

ALL APPROPRIATE INQUIRY:

New Phase I Environmental Standards to be Promulgated by EPA

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The driving force behind due diligence has historically been the Comprehensive Environmental Response, Compensation and Liability Act/Superfund Amendments and Reauthorization Act (CERCLA/SARA). Enacted in 1986, CERCLA serves as an addendum to the original Superfund law of 1980. To date, CERCLA, or "Superfund," has achieved the following: 1) established prohibitions and requirements concerning closed and abandoned hazardous waste sites; 2) provided for joint, strict, and retroactive liability of persons responsible for releases of hazardous waste at these sites; and 3) established a trust fund to provide for cleanup when no responsible party could be identified.

Superfund has always had an "out" by allowing the assertion of the "innocent landowner defense" to liability, requiring that "all appropriate inquiry into the previous ownership and uses of the property be consistent with good commercial or customary practice."

Until recently, the criteria to qualify as an innocent landowner were uncertain. Fortunately, recent amendments to Superfund clarify what constitutes "all appropriate inquiry." The Small Business Liability Relief and Brownfields Revitalization Act became effective in 2002. The Amendments embrace the American Society for Testing and Materials (ASTM) Standard Practice for Environmental Site Assessment (E1527-97). The Act requires the Environmental Protection Agency (EPA) to adopt regulations within two years that establish standard for "appropriate inquiry."

Other liability clarifications, such as for "contiguous property owners" and "bona fide purchasers," also are included in the Act, although their practical effects may be limited. Interestingly, the Act specifically provides for the purchase of a contaminated property, while limiting liability if certain conditions are met.

In accordance with the 2002 Small Business Liability Relief and Revitalization Act, the EPA is finalizing draft regulations covering due diligence standards for "all appropriate inquiry" (AAI) – the process by which a property's potential to be contaminated is investigated.

The EPA is slated to propose a draft AAI rule in late summer 2004, followed by a 60-day public comment period. After any necessary changes are made, the final regulations likely will be promulgated in early 2005.

Meanwhile, members of the environmental consultant community, particularly phase I professionals, are following the development of the proposed AAI rule with great anticipation. The draft rule replaces the current reference in the Act to the ASTM E 1527-00 site assessment standard, giving it the potential to affect every real estate transaction in the United States once the final rule is promulgated. It therefore has been critical for those involved with due diligence for commercial real estate to stay apprised of any

developments that will likely impact a significant number of commercial real estate transactions.

ALL APPROPRIATE INQUIRY CRITERIA

The new regulations clearly outline the steps property owners must take to be able to assert a defense to CERCLA liability. While this defense is nothing new (it first appeared on the scene in 1986 in amendments to Superfund), the promulgation of detailed regulations regarding AAI is.

The operable assumption in the marketplace for many years has been that the ASTM guidance sets the standard for AAI and is consistent with good commercial practices, as required by the 1986 Superfund amendments.

The Act, in attempt to facilitate brownfields redevelopment, not only amended the innocent landowner defense, but also added two new landowner liability defenses for the first time:

1) **Bona fide prospective purchaser:** creates protection for a property owner who knowingly purchases contaminated property, provided that the contamination occurred prior to purchase; and

2) **Contiguous property owner:** creates a defense for an owner of property when contamination is caused by a nearby property, provided the owner did not know of it at the time of purchase.

Congress expressly required 10 criteria be addressed by the regulations as outlined on page 21.

APPLICABILITY: ALL COMMERCIAL PROPERTY & SOME RESIDENTIAL TOO!

While the Act is clearly intended to facilitate brownfields redevelopment and to offer liability relief to those attempting to develop contaminated property, the AAI regulations are intended to cover all types of commercial





properties, not just brownfields. It should also be noted that AAI includes residential properties under certain circumstances. For example, residential properties used for commercial purposes, as well as residential properties under government ownership, are included.

CONTAMINANTS COVERED BY AAI: CHANGES FROM ASTM

Under ASTM, the objective of AAI was to identify "recognized environmental conditions," which generally means the presence or likely presence of hazardous substances or petroleum that is indicative of a release. Under AAI, petroleum is generally excluded from the objective, and the objective is subtly different: "to identify conditions indicative of releases or threaten releases of hazardous standards ..."

It is worth noting that significant releases (and liability) can be attributed to petroleum spills or leaks (i.e., leaking underground storage tanks, MTBE), and AAI should be augmented to cover these risks.

PROFESSIONAL JUDGMENT & PERFORMANCE CRITERIA

While the negotiated rule-making committee anticipated a shift away from prescriptive or a "checklist" mentality for AAI, they did build in safeguards to confirm that appropriate professional judgment is being exercised. Performance criteria were built into AAI as guideposts, and it appears that it was the Committee's intent to force the marketplace to respond to significant data gaps, data failure or false or misleading information.

To satisfy AAI, either the environmental professional or the prospective "innocent" landowner must do the following:

- Gather information that is publicly available, obtainable within a reasonable time and cost, and that can be reviewed practicably
- Review the thoroughness and reliability of the information gathered, taking into consideration any data gathered in complying with other portions of the AAI rule

- Identify any data gaps and comment upon the significance of those gaps

- Identify any releases or threatened releases (except for those releases that would not pose a threat to human health or the environment) Other significant changes associated with the new AAI regulations include the following:

1. **Environmental Professionals:** Must now meet specific education, experience and certification requirements under the AAI rule, and certify that these provisions have been met in the report.

2. **Record Review:** The standard review of federal and state government records under ASTM E 1527-00 is expanded under AAI to encompass records from local government agencies, as well as records maintained by Indian tribes.

3. **Institution Control:** Searches for engineering and institutional controls within one-half mile of the subject property must be conducted by environmental professionals

under the draft AAI rule and are reflective of an increase in brownfield sites.

4. Historical Research: The draft AAI rule's provisions for historical research are very general, leaving decisions about the research time frame, data sources and search intervals up to the environmental professional's judgment. This may be detrimental to report quality, with little guidance from the regulations on the appropriate levels of inquiry.

5. Interviews: Interviews with owners or occupants of neighboring properties will be mandatory for ESAs at brownfield sites. In addition, past owners or operators of a subject property must be interviewed.

6. Shelf Life: Environmental inquiries under the AAI rule are good for one year. Phase I ESAs older than one year will need to be redone.

7. User Obligations: Under the proposed rule, it would appear that a key element of AAI is a full disclosure of information. In particular, the user must share the following pieces of information with the environmental professional: 1) details about environmental cleanup liens that have been recorded; 2) any specialized knowledge or experience; 3) the relationship of the purchase price to the fair market value of the property, if the property is not contaminated; and 4) commonly known or reasonably ascertainable information about the property. If this information is available and not provided, some commentators have suggested AAI will not be validated and complete.





THE BOTTOM LINE

While Congress had in mind the promulgation of regulations that will expand liability defenses previously available, the expansion will likely result in more exhaustive and expensive Phase I assessments and changing due diligence standards (whether CERCLA-driven or not, the new regulation clearly will impact customary practices).

In addition, it seems clear that in order to be able to assert the innocent property owner or contiguous property owner defenses, the bar will be raised for level of quality, and documentation (e.g., file review) will be necessary.

Of course, ultimately the marketplace will determine what impacts these new, more complex and intensive regulatory-driven requirements will have, but until the final regulations are approved later this year, we can only anticipate that the cost of due diligence will be on the rise. ♦

10 Criteria for Conducting All Appropriate Inquiry

The Act establishes a number of conditions that parties must meet in order to qualify for any of the above CERCLA liability defenses. The criteria to be addressed by the final "all appropriate inquiry" standard are as follows:

1. Interviews with the past and present owners, operators and tenants of the facility to gather information regarding the potential for contamination of the facility.
2. Review of historical sources, such as the chain of title documents, aerial photographs, building department records, and land use records to determine previous uses and occupancies of the real property since the property was first developed.
3. Searches for recorded environmental cleanup liens against the facility that are filed under federal, state or local law.
4. Review of federal, state and local governmental records, waste disposal records, and hazardous waste handling, generation, treatment, disposal and spill records, concerning contamination at or near the facility.
5. Visual inspection of the facility and adjoining properties.
6. Specialized knowledge of experience on the part of the individual seeking to assert the defense.
7. The relationship of purchase price to the value of the property, if the property was not contaminated.
8. Commonly known or reasonably ascertainable information about the property.
9. Results of an inquiry reported by an environmental professional.
10. The degree of obviousness of the presence or likely presence of contamination at the property, and the ability to detect contamination by appropriate investigation.