Real Estate, Environmental and Land Use Department

UPDATE: EPA's New All Appropriate Inquiry Rule Makes Important Changes in Due Diligence on Contaminated Properties for Prospective Purchasers

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This update aims to inform *prospective purchasers of properties challenged by real or threatened environmental contamination* of new opportunities and obligations with regard to pre-purchase due diligence examination of the subject properties.

In January 2002, President George W. Bush signed into law the "Small Business Liability Relief and Brownfields Revitalization Act" ("BRA"). Among other important provisions, the BRA amended the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA" or "Superfund," 42 U.S.C. §§ 9601 et seq.) to provide protection against liability under that statute to prospective purchasers of properties with actual or threatened environmental contamination (the "innocent purchaser" defense). 42 U.S.C. § 9607(r)(1). The BRA also required the U.S. Environmental Protection Agency ("EPA") to issue regulations that would set standards for "all appropriate inquiry" ("AAI")—*i.e.*, the *due diligence* exercise that such prospective purchasers must carry out before purchase of the subject property in order to meet a threshold for asserting the innocent purchaser defense.

The BRA provides that, until EPA's new AAI regulations become effective, however, prospective purchasers may qualify for the innocent purchaser defense by conducting Phase I environmental assessments that comply with the standards of the American Society of Testing Materials issued before enactment of the BRA (the "ASTM E1527-00"). The ASTM E1527-00 has become the presumptive industry standard for due diligence exercise by prospective purchasers of commercial, industrial, and mixed use properties. On November 1, 2005, EPA finally issued its landmark AAI rule, which will go into effect on November 1, 2006. 40 Federal Register 66070, amending 40 C.F.R. Part 312. (See http://www.epa.gov/brownfields/regneg.htm.). Meanwhile, prospective purchasers may continue to rely upon on the ASTM E1527-00, but *may not do so after October 31, 2006*. The AAI standard under the new regulations will create more stringent obligations for prospective purchasers, with which they, their consultants, and counsel should become familiar.

AAI as a Threshold Obligation

Compliance with the regulations will remove a prospective purchaser from the definition of a "potentially responsible party" under Superfund, provided the party also takes "reasonable steps" *after the purchase* to address any contamination discovered as part of the AAI process, cooperates with regulatory authorities, and abides by existing engineering and institutional controls on the subject property. A prospective purchaser's compliance with the BRA and the new regulation will not, however, provide a

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defense to any actions brought under state law unless the particular state in which the property is located has adopted the federal standard and the purchaser otherwise meets requirements imposed by state law.

Obligations Beyond Those of the ASTM E1527-00

Compared to the ASTM E1527-00, the AAI rule:

- Uses a performance-based approach instead of a prescriptive approach to conduct inquiries.
- Specifies minimum qualifications that the environmental professional (EP) must have, including specific education, experience, and licenses (such as "Professional Engineer" and "Professional Geologist" as well as "Licensed Site Professional" in Massachusetts and "Licensed Environmental Professional" in Connecticut).
- Provides that the AAI process must be conducted within one year prior to purchase date, with certain aspects conducted or updated within 180 days of purchase date (site inspection, interviews, local record search, EP's declaration).
- Places extensive reliance on the EP's professional judgment.
- Requires a broader scope of environmental inquiry into tribal and local, as well as federal and state records.
- Adds the requirement to search for engineering and institutional controls.
- Mandates interviews with "major occupants" of multi-tenant properties, present and past owners of target properties and owners or occupants of neighboring properties at abandoned sites.
- Requires written opinions by the EP addressing the thoroughness and reliability of the data gathered in the AAI process, and certain affirmative declarations in the written AAI report about the EP's credentials and qualifications.
- Obligates both the EP and the party seeking to take advantage of the inquiry as a defense to Superfund liability to identify all data gaps, describe efforts to resolve them, and requires the environmental professional to issue an opinion about the impact of the data gaps on his or her ability to identify conditions indicative of releases or threatened releases of hazardous substances.

New Inquiries Required to be Made by the Prospective Purchaser

The regulation imposes specific inquiry obligations on prospective purchasers to:

1. identify "environmental cleanup liens against the subject property that are filed or recorded under federal, tribal, state, or local law" unless otherwise listed by the EP in its inquiries;
2. "take into account, their specialized knowledge of the subject property, the area surrounding the subject property, the condition of adjoining properties, and any other experience relevant to the inquiry, for the purpose of identifying conditions indicative of releases or threatened releases at the subject property";
3. "consider whether the purchase price of the subject property reasonably reflects the fair market value of the property, if the property were not contaminated"; and
4. "take into account commonly known or reasonably ascertainable information within the local community about the subject property and consider such information when seeking to identify conditions indicative of releases or threatened releases" unless that information has been obtained by the EP in its inquiries.

To meet the increased obligations of AAI, ASTM has updated its E1527 standard with a new version, the ASTM E1527-05, compliance with which the AAI regulations recognize as equivalent to meeting the criteria of the regulation. Oddly, while the ASTM E1527-05 requires the party who commissions the Phase I study to disclose the results of its own required inquiries to the EP, the AAI regulation itself makes such disclosure discretionary. Failure to make such disclosure, however, could result in the creation of a "data gap" that the prospective purchaser and the EP must fill with other efforts.

Duty to Fill Data Gaps

In any event, whenever a data gap occurs, whether it relates to the inquiry of the prospective purchaser or the EP, *both* have the obligation to "identify such data gaps, identify the sources of information consulted to address such data gaps, and comment upon the significance of such data gaps with regard to the ability to identify conditions indicative of releases or threatened releases of hazardous substances." A prospective purchaser who does not join the effort of the EP to fill data gaps may face a challenge to the sufficiency of its due diligence for the purpose of establishing a BRA defense to a CERCLA action.

Increased Cost

The new AAI regulations will probably significantly increase the cost of Phase I environmental assessments. In its "preamble" to the new AAI rule, EPA estimates an incremental increase in cost for an AAI compliant Phase I examination over one done consistently with the ASTM E1527-00 to amount only to a range of $41 to $48. This unrealistically low estimate does not appear to consider increased EP time and expense that the rule will require with regard to additional interviews, visual inspections, and consultations with regard to data gaps, as well as cost of the prospective purchasers' time and efforts to fulfill their independent obligation for their additional inquiries as described above. Large incremental costs will likely arise from the higher level of qualifications required for the EP, the requirement for fresh information (much of which must be gathered within 180 days before purchase of the subject property), a broader and deeper inquiry, and greater risk of professional liability for the EP due to the expanded reliance on his or her judgment.

Additional Concerns: Confidentiality and Burden

Before conducting a Phase I site assessment compliant with either the new AAI rule or the ASTM E1527-05 the prospective purchaser should also consider its own requirements for confidentiality. This concern arises from the rule's demand for broadened inquiries, personal interviews, and visual inspections that could result in disclosure of commercially valuable information, such as interest in properties that need to be aggregated. Such disclosure could drive up price or result in unwanted attention by activist groups, NIMBY ("Not In My Back Yard") interests, or regulators.

The prospective purchaser should also consider the burden the AAI regulation imposes on it to become an active participant in the assessment exercise. In addition to exploring the record for environmental liens (or commissioning the EP or another qualified entity to do so), the prospective purchaser must also inquire into valuation questions with regard to the property. The preamble to the regulation notes that this probably will not require an independent site appraisal in every case, but the prospective purchaser will need to explain in a record contemporaneous to the AAI inquiry any blatant discrepancies in price between the subject property and similarly situated uncontaminated properties. In addition, the prospective purchaser will have to consider and record whether its own "specialized knowledge" of the subject property should lead to additional inquiries about the property that one without that knowledge would not undertake. Finally, unless already discovered by the EP, the prospective purchaser will have to consider "commonly known or reasonably ascertainable information about the property." Except in the most obvious cases, a prudent innocent purchaser should consult with counsel on any or all of these inquiries—another expensive addition to the due diligence exercise.

Do You Really Need an AAI Compliant Diligence Examination?

Parties undertaking diligence inquiries of routine commercial properties where they have no reason to anticipate site contamination and attendant liability, may wish to consider ordering their environmental consultants to continue to follow the requirements of the less expensive and less onerous ASTM E1527-00 standard to screen properties for environmental issues. If, during the course of the E1527-00 examination (which would not provide a BRA defense to CERCLA liability), the consultant discovers unanticipated liability concerns, it should have the flexibility to convert the

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examination into a broader AAI examination (which would do so). In any event, prospective purchasers of commercial and industrial properties should consult with counsel as to the nature, extent, and quality of the diligence examination they will perform on subject properties.

[Wiggin and Dana LLP partner Barry J. Trilling served as the representative of the 12,000+ member National Association of Industrial and Office Properties ("NAIOP") in the Federal Advisory Committee Act (FACA) negotiations that resulted in the proposed AAI regulation. The 25 member committee on which he served included representatives of various organizations and stakeholders with an interest in environmental due diligence, including the real estate industry, the lending industry, environmental activist groups, community organizations, environmental professionals, and federal, tribal, state, and local governments. (See, http://www.epa.gov/brownfields/aai/faca_info.htm.)]

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