

Building Energy Performance: The New Frontier of Transactional Due Diligence (and Contractual Liability)

The American Society for Testing and Materials (ASTM) recently published its much heralded *Standard Practice for Building Energy Performance Assessment for a Building Involved in a Real Estate Transaction E-2797-11* (the “Standard”) in response to the perceived market need for a uniform methodology for evaluating energy efficiency in buildings. The Standard is available for purchase and download her: <http://www.astm.org/Standards/E2797.htm>. The Standard defines a careful process through which a “qualified Consultant” collects and analyzes “energy use” information, and specifies the format in which various “findings” are reported, the most relevant of which are (i) “pro forma building energy use” (reported in kilo (10^3) British thermal units (kBtu) per year), (ii) “energy use intensity” (reported in kBtu per square foot), and (iii) “pro forma building energy cost” (reported in US Dollars (\$) per year and \$ per square foot per year). The stated (and laudible) objectives of the Standard are to

- (1) define a commercially useful practice for collecting, compiling, and analyzing building energy performance information associated with a building involved in a commercial real estate transaction;
- (2) facilitate consistency in the collection, compilation, analysis, and reporting of building energy performance information as may be required under building labeling, disclosure, or mandatory auditing regulations;
- (3) supplement as needed a property condition assessment conducted in accordance with Guide E2018 or an environmental site assessment conducted in accordance with Practice E1527;
- (4) provide that the process for building energy performance data collection, compilation, analysis, and reporting is consistent, transparent, practical and reasonable; and
- (5) provide an industry standard for the conduct of a BEPA [building energy performance assessment] on a building involved in a commercial real estate transaction, subject to existing statutes and regulations which may differ in terms of scope and practice.

The Standard references and in some respects parallels the Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process (E1527), the ASTM’s effort to standardize the practices and procedures that satisfy the “all appropriate inquiry” element of CERCLA’s innocent landowner defense. Having witnessed the evolution of environmental due diligence from the mid-1980s through the present, and the concomitant expansion in breadth and depth of contract representations, warranties and indemnities specifically addressed to environmental concerns, I cannot help but wonder when green building and energy efficiency issues will find their way into standard “due diligence” checklists and definitive agreements for corporate mergers and acquisitions transactions. Not long, I suspect.

The Standard, together with a variety of other benchmarking tools now (or soon to be) available to the market, have progressed us towards objectively measurable criteria, which in turn facilitates creation of legally enforceable obligations. Among the additional due diligence practices and external factors referenced in Section 13.1 of the Standard are a number of ASHRAE protocols, the Capital Markets Partnership Green Building Investment Underwriting Standard, Green Value Score, EPA Energy Star Building Labeling Assessment – Statement of Energy Performance, Green Globe’s Continual Improvement Assessment for Existing Buildings, and USGBC’s LEED for Existing Buildings: Operations and Maintenance (sometimes referred to as LEED EBOM). Additionally, the International Standards Organization is expected to publish ISO 50001 Energy Management Standard <http://www.iso.org/iso/pressrelease.htm?refid=Ref1399> in the third quarter of this year. While this will

be geared towards energy management rather than measurement of energy use, the availability of an ISO benchmark signals the urgency with which the market is developing and adopting new tools to assist in the accurate measurement of the environmental impacts associated with the built environment.

The rapid evolution in market forces in this arena was not, however, the sole driver for the Standard. A meaningful number of municipal and state authorities, most notably the Cities of San Francisco, New York and the District of Columbia, have adopted mandatory disclosure requirements related to building energy performance. The illustrative list appended to the Standard as Table X1.1 identifies twenty-six separate state laws or municipal ordinances governing record-keeping and disclosure for various sub-sets of commercial properties. New York's ordinance also mandates that large commercial buildings undergo energy audits and retro-commissioning on a 10-year cycle. In fact, the deadline for owners of large building in New York City to submit the first wave of benchmarking data from covered buildings was May 1, 2011.

To address the obvious "where do I start?" question, at least one software provider has developed an on-line tool that facilitates the data collection and analysis required under the Standard. Sustainable Real Estate Solutions' assessment and benchmarking module <http://www.srmnetwork.com/solutions> is designed to meet the requirements of the Standard, and also incorporates other industry protocols, most notably Energy Star and LEED. Based on the product demo I saw earlier this week, it lives up to its billing. In particular, the tool provides a seamless interface with EPA's Energy Star Building Labeling Assessment – Statement of Energy Performance, which is particularly helpful in the context of New York's ordinances related to its Greener, Greater Buildings Plan, as well as LEED EBOM credit for optimizing energy efficiency, for which 15 points are potentially available.

What does this all mean for M&A, environmental and real estate practitioners? Here are some initial observations:

- First, we should add ***Facility Energy Performance and Disclosure*** as a due diligence item for all business and real estate transactions. A check of local law for potential disclosure or other compliance obligations (e.g. reporting of building energy performance) is a must. In this regard, care must be taken to distinguish absolute legal requirements from aspirational standards, as much of the legislative activity in this arena is of the "carrot" and not the "stick" variety.
- Second, assuming there are no independent legal requirements that must be satisfied, we must discuss with our clients the advisability and extent of the desired due diligence. For publicly reporting companies, issues of carbon footprint reporting and corporate sustainability policies may prove a stronger catalyst for comprehensive due diligence.
- Following the due diligence discussion and evaluation, we should facilitate our clients' evaluation of the proper context of these issues within the overall "deal dynamic". Is there a minimum performance standard (on either a single facility or aggregate basis) which, if not met, would give rise to a claim for damages or indemnity? Or is the intent simply a disclosure exercise that may or may not potentially impact deal pricing?
- Fourth, we of course must draft to accomplish the deal objective. Green lease forms <http://legallygreenblog.com/green-leasing/leed-ebom-and-existing-leases-%e2%80%93-a-square-peg-in-a-round-hole> as well as construction contracts for green projects may provide a useful starting point for this exercise, but the legal context of these agreements may not necessarily translate well to mergers and acquisitions practice. Alas, we brave pioneers may have to tackle this one without the aid of a form book.

- Finally, we must facilitate understanding. Not only must we surmount our own learning curve, we must teach others. Having practiced environmental law in a transactional setting for most of my career, I have grown accustomed to this aspect of the job. This is just one more area where we, as practitioners, must adopt a legal framework to address a new market reality.

There is no doubt that the green wave has crested. Learning to address building energy performance in acquisition transactions is but one of many new legal challenges which await us in the brave new world of sustainability. As they say, just another day at the office.