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# A Better Real Estate Deal Through Enviro Due Diligence

Law360, New York (February 9, 2016, 11:00 AM ET) -- In any transaction, unless environmental due diligence is sufficient to reveal existing issues and provide a basis to determine associated costs, at least one party may not end up getting what it bargained for. Where a transaction involves real estate, whether it is a merger, acquisition, real estate purchase, sale, lease or financing, environmental obligations and liabilities will be allocated between the parties. The allocation will be accomplished through representations and warranties, indemnities and covenants, sometimes setting "caps" and "baskets" for recourse, and may involve escrowing funds to cover future environmental costs. Determining and assessing the environmental issues, liabilities and costs is essential in order to appropriately frame the business deal and the contract provisions.

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Selecting an appropriate environmental consultant, setting the correct scope of work, negotiating acceptable terms and conditions for performing the work and ensuring that the consultant's final reports advance the client's interests are all important steps in the due diligence process, as follows.

## 1. The Consultant Selection

A local consultant may be best for a deal with a single property, but due diligence on a transaction involving properties in multiple jurisdictions is usually best managed by a national consulting firm with local offices. It is important to have a single point of contact to lead the project and ensure consistency, but the quality of each individual project manager conducting the investigations and preparing the reports is the most critical. Ask questions about the particular personnel involved. What relationships do they have with the relevant state and federal agencies? Are the consultants involved in environmental agency work groups so they know first-hand the agency's current and planned future regulatory focus? And in jurisdictions like Connecticut, Massachusetts and New Jersey with "privatized" programs, make sure the project staffing includes a state-licensed professional, unless specifically prohibited in the particular transaction (some selling parties will not allow use of a consultant whose license mandates independent reporting obligations). In the end, the consultant should be someone who is able not only to marshal technical information, but also to accurately outline the regulatory process and the expected costs required to address any findings of the investigation.

## 2. The Scope of Work

The contract with an environmental consultant consists of two parts: the proposal that sets

the scope of work, cost and schedule, and the consultant's standard terms and conditions. Both documents can and should be negotiated.

Environmental due diligence typically begins with conducting a Phase I Environmental Site Assessment under American Society for Testing and Materials Standard E1527-13. It is possible, however, for a report to technically comply with the ASTM standard and still fall short in assessing site conditions. For example, consultants often rely on database entries and assumptions on groundwater flow direction rather than reviewing state files to determine whether off-site releases from dry cleaners, gas stations and other properties of concern present an actual risk and warrant further investigation. Assessments of asbestos, wetlands, radon, mold, lead paint and compliance with permitting requirements are not required by the ASTM standard, so those need to be specifically requested if desired. Additionally, vapor intrusion is a hot topic now with regulatory agencies throughout the country, but often is inadequately addressed in Phase I reports. Setting clear expectations at the outset will result in a better report and avoid delays (a particular issue when a report is received just before the due diligence deadline) from having to revisit issues that were not adequately addressed. Finally, make sure the consultant understands and can knowledgeably assist in taking advantage of any liability protections available under state brownfields laws.

## 3. The Terms and Conditions

Not surprisingly, the boilerplate terms and conditions appended to a proposal are heavily weighted in favor of the consultant, often providing very little recourse for the client if the consultant misses something. Terms including limits of liability, availability of insurance, ownership of documents, standard of care and client responsibilities usually all require some revision to protect the client.

## 4. The Reports

It is important to review and discuss with the consultant a draft of any due diligence report, whether a Phase I, Phase II (subsurface testing) or compliance audit, before the report is finalized. Often, the draft is first reviewed by the client's environmental attorney to assess not only what is in the report, but also what information and analysis should and should not be in the report. A report is most helpful when it succinctly discusses and also attaches relevant documentation, such as correspondence with state agencies, use restrictions and former investigations. Conclusions must be clear. Specific recommendations are often useful to the client, although there may be good reason to keep those out of the report and in a separate document. The consultant should assess regulatory closure that occurred many years ago through the lens of today's closure standards. For example, certain chemicals are now known to be more toxic than thought to be a decade ago. And older regulatory closures did not address vapor intrusion, which is currently a particular focus of state and federal environmental agencies. Finally, a draft report may dismiss some contamination because it is not "reportable" under state law. This conclusion will not be helpful to the client if the contamination presents an actual human health risk, or will result in additional development costs for handling and disposal of contaminated media. The final report needs to include all information and analysis required to meet the client's objectives.

## 5. Other Considerations

In the event a due diligence investigation reveals a release that will require a clean-up, the consultant should put together a remediation cost proposal that lays out the regulatory process, cost and timing. Before the consultant begins that exercise, the client will want to provide direction. For example, there may be different paths to regulatory closure depending on whether brownfields liability protection is important to the parties. There may be significant differences in timing and costs, depending on which regulatory option is pursued. Having that discussion at the outset will help the consultant frame the analysis to

provide the most useful advice.

## Conclusion

Finally, while insurance products are available to manage the risk of environmental liability, insurance is not a substitute for good due diligence. Policies are limited in term, contain exclusions, include deductibles, carry the risk that a claim may be denied and are more expensive when less information is available about the property to be insured. Closing a deal with insurance instead of conducting adequate due diligence means that the party bearing the future risk has lost the opportunity to bargain with the other for a price reduction. The better course is to conduct thorough due diligence, negotiate from a position of greater certainty, and after that, if necessary, obtain environmental insurance to account for unknown liabilities.

Managing the due diligence process from the outset will result in documentation that best advances the business and legal negotiations between the parties. Ultimately, that documentation will support a more favorable outcome where risks are properly identified and allocated, avoiding surprises after closing.

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