier. In Central and Eastern Europe, there is often lack of central regulatory databases as information is held at local or regional level. This results in the work being often more labour-intensive. Furthermore, such data can be omitted from the assessment, as non-native consultants may not be aware of existence of such information.

The above opinion can be best demonstrated on a case study when US multinational partnership was considering acquisition of a portfolio of commercial properties within the Czech Republic. A non-native consultant conducted the initial due diligence study and failed to fully identify historic activities at some properties of the portfolio. Subsequent research of publicly available data by RSK ENSR identified former military use at one property with recorded former fuel storage, vehicle maintenance and known soil and groundwater contamination.

The countries of Central and Eastern Europe often have well defined and functioning mechanisms to gather and record information from the previously conducted assessments (geological/hydrogeological surveys of regional character, local and site-specific geotechnical and environmental studies). Such information is then available within public domain and provides invaluable information, often specific to the site under investigation. Again, in this instance, this information may remain undiscovered by non-native consultants.

Numerous privately owned companies have recently invested into the data acquisition and hold large databases of publicly available data (geology, hydrogeology, topography, hydrology, groundwater vulnerability, protection zoning, etc.). Such data is often stored within a powerful Geographical Information Systems (GIS) and can be a very valuable, flexible and cost-effective source of information.

Conclusions

Increased investment will lead to increased due diligence and its importance will grow under the current regulatory framework. The improved regulatory enforcement will shape up the behaviour of transacting parties. The countries of Central and Eastern Europe provide sufficient information necessary to conduct an environmental due diligence and such study can be conducted within the available transaction time frame. It is just a question of knowing where to find the necessary information.

References

- (1) American Society for Testing and Materials, ASTM E1527-00 Standard Practice for Environmental Site Assessment: Phase 1 Environmental Site Assessment Process, (2000).
- (2) International Organisation for Standardization, ISO 14015 Environmental Assessment of Sites and Organisations, (2001)