



Environmental Due Diligence and Risk Allocation: A Focus on Vapor Intrusion

Seth D. Jaffe

EDR Due Diligence at Dawn

April 11, 2012

New Title: Due Diligence at High Noon



Or: Bad Day At Black Rock



Environmental Due Diligence

Environmental Due Diligence is a Subset of Overall Due Diligence

- Purpose: Help client value assets and quantify risk as to individual matters and in the aggregate
- Sometimes handled exclusively by environmental lawyers from outset of transaction
- Sometimes the business lawyer kicks it off and then involves the environmental lawyer
- Given the plethora of laws (federal, state, and local) and the potentially high financial stakes, it's advisable to involve an environmental lawyer early on (and the next time it happens, will be the first time it happens!)

Results of Due Diligence

- Establish baseline of information for:
 - Evaluating suitability of asset for its intended use
 - Evaluating risks
 - Defining costs
 - Securing financing
 - Allocating liabilities between the parties
 - Negotiating indemnities and other contractual provisions
 - Obtaining insurance
 - Obtaining brownfields liability relief

- Occasionally deal breaker (but more often just blamed as a deal breaker)

Addressing Vapor Intrusion

- E 2600-10, Standard Guide for Vapor Encroachment Screening on Property Involved in Real Estate Transactions (ASTM - June 2010)
- ASTM has become the standard for property due diligence, so it is likely that the VI guidance will similarly become routine. However →
- Massachusetts regulations are more stringent and require more than the ASTM standard – Will state programs overtake ASTM guidance?

MassDEP's New Approach to VI

- Over 100 MCP audited sites have been reopened by MassDEP since 2008 due to potential VI concerns, including some that had been closed for over 15 years
- Responsible parties have been required to perform additional environmental response actions at significant expense
- Much more uncertainty about what it takes to achieve MCP closure for VI sites
- The relevant result here? → New disincentives to buying, selling, leasing, or financing sites with VI issues

MassDEP's Interim Guidance on VI

- Draft guidance released in December 2010
- Substantial comments submitted (e.g., by NAIOP)
 - Improper rules and regulations; not guidance
 - Another step away from privatized, risk-based MCP program
 - Difficult for sites with *possible* VI issues to achieve closure
 - discourage brownfield redevelopment → less clean up
- Interim guidance released in December 2011
 - 148 pages
 - Additional 52 pages of responses to comments

Ongoing Developments

- EPA published toxicity values for PCE in February 2012. ARCADIS, NAIOP & LSPA urged adoption by MassDEP, which planned to complete review “by the end of March”...

- MassDEP considering VI and AUL changes to MCP
 - Strawman proposal on MCP Closures (Temporary and Permanent Solutions) published on March 27, 2012
 - Initial proposal and related information available here:
<http://mcpregreform.wordpress.com/category/vapor-intrusion/>

VI Due Diligence Relevant to a Broad Array of Transactions

- VI Issues Capable of Impacting:
 - Purchase/sale of real estate
 - Purchase/sale of ongoing business with real estate assets and/or environmentally sensitive operations
 - Merger/stock acquisition

- Important to remember:
 - Potential impact on down-gradient properties
 - Potential impact of up-gradient properties

VI Due Diligence: Merger/Stock Acquisition

- Evaluate potential risk associated with each previously-owned or operated property
- Evaluate inherited and assumed liabilities
 - You “get” more than meets the eye – liabilities associated with former facilities

Risk Allocation

Putting the Deal on Paper

- There is no single model that works for all situations
- Form documents are of limited use
- Understanding of risks and applicable law is key
- Must now be informed by the possibility that MassDEP may:
 - Reopen closed sites to address VI issues; or
 - Require more than it would have previously required at VI sites that have not yet achieved closure

What Does Seller Want?

- “As is” sale, with no contingencies
- No representation or warranty about anything
- Buyer releases seller for everything
- Buyer indemnifies seller for everything
- No deduction in price or hold-backs

What Does Buyer Want?

- Detailed representations and warranties (and not just limited to seller's "knowledge," with no "materiality" threshold)
- Seller releases buyer for everything
- Seller indemnifies buyer for everything
- Price reduced/escrow for liabilities
- Buyer's obligation to close is contingent on seller's remedial action
- Insurance policies

Common Risk Allocation Techniques

- Price reduction
 - Administrable, but crude
 - Works when there is little disagreement about the magnitude of the risk or problem
 - With VI Issues, uncertainty regarding future requirements makes value assessment difficult

Common Risk Allocation Techniques *(continued)*

- Seller agrees to fix identified problems within a specified time (before or after closing)
 - Can be effective, but seller often loses incentive after the sale
 - Tension: Seller wants to control its money, but buyer wants to make sure seller doesn't cut corners
 - Make sure to provide with specificity what needs to be fixed and how (e.g., for a 21E clean-up, can an AUL be used?)
 - Caution: In MA, certain tax incentives favor buyer-financed clean-up (or at least clean-up by “innocent” party)
 - Time limitation on seller cleanup is a problem for VI cases

Common Risk Allocation Techniques *(continued)*

- Escrow for known liabilities
 - Effective where a liability is known, but cost is not, or is disputed
 - A pain to administer
 - Hold-back in purchase price is similar
 - Time limit? What is time limit if DEP sees no limit on its rights to review? Who controls? Dispute resolution?

Common Risk Allocation Techniques *(continued)*

- Indemnities
 - Capped at fixed amount? Is there a basket?
 - Consider credit-worthiness of indemnitor
 - Coverage – all “preclosing” conditions, or only specific ones?
 - Expect disputes if a major claim is made
 - Time limit for claims? Time limit traditionally set to audit time periods. What now?

Examples of VI Issues Impacting Deals

Let's Make a Difficult, but Understood, Process Completely Uncertain

- Facility purchased downgradient of known VOC release
 - Provided information about monitoring results on property
 - No risk for current use, but could be risks associated with future development
 - Purchaser did not consider future development plans at time of sale
 - How much do we need to consider currently hypothetical scenarios? Is this consistent with the way clients operate?
- Former industrial property with several different users over time
 - Every new investigation finds new tank or other structure
 - Formerly, probably would have relied on AUL. Now, buyer is scraping the property

Is This DEP's Devious Plan?

- Drive PRPs and buyers to anticipate all contingencies
- Incentives for Permanent Solutions
- Incentives for Permanent Solutions without AULs
- Costs increase and deals are more difficult, but DEP may be more than satisfied

Questions?

Seth D. Jaffe, Esq.

Foley Hoag LLP

Seaport West

155 Seaport Boulevard

Boston, MA 02210

617 832 1203 (t)

617.832.7000 (f)

sjaffe@foleyhoag.com

www.lawandenvironment.com