

EPA Announces Final Rule for Completing Environmental Due Diligence in Connection with Commercial Real Estate Transactions

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All good things come to those who wait. And, so it is for EPA's long overdue federal standards and practices Rule for conducting all appropriate inquiries ("AAI"), which redefine what is commonly known as the Phase I Environmental Site Assessment process. EPA's new rule was published pursuant to the 2002 Brownfield Amendments of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA or Superfund).¹ Since its inception great debate has swirled around the notion of what constitutes "all appropriate inquiry" in connection with the assessment of commercial real estate for environmental impairment liability risk necessitated by Superfund's onerous "strict, joint and retroactive" liability scheme. Twenty-six years later, EPA has answered the question. The goal of the federal Brownfield Amendments is to create a Bona Fide Prospective Purchaser (BFPP) protection from CERCLA liability, among other objectives.

In concrete terms, EPA's rule modifies past standards and practices for the completion of Phase I Environmental Site Assessments, and creates a defense to federal liability for the ownership or operation of environmentally impaired property for BFPPs. The rule also clarifies the obligations of BFPPs who acquire environmentally impaired property in order avoid CERCLA liability. According to EPA, "this regulation may affect most directly those persons and businesses purchasing commercial property or any property that will be used for commercial purposes, and who may, after purchasing the property, seek to claims protections from CERCLA liability for releases and threatened releases of hazardous substances." While many such purchasers will never avail themselves of Superfund's safe harbors, there are important practical considerations raised by the new rule to help manage environmental risk. Given the lead time typically associated with complex environmental issues at contaminated sites, practitioners should review current policies and procedures when considering environmental risk management in light of EPA's new rule, which becomes effective November 1, 2006.

Concurrent with the release of the AAI Rule, ASTM released its revised version of the *Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process* (ASTM E-1527-05), which EPA has opined will also meet the obligations imposed under the new Rule. Unlike EPA's Rule, the new ASTM standard is effective immediately and prospective purchasers accustomed to reviewing Phase I ESA reports will begin seeing substantive changes as the new ASTM standard is implemented by their consultants. Indeed, most parties will continue to look to the new ASTM process for evaluating environmental risk, as ASTM was not constrained by limiting factors (e.g. CERCLA's petroleum exclusion, etc.) in finalizing its revised standard.

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¹ Federal Register Vol. 70, No. 210, Tuesday November 1, 2005. Environmental Protection Agency, 40 CFR Part 312. Standards and Practices for All Appropriate Inquiries. Final Rule.

This article presents an outline of the substantive changes to the general practice for conducting environmental due diligence in conjunction with commercial real estate acquisition.

Know thy consultant!

One important concept to emerge from EPA's decision making process is the definition of who is an "Environmental Professional" capable of completing Phase I Environmental Site Assessments. It is well established that the completion of environmental site assessments requires a varied skill set gained through both substantive knowledge and professional experience. Historically, the quality of Phase I Environmental Site Assessments varied significantly from consultant to consultant and even within different offices of the same regional or national firm. Stakeholders and the Agency ultimately agreed that there are important considerations in deciding whether one is an "Environmental Professional" capable of completing such work. According to the final rule an Environmental Professional must:

1. Hold a current state Professional Engineer's or Professional Geologist's license or registration *and* have the equivalent of 3 years of relevant experience; or
2. Be licensed or certified by the U.S. Government to perform environmental inquiries *and* have the equivalent of 3 years of relevant experience; or
3. Have a Baccalaureate or higher degree from an accredited institution of higher education in science or engineering *and* the equivalent of 5 years of relevant experience; or
4. Have the equivalent of 10 years of relevant experience.²

Importantly, the new rule requires that the Environmental Professional sign the report and document that they meet the foregoing definition. The rule also allows individuals who do not meet the above definition to participate in the preparation of the assessment; however the final report must be reviewed and signed by the Environmental Professional. The Environmental Professional is not required to "certify" the results of the all appropriate inquiry when signing the report. However, the written report must state:

"[I, We] declare that, to the best of [my, our] professional knowledge and belief [I, we] meet the definitional of Environmental Professional as defined in § 312.10 of this part."

"[I, We] have the specific qualifications based on education, training, and experience to assess a property of the nature, history, and setting of the subject property. [I, We] have developed and performed all the appropriate inquiries in conformance with the standards and practices set forth in 40 CFR Part 312."³

In most instances, reputable environmental consultants will meet the foregoing definition. However, EPA's new requirement is a balanced attempt to ensure that the responsibility for undertaking environmental due diligence meets a reasonable standard of accreditation without

² Id. § 321.10

³ Id § 321.21

creating a federal licensing body. A knowledgeable and experienced environmental professional plays an invaluable roll in this task. Experience suggests that it is far more cost effective to identify potential areas environmental concern prior to acquisition and allocate risk among the parties.

Responsibilities for Prospective Landowners

Citing the need for confidentiality, among other considerations, EPA's final rule does not *require* prospective landowners to provide information collected as part of the "additional inquires" to the Environmental Professional. Additional inquires are defined as "specialized knowledge or experience of the landowner (or grantee); the relationship of the purchase price to the fair market value, if the property were not contaminated; and commonly known or reasonably ascertainable information about the subject property."⁴ This was a departure from previous drafts that creates a burden-shifting requirement to the extent that the Environmental Professional may identify the foregoing "data gaps" in the report and whether the lack of such information impacts the Environmental Professional's ability to render an opinion regarding the significance of the assessment.

Increasingly, parties to Brownfields-type transactions have relied on institutional and engineering controls (e.g. deed restrictions, vapor barriers, etc.) to meet site specific environmental risk management criteria. As these sites are transferred to subsequent purchasers it is incumbent on the Environmental Professional and the Prospective Purchaser to be aware of such controls, and insure that they are maintained on a going forward basis. In theory, such controls can be as simple as requiring a paved parking lot to be maintained as cover to an impacted area of the subject property. However, the practical communication for maintaining engineering and environmental controls is frequently overlooked by subsequent owners and/or occupants that were not parties to the creation of such requirements or were otherwise unaware of their existence.

In most instances, the prospective purchaser should disclose all know and/or suspected environmental conditions to the Environmental Professional so that these issues can be included within the scope of protections offered by the defenses to liability under federal law. Concerns relating to confidentiality of information supplied by buyers and sellers can be (and frequently are) addressed through side agreements or as part of the contracts between the parties. Ultimately, liability for environmental concerns rests with the prospective purchaser of the property, and the decision of whether to provide potentially sensitive information should be reviewed in conjunction with experienced legal counsel.

Increasing Burdens for Consulting Community Means Increased Transaction Costs

Not only does EPA now mandate who is capable of meeting the definition of being an "Environmental Professional", the rule makes clear that the Environmental Professional must "determine previous uses and occupancies of the real property since the property was first developed".⁵ This is a broader requirement than previously included within the former ASTM

⁴ Id.

⁵ Id. §312.1

standard. As with previous practice, this information will be obtained through interviews with past and present owners, reviews of historical sources, reviews of government records, visual inspections, and commonly know or reasonably ascertainable information concerning the subject property.

Moreover, EPA enumerated certain *Performance Factors* that must be considered by the prospective purchaser and Environmental Professional in performing each of the standards and practices to meet the objectives of the new Rule.⁶ Perhaps most troubling to the Environmental Professional is the requirement to “review and evaluate the thoroughness and reliability of the information gathered in complying with the standard and practice...taking into account information gathered in the course of complying with other standards and practices.”⁷ In other words, the Environmental Professional must now opine as to the existence of data gaps (i.e. the lack of or inability to obtain information required by the rule), and the significance of such information or lack thereof on the findings of the report. “Why would any environmental consultant give an opinion that the absence of information over a significant period of years (i.e. Data Gap) was insignificant?” Charles “Chic” Creales of GZA in Norwood, MA asks rhetorically. In more urbanized areas of the United States it is often possible through a variety of historical and regulatory agency sources to develop a mosaic of historical ownership, use and agency contacts of the subject property with sufficient accuracy. In other cases, the lack of historical sources or other information can produce data gaps in which little is known or understood about the site. In these instances the Environmental Professional is left with little option but to either a.) assume the risk that no adverse use was present, or b.) recommend additional study in the form of a Phase II subsurface investigation. As the former increases risk to the environmental consultant and the later increases profits it is not stretch of the imagination to foresee additional reliance on soil and groundwater investigations.

Under the Rule, the Environmental Professional must now state an “opinion as to whether the inquiry has identified conditions indicative a releases or threatened releases of hazardous substances...on, at, in or to the subject property.”⁸ Note that the ASTM version retains the familiar “*recognized environmental condition*” language which includes petroleum products within its definition.⁹

The Need for Additional Investigation

Not infrequently a Phase I ESA performed in accordance with the all previous versions of ASTM’s Standard Practice will identify *Recognized Environmental Conditions* (RECs) in connection with the study site. ASTM’s latest version of the E 1527-05 Standard states that the “...environmental professional should provide an opinion regarding additional appropriate investigation, if any, to detect the presence of hazardous substances or petroleum products. This

⁶ Id § 312.1(f)

⁷ Id.

⁸ Id §312.21

⁹ CERCLA specifically and consistently exempted petroleum products from its definition of “hazardous substances”, notwithstanding the fact that petroleum products clearly comprise a substantial share of “concerns” identified in the completion of Phase I Environmental Site Assessments. ASTM was not bound by CERCLA’s petroleum exclusion definition.

opinion should only be provided in the unusual circumstance when greater certainty is required regarding the identified recognized environmental condition.”¹⁰ (Emphasis added). EPA’s Rule notes the distinction between the consultants “opinion” and a “recommendation” that additional work be completed. Nevertheless, it is up to the user of the report to determine whether such additional study should be conducted, and accept the consequences that flow from that decision. Accordingly, Phase I ESAs that identify RECs need to be carefully reviewed in light of the potential obligations that may be created through acquisition of a contaminated site. For example, BFPP protections may be lost in the event the prospective purchaser chooses not to implement the recommended scope of work, fails to stop a continuing release or prevent future releases, or otherwise fails to prevent human exposure to site contaminants. Such a scenario raises a number of conflicts that will require consultation with experienced environmental legal counsel. Moreover, for sites where environmental risk is suspected early in the pre-acquisition process prospective purchasers should consider retaining the environmental professional through legal counsel in order to receive confidential legal advice concerning the implications of moving forward with the transaction.

Role of Environmental Insurance

The use of environmental insurance as a mechanism for risk transfer has become increasingly familiar in today’s Brownfields marketplace. In essence, the placement of environmental insurance can obviate the need to conduct substantial (but not all) soil and groundwater testing given the use of more sophisticated risk modeling. According to MaryAnn Susavidge, an environmental underwriter with the XL Insurance companies, "the new Rule certainly gives more choices to perspective property buyers. They can take advantage of the additional comfort and protection from liability that the AAI Rule offers. Yet, as there still may be unknowns when purchasing a property, environmental insurance will remain an important risk management consideration when purchasing property". Insurance companies and prospective purchasers will also benefit from increased quality in the preparation of Phase I ESAs. “In the underwriting process, we rely on quality data in order to provide the most effective insurance coverage and efficient terms and pricing," said Ms. Susavidge. "The new Rule should facilitate an increase in quality information about the environmental condition of the property which, in turn, may help in the insurance underwriting process. It certainly offers our insureds a greater comfort level when entering into a property transaction."

Practice Tips

Real estate practitioners, developers, lenders and attorneys should be mindful of the following practice tips:

1. The “new” ASTM E 1527-05 Standard has been published and will remain an acceptable mechanism to meet the All Appropriate Inquiry requirements imposed by the 2002 Brownfields Law, which take effect on November 1, 2006. However, many environmental consultants are now implementing the requirements of the new rule by adopting the new ASTM standard;

¹⁰ ASTM E 1527-05 Sec. 12.6.1

2. Confirm that your Environmental Professional meets EPA's new requirements and carefully review the terms and conditions contained in the professional services contract as these terms are likely to change in light of the rule and revised ASTM standard;
3. Establish an agreed upon scope of work and whether the Phase I Environmental Site Assessment will meet the requirements of 40 CFR 312;
4. Review confidentiality and access issues as part of the proposal process to avoid pitfalls at a later date;
5. Carefully consider the objectives of the Phase I ESA, understanding that those that do not meet the new federal regulation or ASTM equivalent may not provide a defense to liability for a subsequent purchaser;
6. Environmental due diligence costs are likely to increase beyond current pricing, however, high quality environmental reports can avoid substantial costs down the road;
7. When possible, provide all data pertaining to the environmental conditions at a site to the environmental consultant.
8. Contact a knowledgeable environmental attorney as soon as possible when environmental conditions are suspected or identified to meet the Rule's requirements for maintaining BFPP status;
9. Consult experienced environmental transactional support professionals to address issues of risk allocation and transfer, such as environmental insurance;
10. Remember – All appropriate inquiry makes sense from both business and legal perspectives. Identify potential areas of environmental concern early on in the deal process and allocate responsibility accordingly. Knowledge is power.

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