

Due Diligence: What It Is and How to Deal With It

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June 5, 2012



Since 1989, ESA has performed roughly 100 Due Diligence projects each year that equate to approximately 2,000 such assignments in the last 23 years. Over time, we noticed that the term ‘Due Diligence’ has become a catchall phrase, and what it means in environmental consulting is frequently misunderstood. This essay defines the concept of Due Diligence in the context of environmental consulting, explains the disparity in price that is often encountered in these projects, and describes how to prepare when a property is about to undergo Due Diligence.

The Purpose of Due Diligence

Due Diligence is a non-intrusive investigation (meaning an investigation without the acquisition of any soil or groundwater samples and their attendant laboratory analyses) to determine if any areas might be environmentally impacted. Depending on the form of Due Diligence, these are known as either areas of concern (AOCs; per the New Jersey Department of Environmental Protection, a.k.a. NJDEP) or recognized environmental concerns (RECs; per the American Society of Testing Materials, a.k.a. ASTM). Due Diligence is most often performed during a purchase or refinance of a commercial or industrial property. In New Jersey (and several other states), under some circumstances, you cannot sell, close, or transfer ownership of selected businesses unless the property has undergone Due Diligence prior to completing the transaction. In addition, the state of New Jersey requires Due Diligence when complying with the Industrial Site Recovery Act (ISRA). If one or more AOC/RECs are identified during the Due Diligence process, their presence may prompt a recommendation to perform additional work in the form of sampling and laboratory analysis.

Forms of Due Diligence

The archetype for Due Diligence is defined by the ASTM in their publication *ASTM E1527 - 05 Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process*. According to the ASTM, this is their definition of a Phase I:

“The purpose of this practice is to define good commercial and customary practice in the United States of America for conducting an environmental site assessment of a parcel of commercial real estate with respect to the range of contaminants within the scope of Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) (42 U.S.C. 9601) and petroleum products. As such, this practice is intended to permit a user to satisfy one of the

requirements to qualify for the innocent landowner, contiguous property owner, or bona fide prospective purchaser limitations on CERCLA liability (hereinafter, the "landowner liability protections," or "LLPs"). That is, the practice that constitutes "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice" as defined at 42 U.S.C. 9601(35)(B)."

In other words, in addition to identifying potential RECs, a Phase I performed in accordance with ASTM E1527 – 05 also confers certain protections under CERCLA (also known as "Superfund"). Furthermore, the ASTM Phase I is now standardized and accepted in all 50 states.

Knowing the above to be true, why do I recommend in almost all instances that, when performing Due Diligence in New Jersey, you DO NOT perform an ASTM Phase I, but instead perform something called a Preliminary Assessment (PA)? Simply put, The NJDEP took the ASTM Phase I and altered its form and upgraded its content. So, when one performs a PA, the product is very similar to an ASTM Phase I, and it can delve even deeper. For this reason, the PA normally costs a bit more. Moreover, the mere act of writing a PA prior to buying a commercial or industrial property in New Jersey automatically confers some very important protections relative to New Jersey's environmental laws via New Jersey's Brownfield and Contaminated Site Remediation Act. (If interested, ESA has written a separate whitepaper that expounds in greater detail the differences between an ASTM Phase I vs. a PA. Send an email to sfauer@askesa.com to request a copy.)

Finally, there are some lesser forms of Due Diligence that are most often used by banks and other lending institutions. These are known by various names including transaction screen, site walk, and a walk-through. Before considering one of these lesser forms of Due Diligence on your own, you may want to speak first with ESA. The bank's Due Diligence requirement is all about protecting their interests, not yours. Depending upon the nature of the property you are buying or refinancing, their less expensive Due Diligence requirement may be perfectly acceptable, but there are occasions when you would be well-served by performing either a PA or a Phase I.

How to Prepare for Due Diligence

When you know that you are going to undertake Due Diligence, there are things you should do to prepare. The following is a suggested list.

1. First and MOST important, you need to prepare yourself mentally. Depending upon the company you retain, the price for Due Diligence (either a Phase I or a PA) can range from \$3,000 to 5,000 (under certain circumstances, costs may be much higher).

Several thousand dollars for Due Diligence may seem like an exorbitant sum but, compared to what a property can cost, it is very worthwhile. For example, several years ago, ESA was asked to explore an impacted property that had been recently purchased. The buyer did a cash purchase and, in part because lenders were not compelling him, he decided to forego the Due Diligence process. As it happens, the environmental issues attendant with this property would have become readily apparent via Due Diligence. Consequently, the buyer faced several hundred thousand dollars in remedial costs that could have been avoided.

The table below presents hypothetical Due Diligence prices for different properties. You can see that the cost of Due Diligence is reasonable when compared to the sale price.

Hypothetical Price for Due Diligence	Price Paid for Property	Percentage of Sale Price
\$4,000	\$500,000	0.8%
\$4,000	\$1,000,000	0.4%
\$4,000	\$2,000,000	0.2%

2. Get a recent title search for the property or, at minimum, obtain a chain of title. Your consultant is going to request it.
3. Obtain copies of every environmental report written for or about the subject property. Your consultant needs to read each one of them.
4. Let your attorney know that you are about to perform this service because they may have some particular advice they wish to impart. **A Note Concerning Your Attorney: it is normal and expected that you will retain a real estate attorney if you are buying, selling, or refinancing an industrial or commercial property. However, if you suspect that environmental issues exist, be sure that your attorney fully understands environmental law. If not, consider one of two possibilities: either hire an environmental co-counsel or retain a new attorney better versed in such matters.**
5. Double Due Diligence: When a seller has had Due Diligence performed recently, is it acceptable to use that document? Yes, it is acceptable, but it is akin to using the seller's attorney to represent your firm at the closing. Most firms insist on being represented by their own attorney at closing to ensure that their legal rights are preserved. By the same measure, why would you not retain your own environmental consultant to ensure that your environmental rights are preserved?
6. If an ASTM Phase I is completed fewer than 180 days prior to the date of the transaction, it is presumed to remain valid. If it is any older, your consultant should perform a contemporaneous site inspection and review to be sure that there were no changes in either the use of the property or activities at the property. Typically, if a Due Diligence report is more than one year old, it is often best to re-do it. And, like many things, this should be discussed with your consultant and your attorney.

7. Due to the Site Remediation Reform Act (SRRA), it is accepted practice in New Jersey that a Licensed Site Remediation Professional (LSRP) not be used when performing Due Diligence other than when required by NJDEP via rule or regulation. This is because LSRPs have certain reporting requirements. This should be discussed with your attorney.
8. Environmental inspections for Due Diligence purposes are always scheduled in advance because the inspector is normally accompanied by someone familiar with the property. Therefore, one should prepare for the environmental inspection part of the Due Diligence process and the property owner should prepare prior to the inspection. Why is this recommended? Because, if you want to garner the highest price possible for a commercial property, you should treat it as you would your primary domestic residence by ensuring the property is clean and orderly. Prior to showing your home to a prospective purchaser would the beds be unmade, dishes remain in the sink, or your trash can be overflowing? Certainly not!

Conclusion

Due Diligence is considered by many a perfunctory matter. However, it is anything but that. I have seen many examples of business people who were stung badly from their failure to perform Due Diligence. Ironically, Due Diligence poses an inordinately high degree of risk to all environmental consultants when compared to the relatively low price. People rely upon ESA's reports to make million dollar decisions, so our observations must be keen and our conclusions correct.

The goal of this report is to explain some of the most important features of Due Diligence. By no means is it an exhaustive document. For further information on this or any issues surrounding environmental remediation, call me at 732-469-8888 x201, or send an email to (sfauer@askesa.com) for prompt answers to your most pressing questions.