

# **Environmental Due Diligence Issues in Mergers, Acquisitions, and Real Estate Transactions**

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The pressure to complete certain business transactions quickly and confidentially can present hurdles to performing appropriate due diligence reviews. In particular, many transactions are near completion before potential environmental matters are subjected to focused review. For instance, parties sometimes wait until the final stages of an acquisition before evaluating the target entity's regulatory compliance or considering the need to obtain or transfer a target entity's permits. Yet environmental issues can significantly affect the use of an acquired asset or business, or impose substantial liability on a party that acquires contaminated property. Therefore, it is important to consider potential environmental issues early in any transaction. Here are some practical tips on doing so.

## **I. Remember That Each Transaction Is Unique**

All transactions are unique and present unique potential environmental issues. A successor company might inherit liability for the past environmental practices of its targeted acquisition (such as liability for waste disposal decisions the target made). Or the target company might be the subject of litigation involving environmental claims, triggering the need to evaluate the claims. Even if only assets are being acquired, it still is necessary ensure that purchased assets can be used as planned, and that necessary permits can be obtained or transferred.

Transactions involving the transfer of real property might involve sites that have been developed and used in numerous ways in the past. Potential environmental concerns are not limited to former industrial sites; even properties formerly used for commercial, residential, or agricultural uses might have contamination for various reasons, such as the presence of underground storage tanks, the use of asbestos in construction, or the prior application of herbicides or pesticides on a property.

If these types of issues are identified in the early stages of a transaction, then a strategy for addressing them can be implemented.

## **II. Understand the Objectives of Environmental Due Diligence**

Environmental due diligence is the process used to identify, understand, and evaluate potential environmental liabilities. Not all transactions merit the same level of environmental scrutiny. Acquiring an on-going industrial or manufacturing business with multiple operating sites is significantly different from purchasing a vacant site for development. But all transactions merit *some* consideration of potential environmental liability. Even a vacant site might have been used previously in ways that adversely affect its planned future use. Or sensitive environmental features, such as wetlands or endangered species, might be present on the site. Such conditions can impede, or even prevent, planned development of the site.

Well-planned environmental due diligence can help identify potential issues and assist in addressing them. Some protection, for example, can be achieved by incorporating appropriate representations, warranties, indemnities, and releases into transaction documents, or through the use of environmental insurance.

Other risk management methods include reliance on statutory protections or programs—such as “brownfields” programs, innocent purchaser provisions, or voluntary cleanup programs. But, to receive the benefits of these programs, it is important to know and follow the applicable criteria.

Due diligence also helps inform the parties about time frames that might affect a transaction. Transferring permits, for example, might require providing notification to an agency prior to the effective date of transfer. The transfer of permits also might not be automatic, and might require approval of a reviewing agency. These issues should be identified so the parties’ expectations regarding closing dates and contingencies can be properly addressed.

Certain organizations—the American Society for Testing and Materials (“ASTM”) and the International Standards Organization (“ISO”)—have developed guidelines to help “standardize” what steps to perform in environmental due diligence investigations or in evaluating the environmental practices of a company. ASTM, for example, has developed guidelines for performing site investigations in phases (e.g., ASTM Phase I, ASTM Phase II). Carrying out the records review and site inspection associated with an ASTM Phase I investigation, for example, might eliminate the need to perform additional, more intrusive soil or groundwater sampling investigations. And it can be used as evidence that the type of inquiry needed to obtain certain statutory defenses has been performed.

### **III. Consider Federal, State, and Local Laws and Rules**

Many government entities, ranging from federal agencies to counties, cities and, sometimes, independent special purpose agencies, have jurisdiction over environmental matters. The laws and rules in these various jurisdictions might conform in many ways, but they also can have significant differences.

Under federal law, for example, a purchaser might be able to acquire property with known contamination without incurring liability by relying on a “bona fide prospective purchaser” defense if the purchaser, among other things, did not cause the contamination, had no affiliation with the party liable for the contamination, made appropriate inquiry into previous ownership and uses of the property, and took measures to ensure the contamination is not exacerbated. There is Florida case law, however, that has interpreted Florida’s statutory scheme as restricting the availability of this defense, at least in cases involving petroleum or dry-cleaning contamination.

Also, some cities or counties with authority for their own environmental programs might impose obligations that differ significantly from state or federal programs. Hillsborough County, Florida, for example, has a wetlands protection program that uses criteria that differ from corollary state and federal approaches. Hillsborough County also has a unique “historic landfills” program that does not have a specific parallel at the state or federal level. Florida also

has independent water management districts with programs that overlap some federal and state environmental statutes. The variations among these overlapping jurisdictions need to be reviewed and considered.

#### **IV. Assess Competing Interests**

Typically, a purchaser in a transaction wants more environmental due diligence to be performed so that potential statutory defenses are preserved, information is available to properly structure terms of a transaction or, perhaps, to obtain environmental insurance, and the scope of possible future liabilities is outlined. A seller typically wants less due diligence. Despite these differences, a seller might want to use due diligence to better identify and resolve uncertainties quickly and to expedite closing. The parties need to focus on the end point—the closing—and work to find mutually acceptable ways to meet their needs.

Lenders involved in these transactions have separate interests. In addition to the need to determine the value of property used to secure a loan, lenders have potential statutory environmental liability, and defenses to liability, of their own. Therefore, they have an interest in ensuring that environmental due diligence is performed.

#### **V. Choose Team Members Carefully**

It is important to involve environmental consultants and environmental attorneys in the process as soon as possible to structure investigations properly. While sampling data might not be protected by common legal privileges, many transaction documents and other communications can be. Depending on the circumstances, it might be important for an outside attorney to retain the environmental consultant to better maintain any privileges associated with the work performed.

Expectations concerning the need and best methods for sharing information also must be considered. Parties ultimately might need to rely on work performed by another party's consultant. So a confidentiality agreement between the parties might be needed. Some of the questions to consider regarding communications issues are whether results obtained could trigger a reporting requirement; the need for reliance letters so a seller, buyer, or lender will be entitled to rely on a particular consultant's work; or what information can be shown to third parties, including lenders or potential insurance carriers.