The role of environmental consultants

This note summarises the role of an environmental consultant in a transaction.

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Scope of this note

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Scope of this note

This note discusses the role of an environmental consultant in a transaction. It looks at the due diligence exercise carried out by the consultant and how that exercise fits into the wider transaction. It also considers the relationship between the environmental consultant and the lawyer and how best they can work together.

What due diligence is undertaken by an environmental consultant?

In most instances, the core environmental risk under consideration is the initial assessment of the risk of contamination causing significant harm to relevant receptors. In a due diligence context, this includes the potential for associated liabilities to be incurred by the site owner or occupier. While environmental assessments have their roots in pure contamination assessment, their typical use during due diligence has expanded to include other issues relevant to investors, including flooding, ground stability and operational compliance.
The exact scope of works varies depending on the nature of the transaction. However, core issues that tend to be considered over and above contamination risk can include:

- Flooding.
- Ground stability.
- Asbestos.
- Safety, health and environmental (SHE) operational compliance.

There are various stages to the environmental due diligence process, which are designed to identify environmental risks and, where appropriate, advise on mitigation measures to minimise any risks identified.

For more information on determining the scope of an environmental due diligence exercise and the types of assessment that can be carried out, see:

- Practice note, Appointing environmental consultants: scope of work.
- Practice note, Environmental searches and desktop reports.
- Practice note, Phase 1 environmental and compliance assessments and Phase 2 intrusive environmental investigations.
COMMISSIONING ENVIRONMENTAL DUE DILIGENCE

Who commissions the work?

Commissioning of an environmental consultant to undertake a due diligence environmental assessment can come from a number of parties:

- **Direct from the client.** This is more common where the client is an investment or fund manager, or where there is a recurring relationship.

- **Lawyers.** This common across all client types.

- **Other advisers.** For example, property surveyors, or cost consultants who have been appointed by the client, but agree to provide additional environmental due diligence services as part of their appointment. Larger advisory firms may offer these services in-house, but many will require a specialist environmental consultant to be appointed as a subcontractor.

Often, if a consultant is brought on after initial bids are accepted or the due diligence process has otherwise started, the process is largely controlled by the client or the established deal timetable, which in turn may compromise the robustness of the assessment that can be undertaken, due to limitations on timescales.

Where a professional adviser, such as a lawyer, seeks to appoint environmental due diligence work, there are numerous questions that a consultant is likely to ask for them to scope the work appropriately and then undertake it:

- Who is the ultimate client? Will they be appointing the work directly, or will appointment come via the lawyer (or another third party)?

- What is the nature of the transaction: acquisition of property, acquisition of equity or share capital, divestment, refinancing?

- What is the nature of the target company’s operations? Does it operate from a single site or multiple sites? Are operations international? What is the scale of the operations?

- Who is the audience for the report: the client, the bank, other advisers? Who will require reliance on the final report?

- What elements of assessment are important to the client: straightforward legal compliance, wider environmental, social and governance (ESG) issues, supply chain management?

- Is the assessment required by the client purely environmental or are wider issues such as health and safety required to be assessed?

**Terms of appointment**

One of the important considerations in appointing an environmental consultant to undertake a due diligence assessment is to agree the terms and conditions of the engagement as early as possible. Limitations on liability, reliance and whether warranties will be required should all be agreed at the outset wherever possible, which in turn will be reflected in the fee for completing the required assessment. If these issues are considered during the due diligence process, or indeed retrospectively once an assessment has been completed (that is, a funder requires additional protective clauses or increased professional indemnity (PI) cover), additional costs are likely to be incurred by the client, and potentially delay the completion of the transaction.

For more information on how to appoint an environmental consultant, see Practice note, Appointing environmental consultants.
SCOPING THE WORKS

Scoping the work with a lawyer’s input

Certain information can be crucial in establishing an appropriate scope of works, and the absence of the information will reduce the certainty of the scope and fees in the consultant’s proposal. Key information that needs to be provided includes, for example, the type of industry, the property location and the scale of the target’s operations. While proposals can be produced without this information, they are likely to need revision once the information becomes available, which is often unpalatable for clients.

Certain aspects can be confirmed later in the process, particularly if there is a history of a good working relationship between the parties. If there is no history, then confirmation of client and invoicing details may need to be confirmed in advance and could conceivably delay the commencement of a project.

A significant amount of potentially important information may not be available at the time that a fee quote or proposal is needed from the consultant. Consequently, the consultant’s scope may need to be adjusted as the project progresses and more information is obtained. This can result in the scope of works expanding or contracting. Honest and regular dialogue between the consultant and lawyer is important to ensure that the scope is always appropriate and that the client is kept abreast of changes (in particular, what it means for fees being charged and the timescales of the assessments).

Property versus corporate transactions

On real estate transactions, the client is more likely to require a less extensive scope of works, focusing on contamination and a limited number of additional aspects (such as flooding or coal mining) that are relevant to a property owner, rather than an operator. Depending on the nature of the site in question, works could take the form of a desk-based screening assessment, rather than a full Phase 1 with site walkover.

A lawyer advising on a corporate deal is more likely to require a greater scope of works that assesses the operational risk or compliance of the target company over a wider range of aspects. These could include permitting, water management, energy management, air emissions, and so on, on the purely environmental side. There may also potentially be health and safety and ESG issues, depending on the client’s requirements.

Latent liabilities

When advising on corporate transactions, it is important to consider whether there could be any latent contamination liabilities, for example, attached to formerly owned properties. Where a company has divested a property freehold or a leasehold and where supporting contractual documents are not available to confirm that all historical liabilities were passed on to the new owner or occupier, these could represent a liability over which the company has no control and which could result in a claim at any point in the future.

For more information on determining liability for contamination, see Practice note, Contaminated land regime: overview: Who is responsible for remediation?

It is important for consultants to work with lawyers on this issue to identify previously owned properties and to determine whether liabilities for contamination were transferred and if so, what the associated risk is. This process can add significantly to the due diligence work required and clients often choose not to focus on it during the due diligence process.

Portfolios

How to deal with portfolios and agreeing a tailored approach

The assessment of large portfolios of properties or operations within a time-constrained due diligence process can require alternative approaches to the traditional Phase 1 environmental due diligence assessment.
A common approach is for the consultant to assess a representative sample of the properties within the target company’s portfolio. In practice, this could mean the consultant:

- Visiting and assessing approximately 20% of the target’s sites.
- Participating in a conference call or meeting with central or senior management to establish general working practices and understand existing knowledge of identified issues across the portfolio.
- Reviewing the data room.

This combined approach can enable potential environmental risks attached to a transaction to be quantified to the satisfaction of the purchaser or funder without the need to assess each property or operational premises across the portfolio individually.

Shorter desk-based screening reports can also be appropriate to address contaminated land issues across a larger property portfolio.

The standard Phase 1 assessment process is designed to address target companies’ activities on a site-by-site basis. However, where a firm’s environmental issues primarily arise from processes, rather than properties, an alternative approach can be more appropriate. A typical example of this would be an outsourcing company, whose own properties are limited to administrative functions, but whose employees potentially impact on environmental receptors at third party sites. In this situation, management interviews and a review of written procedures may be appropriate, rather than onsite assessments.

**Multi-jurisdictional portfolios**

The quality and scope of environmental due diligence advice can vary between countries. Where the portfolio of assets included in a transaction are located across multiple jurisdictions, it is often prudent for the appointing party to retain a single consultancy to undertake the assessment (utilising subcontractors or local offices, as required), who has responsibility for the final output of the process. This will help to ensure consistency of output and technical quality across the portfolio.

### ADDRESSING IDENTIFIED ISSUES

**How to deal with issues found: legal, practical and technical solutions**

The division of responsibility and expertise between consultants and lawyers is relevant both for:

- Certain aspects of assessment.
- The development of solutions to risks that are identified during the assessment.

Environmental consultants’ expertise and, indeed, professional indemnity insurance cover, does not allow them to give advice on the interpretation of legal documents.

During the assessment, the most common technical interaction between consultant and lawyer is in relation to the target’s contractual documents; in particular, the review of lease documents to determine responsibility for environmental issues, such as historical contamination. The consultant will identify, as part of their assessment, when the determination of responsibility for historical contamination at a property becomes relevant. It should be raised with the lawyer as early as possible in the process. The lawyer can then confirm whether, and to which party, the lease allocates responsibility for historical contamination (or whether it is silent on the matter). The outcomes and implications can be discussed between the advisers and incorporated within the relevant reports.
The consultant’s report should highlight clearly those issues that require further attention from the wider deal team and indicate the possible tools that can be used to mitigate the risks or impacts. Often, if the transaction allows for such negotiation, then existing environmental issues can be incorporated into the share purchase agreement (SPA) as warranties or indemnities. For more information, see Practice note, Environmental indemnities: overview. Negotiating the scope of an environmental indemnity: relationship with due diligence.

Where the consultant identifies legal non-compliance during their assessments, they can advise on the technical aspects of the breach and on the likely capital or operational expenditure required to bring the situation back into compliance. In conjunction, the lawyers can advise on the legal risks and potential implications of non-compliance.

A consultant should estimate the financial impact of any issues identified if at all possible. However, there will be occasions where the issue requires input from other parties to quantify it or effectively de-risk. This may be because additional studies are needed to determine the scale of the issue (for example, a Phase 2 assessment may be required to identify the nature and extent of contamination at a site) or because the issue requires a particular technical specialisation that the due diligence consultant does not have (for example, asbestos removal works).

Larger consultancies may have all the required expertise in-house, but there will be occasions where a quantity surveyor or similar may need to become involved. Alternatively, it may be possible to mitigate the unquantified nature of a risk through contractual or insurance routes.

Role of insurance

Transaction timescales and cost limitations often do not allow for a full assessment of certain issues, in particular contamination within the due diligence phase. Where this is the case, other fiscal or contractual solutions are often sought.

Insurance, in particular, environmental impairment liability (EIL) insurance, can offer a solution. The client will need to seek specialist advice from a Financial Conduct Authority (FCA) regulated insurance adviser or broker with regards to the details of what each policy does, and does not, cover. However, EIL insurance can offer a solution that pays out to claimants in the event that contaminated land liabilities are incurred by the site in question within the policy period. Policies are often available to cover short and medium-term risk exposure.

Information generated by the environmental consultant is provided to an insurance broker, who presents the relevant material to the insurance market to gather quotes. While not instant, EIL insurance can normally be obtained within typical deal timeframes, particularly if the issue is raised early in the process.

For more information on environmental insurance, see Practice note, Environmental insurance.