

### KNOW WHAT YOU ARE BUYING – HAZMAT DUE DILIGENCE IN PRIVATE EQUITY



#### OVERVIEW

A manufacturer of a smoke producing pyrotechnic device had been operating for nearly 50 years under the assumption that its product was unregulated. About 15 years ago, a private investor purchased the company with no awareness of potential regulatory implications.

Five years ago, a United States Department of Transportation (USDOT) investigator inspected the facility and determined that the device should be classified as an explosive. The investigator informed the company that shipments could not continue until an explosive (EX) approval was obtained. This unexpected ruling disrupted operations, created significant cost increases, and forced changes in distribution. HazMat Safety Consulting (HSC) was engaged to secure approvals, educate stakeholders, and mitigate long-term risk.



#### THE PROBLEM

When the product was unexpectedly reclassified as an explosive, the company encountered a series of obstacles that went far beyond what had been anticipated during the acquisition.

- **No awareness of regulatory exposure:** The investor had no idea that the product was, in fact, a hazardous material. This lack of knowledge meant that every piece of pre-purchase planning around transport, warehousing, and distribution was immediately outdated once the USDOT issued its ruling.
- **Regulatory shock:** USDOT determined that the device was an explosive requiring an EX-Approval. The company was told that shipments could not continue until this approval was secured, essentially bringing all distribution to a standstill.
- **Escalating costs:** Once classified as hazardous, shipping costs rose by more than 50%. On top of that, many transportation partners simply refused service, as they were not equipped or authorized to act as hazardous materials carriers.
- **Retailer withdrawals:** Insurers for long-standing retail partners prohibited them from warehousing explosives of any kind, regardless of the actual low-risk profile of the product. This forced some of the company's oldest and most loyal retailers to stop carrying the product entirely.
- **Disrupted business assumptions:** Years of transport strategies, warehousing agreements, and logistics arrangements were invalidated, creating major operational inefficiencies.
- **Profitability erosion:** The financial expectations that had supported the acquisition quickly fell apart, as margins were overtaken by increased costs, reduced customer access, and shrinking distribution channels.

## THE SOLUTION

HSC provided the regulatory expertise and structured approach necessary to bring the company back into compliance while also creating long-term strategies to reduce the impact of the explosive classification.

- **EX-Approval secured:** HSC successfully obtained an EX-Approval (Division 1.4S) from USDOT. This action alone enabled the company to legally resume shipments that had been frozen, protecting it from further financial losses.
- **Education and outreach efforts:** HSC worked extensively with logistics partners and retail customers to clarify the true risk profile of the product. While classified as an explosive, the product presented far less hazard than most items in the same category. These conversations helped reduce confusion, reassure business partners, and rebuild confidence.
- **Direct regulatory engagement:** Drawing on deep experience with the classification system, HSC engaged directly with USDOT to begin the labor-intensive process of pursuing reclassification. This step was not only critical for cost savings but also positioned the client's voice to be heard at the policymaking level.
- **Strategic compliance guidance:** Beyond approvals and paperwork, HSC advised the company on how to adapt its operations, adjust warehousing approaches, and navigate the insurance implications of being classified as an explosives manufacturer.
- **Leveraging relationships:** Because of HSC's longstanding connections with regulators, the company had access to decision-makers who were empowered to evaluate whether the product's classification could be reconsidered.

## RESULTS

With HSC's expertise and direct regulatory engagement, the company achieved several key outcomes:

- **Resumed shipping:** Legal approval restored the ability to distribute the product.
- **Customer reassurance:** Education efforts prevented further unnecessary loss of logistics partners and retailers.
- **Pathway to reclassification:** Opened the possibility of reducing future transportation and storage costs.
- **Regulatory access:** HSC ensured the client's case was considered directly by decision-makers within USDOT.

## CONCLUSION

The product manufacturer's experience underscores the risks of overlooking hazardous materials compliance during acquisitions. This case highlights how investors can be blindsided when compliance risks are overlooked. A product long assumed to be unregulated was suddenly classified as an explosive, derailing the original investment strategy. While HSC helped stabilize operations, the lack of hazmat due diligence at purchase led to lost customers, higher costs, and reduced profitability.

### Importance of due diligence

A hazmat due diligence audit could have prevented these issues:

- **Pre-sale clarity:** The seller could have been required to secure a classification determination from USDOT.
- **If explosive:** The buyer could have negotiated a lower purchase price or reconsidered the acquisition.
- **If proven low risk:** The company could have avoided years of added costs and business disruption.

### Lesson for private equity

**investors:** Hidden compliance risks can drastically reduce the value of an acquisition. HSC helps investors uncover these risks, quantify liabilities, and protect portfolio value before deals are finalized.