



Buyer Beware:

New EPA Due Diligence Standards Will Impact All Commercial Real Estate Transactions

By *Sedina Banks and Shriaz Tangri,*
Greenberg Glusker Fields Claman & Machtinger LLP

14

Beginning November 1, 2006, every commercial real estate transaction will be subject to new federal regulations establishing environmental due diligence standards. Compliance with new regulation is a requirement for insulating buyers from potential liability under the federal Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA," also known as "Superfund"). CERCLA imposes liability, without regard to fault or negligence, on past and present owners for any environmental contamination found on the property, a purchaser of land contaminated by the activities of others is nonetheless liable under CERCLA unless it qualifies for one of few statutory defenses, such as those for bona fide prospective purchasers, innocent landowners, and contiguous property owners. However, to qualify for any of these defenses, a property owner must conduct "all appropriate inquiry" on or before the date of acquiring the property. Although conducting all appropriate inquiry is not the sole requirement to qualify for the CERCLA defenses, it is an essential first step. Despite the significance of the all-appropriate inquiry requirement, until recently, no federal statute or regulation defined that standard. As a result, prospective purchasers had



Sedina Banks



Shriaz Tangri

little guidance on how to qualify for the CERCLA defenses. The new federal regulations confirm that a comprehensive environmental site assessment is a necessary part of pre-acquisition due diligence for every commercial real estate transaction.

THE NEW FEDERAL REGULATION MANDATES A PHASE 1 ENVIRONMENTAL SITE ASSESSMENT

The United States Environmental Protection Agency ("USEPA") conducted extensive negotiations

with interested parties to devise a comprehensive due diligence standard. The agency issued its final rule on November 1, 2005, entitled the "Standards and Practices for All Appropriate Inquiries." The rule effective on November 1, 2006, establishes federal guidelines for investigating the previous ownership and uses of a property for purposes of qualifying for any of the CERCLA defenses. Here are the key points that every real estate developer or investor should know about the new standard:

A PHASE 1 ENVIRONMENTAL SITE ASSESSMENT IS ESSENTIALLY MANDATORY

The new federal regulations require that real property purchasers conduct a comprehensive non-intrusive environmental site assessment, commonly known as a "Phase I."

Although it has long been prudent practice to obtain a Phase 1 report, the new federal rules now make it mandatory to qualify for one of the CERCLA defenses. Compliance with the new due diligence standards is also a prerequisite to qualify for CERCLA grants for brown fields redevelopment

THE PHASE 1 MUST BE CONDUCTED BY A QUALIFIED ENVIRONMENTAL PROFESSIONAL

The all-appropriate inquiry investigation must be conducted

or supervised by an environmental professional. Before retaining an environmental consultant to perform a Phase 1 investigation, developers should ensure that the consultant is qualified under USEPA's definition of an "environmental professional" and is familiar with the new standards.

INCREASED SCOPE OF INVESTIGATION

The new federal rule generally requires a more comprehensive investigation than the old Phase 1 standards. An inquiry investigation must include interviews with past and present owners, operators, and occupants; reviews of historical sources of information: searches for recorded environmental cleanup liens; reviews of federal, state, tribal, and local government records; and visual inspections of the property and adjoining properties. In addition, the assessment takes into account any specialized knowledge the prospective purchaser may have about the property, any commonly known or reasonably ascertainable information about the property, and whether their purchase price of the subject property reasonably reflects the fair market value of the

property, if the property were not contaminated. Developers should expect the cost of Phase 1 investigations to increase as a result of the greater scope of inquiry.

EXPLICIT DOCUMENTATION

REQUIREMENTS APPLY

The new rule does not impose any new agency reporting or disclosure obligations. However, it does require that the environmental professionals conducting the inquiry satisfy certain documentation requirements intended to record their qualifications, their opinion as to whether the inquiry has identified conditions indicative of releases of hazardous substances at the property, and an identification of any data gaps in the information developed as part of the inquiry that may affect the conclusion.

PHASE 1 SITE ASSESSMENTS MUST COMPLY WITH THE NEW ASTM STANDARD E1527-05

A critical aspect of the final rule is USEPA's endorsement of ASTM International's revised Standard is widely accepted as the guidance document environmental consultants must adhere to in conducting a

Phase 1 environmental site assessment. A revised ASTM Standard was issued the same date as USEPA's promulgation of its final rule. USEPA's regulation endorses the 2005 ASTM Standard as "consistent with" the final federal rule and "compliant with the statutory criteria for all appropriate inquiries." The revised ASTM Standard is effective immediately, even though the final rule does not take effect until November 1, 2006.

Accordingly, developers should make sure that their environmental consultant complies with the 2005 revision of the ASTM Standard for any new Phase 1.

In addition to meeting the minimum standards set forth in the USEPA all-appropriate inquiry rule, the ASTM Standard is broader in scope than the federal rule. For instance petroleum products, which are excluded from CERCLA's definition of a hazardous substance, are included within the scope of the ASTM Standard. The ASTM Standard also contains more comprehensive inquiry and reporting requirements compared to the rule. Thus, a Phase 1 assessments that complies with the revised ASTM Standard not only satisfies CERCLA's all-appropriate inquiry requirement, but is an essential part of the pre-acquisition due diligence process.

CONCLUSION

USEPA's promulgation of the all-appropriate inquiry rule is a critical step to enable prospective purchasers to qualify for one of the CERCLA defenses. Compliance with the new federal rule will also provide developers with critical information about the environmental condition of a prospective purchase. Prudent developers should work with counsel and their environmental consultants to ensure that their pre-acquisition due diligence protocol satisfies the new federal requirements. 

