

Due Diligence Report

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Bank Survives Claim of Fraudulent Non-Disclosure Involving Phase I ESA

A New York state court recently rejected a claim where a defaulting borrower brought claims against their lenders, claiming the bank had not advised them of environmental issues associated with their contaminated property by a guarantor of a loan.

In *Bank of New York v. Bram Manufacturing*, 2005 NY Slip op. 51130U (Sup. Ct-Rockland Cty. 7/20/05), the defendant borrower entered into a series of loans with a predecessor of Bank of New York (BONY), Nanuet National Bank. In 1998, the borrower learned that its property was contaminated with TCE from a former operation when a potential purchaser conducted a Phase II on the site. Because it could not sell the property, the borrower consolidated its loans with BONY and entered into a \$504,000 mortgage with the plaintiff in January 2000. As part of the restated mortgage, the borrower's principals executed a guaranty. In January 2002, the borrower defaulted on its loan, which had an outstanding balance (principal and interest) of approximately \$475,000. Instead of foreclosing on the property, BONY opted to sue on the mortgage note and the guaranty.

In response to BONY's motion for summary judgment, the guarantors claimed that the bank was not entitled to recover under the note or the guaranty because it had concealed the extent of the contamination. The defendants argued that BONY had an obligation as a secured creditor to perform an environmental assessment and that this failure relieved the defendants of any liability under the guaranty. However, the court ruled that a bank had no such obligation to perform an environmental assessment to maintain its defense to liability. Moreover, the court noted that the defendants had not performed their own due diligence when they first acquired the property in 1985 and that BONY did not have any superior knowledge or unique information in its possession concerning the environmental conditions of the property that it would have been obligated to disclose to the defendants. Indeed, the court noted that the defendants were aware of the contamination as a result of the 1998 Phase II and had equal access to investigate the environmental conditions of their property. Thus, the court granted BONY's motion for summary judgment.

All Appropriate Inquiry (AAI) rule Impact on Phase I ESA Costs

On November 1, 2006, EPA's AAI rule will become effective. AAI defines the level of effort required for due diligence to qualify for the Federal liability exemptions under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or Superfund). To qualify for these liability exemptions new owners will need to conduct Phase I Environmental Site Assessments (ESA) that meet the new AAI requirements. Consulting firms are now beginning to implement changes to their Phase I ESA's to meet the AAI requirements and evaluating the additional costs associated with these changes. It is expected that the cost of AAI compliant Phase I ESA's for commercial and industrial properties will range from \$2,200 to \$3,000. This represents an additional cost of \$300 to \$500 per site. Over the past 10 years the cost for Phase I ESA's has been flat and even dropped in many markets. With the increase in business costs over this period it has driven many firms out of the market and required remaining companies to become very efficient. Customers will need to verify that they are getting AAI Phase I ESA's and may be starting to see their costs increase.

PME's Clients Include:

- Comerica Bank
- Fifth Third Bank
- National City Bank
- Huntington Bank
- Republic Bank
- GMAC CM
- Chemical Bank
- JP Morgan Chase
- LaSalle Bank
- Flagstar Bank
- Citizens Bank
- CIT Small Business
- Key Bank
- Independent Bank
- Charter One
- Retail Petroleum Marketers
- Developers
- Attorneys

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PM Environmental, Inc.

PM Environmental, Inc. (PME) is an environmental due diligence firm that has been serving banking and developer clients since 1992. PME's success is based on our ability to assess environmental risks and help our client's minimize these risks. We help simplify the technical issues so our clients can make sound business decisions. We do over 500 Phase I ESA's per year and have evaluated thousands of sites through out the Midwest.



PME operates our own sampling equipment. This reduces our costs and makes us more responsive!! We just added a 3rd geo-probe to better serve our clients.

Our due diligence services include:

- Bank specific Due Diligence/Risk Assessments
- Transaction Screens (ASTM E1528)
- Phase I Environmental Site Assessments (ASTM E1527)
- Phase II Environmental Site Assessments
- ASTM Property Condition Assessments (PCA)
- Baseline Environmental Assessments (BEA)
- Brownfield Redevelopment Planning
- Environmental Liability Assessments
- Asbestos Inspections and Abatement
- Lead Paint Inspections
- Mold Inspections and Remediation
- Leaking Underground Storage Tank Assessment and Remediation

Case Study: Environmental Insurance

A real estate investment trust (REIT) wishes to purchase a commercial property used as a shopping center. Historically, the center included a dry cleaner which caused a release of solvents into the environment. The seller of the property remediated the contamination and obtained a No Further Action (NFA) letter from the local environmental regulatory agency. However, the seller does not want to provide indemnity to the REIT for environmental conditions.

After the transaction closed, the shopping center property is endorsed onto the REIT's existing real estate environmental liability (REEL) policy and the known, disclosed condition addressed by the NFA is also endorsed onto the policy. Future risk regarding known historical contamination attributed to the dry cleaner is transferred to the insurance company and a major obstacle in the transaction was avoided.

A year later the REIT proceeded to redevelop a section of the property and discovered an unknown leaking underground storage tank. The leaking tank had caused petroleum contamination to the subsurface above regulatory action levels. A claim is filed by the REIT under its REEL policy. Subsequent investigation and cleanup of the petroleum release resulted in remediation expenses and a claim settlement of \$175,000.

To get a comprehensive overview of environmental insurance uses and risks send an email request to charles@pmenv.com.

PME News

Glenn Tolan join PME's Grand Rapids office as a Project Consultant. Glenn brings over 7 years experience conducting due diligence, LUST, and Brownfield projects.

Christina Decker joins PME's Hazel Park office as a Project Compliance Specialist. She has over 7 years experience completing environmental compliance projects for industrial clients and conducting due diligence assessments.

PME is awarded 50 site due diligence project in Michigan. These site consist of gas stations, bulk terminals, and office buildings.

PME completes Phase I ESA and Property Conditions assessments (PCAs) for GMAC Commercial Mortgage for three commercial properties in SE Michigan.