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# Due Diligence Assessment of Risk and Liability and the New AAI Rule

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## Phase I ESA Process Begins

- 1986 passage of the CERCLA/SARA Law (Superfund) contained provisions for Innocent Landowner Defense.
- Landowners must conduct “**All Appropriate Inquiries**” into potential environmental conditions to qualify for defense.
- ASTM issued first standard for Phase I ESA process in 1993, establishing industry standards for “All Appropriate Inquiries”.



## Revised Due Diligence Process

- ASTM E 1527 has been industry standard for Phase I ESAs since 1993. Last updated in 2000 (ASTM 1527-00).
- EPA's 2005 "All Appropriate Inquiries" (AAI) Rule expands some requirements institutionalized by ASTM E1527-00.
- ASTM E 1527-05 replaces and incorporates the AAI rulings.
- AAI Rule goes into effect **November 1, 2006**.



## ASTM 1527-00 vs. AAI Rule

### Key Difference - Applicability

- ASTM E 1527-00 limited to commercial real estate only.
- AAI Rule includes a wider universe of properties, including residential properties in some cases.



Expanded Real Estate Market Requirements



## ASTM 1527-00 vs. AAI Rule

### Key Difference – Definition of Environmental Professional (EP)

- ASTM E 1527-00 broadly defined who is an EP, and who is qualified to conduct Phase I ESAs.
- AAI Rule establishes specific training, education, and experience requirements for EP's conducting AAI assessments.



### **Engineers and Scientist (Geologists)**

- **Bachelors degree and 5 years experience**
- **State license or certification with 3 years experience**
- **10 years experience**



## Key Difference –

### Records of Engineering and Institutional Controls and Environmental Liens

- ASTM E 1527-00 did not require EP to research and include this information in the Phase I ESA report.
- AAI Rule establishes EP shall obtain records on engineering and institutional control, provided it is reasonably ascertainable.
- Requires a search for environmental liens associated with the property.



## ASTM 1527-00 vs. AAI Rule

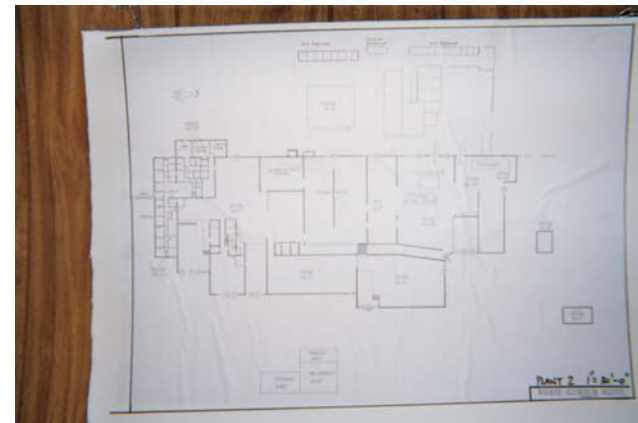
### Key Difference – Government Records Review

- ASTM E 1527-00 only required review of specific federal and state environmental records.
- AAI Rule requires review of a broader universe of federal, tribal, state and local records during an AAI assessment.



### Key Difference – Historic Research

- ASTM E 1527-00 prescribed specific historic sources to research to establish prior site use.
- AAI Rule allows more flexibility as to what historic sources can be utilized to establish prior site use.





## ASTM 1527-00 vs. AAI Rule

### Key Difference – Historic Research Timeframe

- ASTM E 1527-00 required prior site use research to 1940, or first developed use, whichever is earlier.
- AAI Rule requires prior site use research to first developed use.



## ASTM 1527-00 vs. AAI Rule

### Key Difference – Data Gaps

- ASTM E 1527-00 required limited documentation addressing data gaps in historic and other research.
- AAI Rule requires more extensive documentation addressing data gaps in historic and other research.
- EP will be expected to conduct additional interviews, site visits, surveys and limited sampling to close significant data gaps.





## ASTM 1527-00 vs. AAI Rule

### Key Difference – Shelf Life of Phase I Reports

- Both ASTM E 1527-00 and AAI Rule give the site visit, records review, and interviews a sixth month shelf life.
- ASTM E 1527-00 allowed updates of reports older than 6-months, provided the necessary updates are made.
- AAI Rule states that a user can no longer rely on reports older than one year.





## Key Difference – Contaminants of Concern Being Narrowed

- ASTM E 1527-00 primary constituents of concern are CERCLA hazardous substances and petroleum products.
- AAI Rule primary constituents of concern are CERCLA hazardous substances.



Under AAI Rule, petroleum products are only required to be assessed if ESA is funded by an EPA grant (i.e. Brownfield).



## ASTM 1527-00 vs. AAI Rule

### Key Difference – Interviews with Neighboring Property Owners

- ASTM E 1527-00 required at preparer's discretion.
- AAI Rule mandatory at abandoned or vacant properties.





# Business Environmental Risks

- ASTM E 1527-05 identifies the following Out of Scope Considerations – also known as Business Environmental Risks
  - Asbestos Containing Materials;
  - Radon;
  - Lead-based Paint;
  - Lead in Drinking Water;
  - Wetlands;
  - Regulatory Compliance;
  - Cultural and Historical Resources;
  - Industrial Hygiene;
  - Ecological Resources;
  - Endangered Species;
  - Indoor Air Quality, and
  - High Voltage Power Lines.



Environmental liability can be managed to allow for favorable financing and redevelopment by applying established *risk management strategies* that match business tolerance and deal structures:

- **Avoid**
- **Retain**
- **Manage**
- **Transfer**



# Risk Management Strategies

1. **Avoid Risk:** Apply techniques to avoid identified loss by not owning a particular liability or choosing not to engage in a certain activity – walk away from a transaction.
2. **Retain Risk:** Pay for anticipated and unanticipated losses out of pocket as they come up.
3. **Reduce Risk:** Apply techniques to measure and eliminate the severity of the losses. Often involving direct remediation, deed restrictions, engineering controls.
4. **Transfer Risk:** Technique applied to transfer the uncertainty of loss to another party, such as an insurance company, contractor or prior responsible party.



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# Transaction Support

- **Build your team** of professionals that provide a practical understanding of environmental risk with management strategies that facilitate transaction closure by providing deal structure options and risk management strategies that address environmental conditions and obtain the highest leverage for financing.
  - Real Estate Brokers
  - Lawyers
  - Environmental Risk Managers
  - Insurance Brokers
  - Lending Institutions
  - Engineers



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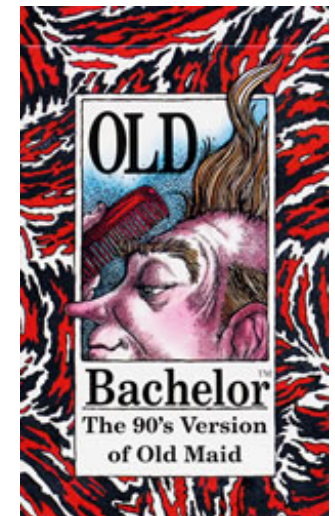
# Liability Transfer

## Transferring Liability: Who gets the “*Old Maid*”

When insurance products provide the essential tool to transfer liability from the parties in the deal to the financial strength of an insurance carrier.

A cost effective alternative that can allow property use to better match up with environmental actions:

- An alternative to extensive Phase II ESA's and regulatory remediation that does not meet development needs.
- Lender assurance to move forward and close a transaction.





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# Environmental Insurance

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# Exposures created by impaired property

- Clean-up costs including off-site migration of pollutants
- Third party bodily injury and property damage
- Legal defense expenses
- Business interruption and cost of delayed construction
- Diminution of property value



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# Environmental Insurance Products

- Pollution Legal Liability
- Cleanup Cost Cap
- Secured Creditor Insurance
- Environmental Protection Program (Finite Risk Policy)



# Pollution Legal Liability

Coverage includes the following:

- On and Off-Site clean up
- Bodily Injury and Property Damage resulting from a pollution occurrence
- Legal Defense Costs
- Business Interruption
- Diminution in value



# Cleanup Cost Cap

- If the costs exceed the budgeted amount, additional funds become available to complete the remediation
- New owners are protected against a financial loss that could impair the company's operation
- Existing owners can set clean-up costs for budgetary purposes

