EXTRA INNINGS REQUIRED? NEW REGULATIONS MAY INCREASE TIME AND COST OF ENVIRONMENTAL DUE DILIGENCE

I. THE BACKGROUND

A. As part of the 2002 Brownfields Amendments to CERCLA, Congress added two more categories of landowner liability protections to the already existing category of innocent landowners[1] ("ILO"); bona fide prospective purchasers[2] ("BFP") and contiguous property owners[3] ("CPO"). In order to be eligible for any of these categories of defenses, ILOs, BFPs and CPOs are required to conduct an "all appropriate inquiry"[4] ("AAI").

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[1] Among other criteria, an "innocent landowner" is one who buys property "without knowing, or having reason to know of, contamination on the property". See U.S. Environmental Protection Agency "Common Elements" Guidance Reference Sheet, available at:

http://www.epa.gov/compliance/resources/policies/cleanup/superfund/common-elem-guide.pdf.

[2] Among other criteria, a "bona fide prospective purchaser" is a party that buys property after January 11, 2002 "knowing, or having reason to know of, contamination on the property". Id.

[3] Among other criteria, a "contiguous property owner" is an owner of property "that is not the source of contamination" but is " 'contiguous' to, or otherwise similarly situated to, a facility that is the source of contamination found on their property." Id.

[4] Notably, complying with the AAI standard is only one prong in determining whether or not ILOs, BFPs or CPOs qualify for protection against liability. In addition, there must be no affiliation with the party who is potentially liable for response costs at the property. Affiliation includes "direct and indirect familial relationships and…contractual, corporate, and financial relationships." Id. Once an ILO, BFP or CPO is awarded liability protection, in order to maintain such protected status, the ILO, BFP or CPO must comply with continuing obligations including, without limitation, compliance with

B. Congress authorized the EPA to issue regulations based on the following ten criteria[5] which would define what constitutes an "all appropriate inquiry":

1. The results of an inquiry by an environmental professional;

2. Interviews with past and present owners, operators, and occupants of the facility for the purpose of gathering information regarding the potential for contamination at the facility;

3. Reviews of historical sources, such as 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;

4. Searches for recorded environmental clean-up liens against the facility that are filed under federal, state, or local law;

5. Reviews of federal, state, and local government records, waste disposal records, underground storage tank records, and hazardous waste handling, generation, treatment, disposal, and spill records concerning contamination at or near the facility;

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land use restrictions and institutional controls implemented in connection with a remediation response activity even though such restrictions may not have been in place at the time of purchase, and taking reasonable steps to "stop continuing releases; prevent threatened future releases; and prevent or limit human, environmental, or natural resources exposure to earlier hazardous substance releases." Id. The Environmental Protection Agency ("EPA") does not, however, suggest that the reasonable steps to be taken by ILOs, BFPs and CPOs would rise to the same level of response obligations as the actual liable party since these reasonable steps would be in response to contamination for which the ILO, BFP or CPO is not responsible for causing. Nevertheless, "[a]ctivities on the property after purchase resulting in new contamination can give rise to full … liability." Id.

[5] Small Business Liability Relief and Brownfields Revitalization Act (Public Law No. 107-118), Section 223(2)(B)(III), amending CERCLA Section 101(35).

6. Visual inspections of the facility and adjoining properties;

7. Specialized knowledge or experience on the part of the defendant;

8. The relationship of the purchase price to the value of the property if the property was not contaminated;

9. Commonly known or reasonably ascertainable information about the property; and

10. The degree of obviousness of the presence or likely presence of contamination at the property and the ability to detect the contamination by appropriate investigation.

C. Final regulations were supposed to be promulgated by January 2004. The EPA, however, was behind schedule and published draft regulations on August 26, 2004.[6] The draft regulations were subject to public comment until November 30 , 2004. Final regulations are expected to be issued later this year.

D. While we wait for these regulations, two interim substitute standards are applicable depending on the acquisition date of the property:

> "[For] properties purchased prior to May 31, 1997… a court shall consider the following when making a determination with respect to [the liability] of the [landowner]: specialized knowledge or experience of the defendant, relationship of the purchase price to the value of the uncontaminated property, commonly known information about the property,

[6] 40 CFR Part 312 (2004).

> obviousness of contamination, and the ability of the defendant to detect contamination by appropriate detection… [For] properties purchased after May 31, 1997, the law requires the use of procedures developed by the American Society for Testing Materials (ASTM), in particular… E-1527-00…."[7]

II. THE ALL APPROPRIATE INQUIRY STANDARD VERSUS THE CURRENT ASTM E-1527-00 STANDARD

A. Because the final rules have yet to be promulgated, it is too early to tell with exactness how the AAI rules will differ from the widely used and implemented ASTM E-1527-00 standards for the creation of Phase I Environmental Assessments. However, even based on the draft rules circulated to date by the EPA, differences, some slight and some significant, differences are already detectable.

B. The ultimate objective of the AAI differs only slightly from the ASTM standards. The traditional goal of the Phase I has been to identify "recognized environmental concerns". While this term has disappeared from the AAI vocabulary, like the ASTM standard, the objective of the AAI rules are to identify conditions indicative of "releases and threatened releases of hazardous substances on, at, in, or to the subject property".[8] The AAI objective applies to anyone seeking any of the landowner liability protections previously mentioned or persons receiving federal grants for conducting assessments of brownfield sites. It does not, however, apply to property

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[7] "Brownfields Fact Sheet for All Appropriate Inquiry" available at www.epa.gov/brownfields.

[8] 69 Federal Register 165 at 52550 (August 26, 2004).

purchased by a non-governmental entity or a non-commercial entity for "residential or other similar uses where a facility inspection and title search reveal no basis for further investigation…and does not affect the existing CERCLA liability protections for state and local governments that acquire ownership to properties involuntarily in their functions as sovereigns…." [9]

C. One of the major differences between the AAI rules and the existing ASTM standards is that the former defines "environmental professionals" more specifically and perhaps, more stringently, while at the same time permits the delegation of duties.

1. The ASTM standard defines an "environmental professional" as one who possesses sufficient training and experience to perform the tasks required under a traditional Phase I and make a conclusion regarding "recognized environmental conditions".[10] There is no mention of the quantity or quality of training or experience.

2. When negotiating the definition of "environmental professional" during the rulemaking process, the AAI committee wanted to ensure that "all appropriate inquiries are conducted at a high standard of technical and scientific quality, while not significantly disrupting the current market for professional site assessment services." [11] Accordingly, in 40 CFR Section 312.10, the EPA sets forth that an "environmental professional" must have the following qualifications:

a. A professional engineer's or professional geologist's license and three years of full-time relevant experience; or

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[9] Id.

[10] "All Appropriate Inquiry Standard Will Create Substantive New Requirements For Phase I Environmental Site Assessments", Gregory A. Bibler and Nathan J. Brodeur (April 2004).

[11] 69 Federal Register 165 at 52553 (August 26, 2004).

b. License or certification to perform environmental inquiries and three years of experience; or

c. Baccalaureate or higher degree from an accredited institution of higher education in a relevant discipline of engineering, environmental science, or earth science and five years of full-time relevant experience; or

d. Baccalaureate or higher degree from an accredited institution of higher education and ten years of full-time relevant experience, as of the promulgation date of the AAI rules.

3. To temper these qualifications, the tasks to be undertaken during the AAI process may be delegated to someone who is not an "environmental professional" as long as "such person is under the supervision or responsible charge of a person meeting the definition of an environmental professional…." [12] Bibler and Brodeur of Goodwin Procter LLP commented that "[g]iven the importance placed in the proposed [AAI] rule on professional judgment and experience, it is notable [the rule] permits individuals that are not qualified environmental professionals to conduct site visits." [13] This irony was not lost on the EPA who noted that the compromise enables

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[12] Id. at 52577.

[13] The EPA recommends, however, that visual inspections of subject properties or adjoining properties be conducted by an environmental professional…"although many other aspects of the all appropriate inquiries may be conducted sufficiently and accurately by individuals other than the environmental professional…[At] a minimum, [the environmental professional should] be involved in planning for the on-site visual inspection. Information collected during the conduct of other required activities such as interviews …and reviews of government records should be reviewed in preparing for the on-site visual inspection." Id. At 52552

individuals who are not "environmental professionals" to participate and contribute, thereby keeping the AAI process still affordable.[14]

D. Other distinctions between the AAI rules and the ASTM standards are the declarations required to be made by the environmental professional in the AAI report.

1. Pursuant to 40 CFR 312.21(d), the environmental professional must declare:

a. "[I, We] declare that, to the best of [my, our] professional knowledge and belief, [I, We] meet the definition of Environmental Professional as defined in [section] 312.21 of 40 CFR part 312"; and

b. "[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] developed and performed the all appropriate inquiries in conformance with the standards and practices set forth in 40 CFR part 312".

2. In the preamble to the draft AAI rules, the EPA is careful to note that these are declarations and not certifications. This was important in the development of the proposed rule because the EPA did not want such statements to imply any potential warranty or guarantee of the AAI report results which in turn could drastically increase the cost and availability of insurance for environmental professionals.

E. The AAI rule also imposes a far greater depth of inquiry requirement as to the subject property than the ASTM standards, and unfortunately, at times with no real guidance as to performance standards.

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[14] Id.

1. For example, as in the ASTM approach, under the AAI rules, the environmental professional must interview the current owner and occupant of the property. Additionally, the environmental professional must also interview current and former facility managers, past owners or occupants. If the property is abandoned together with evidence of potential unauthorized use or uncontrolled access, interviews must be taken of one or more owners or occupants of neighboring properties "from which it appears possible to have observed uses".[15] Missing from the AAI rules are the required content of the interviews. The only thing that guides the environmental professional is the vague standard that these interviews must yield information "necessary to achieve the objectives and performance factors" of the AAI rules.[16]

2. Another departure from the ASTM standards is that the environmental professional must review historical documents and records such as aerial photographs, fire insurance maps, title documents and land use records as far back "as it can be shown that the property contained structures or from the time the property was first used for residential, agricultural, commercial, industrial or government purposes." [17] In the ASTM context, historical records only had to be searched back to 1940. Attorney John Dunn of Warner Cross & Judd, LLP, warns, "If the [proposed AAI rules are]…read literally, the review must extend back to the time that the first tent was pitched on the property." The literal approach is all we have currently

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[15] Section 312.23 of 40 CFR Part 312.

[16] This same concern was noted by John D. Dunn of Warner, Norcross & Judd, LLP, in his article "New 'All Appropriate Inquiry' Regulations Will Affect Transfers of Property" published in September 2004 and available at www.wnj.com.

[17] Section 312.24 of 40 CFR Part 312.

because the proposed AAI rules do not define "structures" at all. As such the scenario predicted by Dunn is not impossible because it is not clear if temporary portable improvements are excluded or included.

3. On top of longer historical searches, environmental professionals must also consider "commonly known or readily ascertainable information within the local community".[18] "[T]o the extent necessary to achieve the objectives" of the AAI rules which is to identify conditions indicative of releases or threatened releases, the following sources may be relied upon to determine if there exists "commonly known or reasonably available information:" current owners or occupants of neighboring properties or adjacent properties; local and state government officials or any others with knowledge of the subject property; newspapers; websites; community organizations; local libraries or historical societies.

4. The proposed AAI rules require scrutiny into the existence of engineering and institutional controls affecting the subject property.[19] Traditionally, this was accomplished through interviews and title searches. The proposed AAI rules, however, also mandate an examination of registries or publicly available lists.

5. Environmental liens must also now be considered pursuant to the AAI standard.[20] These liens may be included as part of the chain of title documents as they constitute encumbrances on property for the recovery of clean-up costs incurred by a governmental agency or a

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[18] Section 312.30 of 40 CFR Part 312.

[19] Institutional controls are administrative or legal methods for minimizing contamination, such as zoning restrictions, or easements,

[20] Section 312.25 of 40 CFR part 312.

third party. As such an inquiry does not require the expertise of an environmental professional, the purchaser can obtain such results on his or her own and deliver the information to the environmental professionals.

6. In the preamble to the draft AAI rules, the EPA declares that the "visual on-site inspection of a property during the conduct of all appropriate inquiries may be the most important aspect of the inquiries…." [21] As such, section 312.27 of the proposed AAI make visual on-site inspections mandatory. If an "unusual circumstance" arises because of physical limitations, remoteness or lack of access, an on-site inspection will not be required provided that the AAI report include the following: visual inspection by the environmental professional by another method such as aerial imagery or inspection from the property line or public road; documentation of efforts to gain access and why such efforts were not successful; and "[d]ocumentation of other sources of information regarding releases or threatened releases…[such as] comments by the environmental professional on the significance of the failure [to inspect]…with regard to the ability to identify conditions indicative of releases or threatened releases…." Please note that an "unusual circumstance" does not arise by the mere refusal of a voluntary seller to provide access.

7. In order to identify the migration of contaminants, the proposed AAI rules also require visual inspections of adjoining properties from the subject property's boundary line, public right of way, or even aerial imagery where necessary to achieve the objective of the AAI process. The visual inspection must focus particularly on areas "where hazardous substances may be or may have been stored, treated,

[21] 69 Federal Register 165 at 52564.

handled or disposed."[22] As in the case of on-site inspections, adjacent property observations are also compulsory except in the event of "unusual circumstance".

8. As a direct consequence of case law, specialized knowledge of prospective landowners and/or the environmental professional must also be accounted for when determining compliance with the AAI rules.[23] For example, in American National Bank and Trust Co. of Chicago v. Harcos Chemicals, Inc., the court prevented the property owner from claiming the innocent landowner defense because the "company was involved in brownfields development, purchasing environmentally distressed properties at a discount, cleaning them up, and selling them for profit…..the company was an expert environmental firm and possessed knowledge that should have alerted it to the potential problems at the site."[24]

9. The AAI report must also contain an analysis of whether or not the purchase price for the subject property reflects the fair market value "assuming that the property is not contaminated".[25] A formal appraisal is not required to satisfy this requirement. The analysis may be conducted by comparing the price of subject property with similar properties or by contacting a real estate expert familiar with the area. The requirement essentially forces the prospective purchaser to find out if a low purchase price may be due more to contamination or threatened contamination as opposed to his or her bargaining skills.

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[22] Section 312.27 of 40 CFR part 312.

[23] Section 312.28 of 40 CFR part 312.

[24] 69 Federal Register 165 at 52566 (August 26, 2004).

[25] Section 312. 29 of 40 CFR part 312.

10. The shelf life of an AAI report is shorter than a Phase I based on ASTM standards. An AAI report is only valid for one year prior to the purchase date of the property but any interviews, lien searches, and visual inspections cannot be more than 180 days old. If the AAI report is more than one year old, an entire new AAI report must be prepared. A Phase I based on ASTM standards that is over a year old can still be used if appropriate updates are made. Because the AAI report shelf life is shorter, greater depth of inquiry is compulsory on a more recurring basis.

F. The importance of a greater depth of inquiry is underscored by the gap in data analysis that is required under the AAI rules.

1. To the extent there are gaps in the data, the AAI report must identify them and their impact on the ability of environmental professional to identify releases or threatened releases.

2. Despite the implicit recognition by the EPA that sometimes it is impossible to get all the information required, the burden of the data gaps is placed squarely on the property owner. The EPA notes, "[a] person's inability to obtain information regarding a property's ownership or use prior to acquiring a property can affect the landowner's ability to claim a protection from CERCLA liability…[if it results in the] inability to comply with…post-acquisition statutory obligations…For example, if a person does not identify, during the all appropriate inquiries…a leaking underground storage tank…the landowner may not have sufficient information to comply with the statutory requirement to take reasonable steps to stop on-going releases after acquiring the property. This may result in an inability to claim protection against CERCLA liability for any ongoing release."[26]

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[26] 69 Federal Register 165 at 52560 (August 26, 2004). See also footnote number 4.

III. THE RAMIFICATIONS OF THESE DIFFERENCES TO OUR SEMINAR AUDIENCE

A. The impact on buyers, sellers and developers are immediate and uncertain.

1. The immediate concern is to check the credentials of your environmental consultant. Do they qualify as an "environmental professional?"

2. With more extensive scope of inquiry and the need for qualified environmental professionals, the cost of an AAI based Phase I Assessment shall most likely increase as will the time period needed to perform them. Interestingly enough, the EPA predicts that the average cost increase per AAI report relative to conducting an ASTM based report will not exceed $50.00. Additionally, the EPA predicts that the average preparation period based on the increase in paperwork burden will be an hour per AAI report relative to an ASTM report. [27] Time will only tell if the EPA correctly assessed the increase in costs and preparation time.

3. On a more practical note, the original innocent landowner defense has seldom been invoked successfully. If the costs and time needed to properly conduct an AAI outweigh the benefits, you may consider the ASTM standards sufficient for your purposes.

B. Lending institutions will also want to update their environmental scrutiny.

1. Since the AAI standard is more rigorous, environmental assessments prepared in accordance with them will provide more complete information about the collateral. Therefore, lenders will most

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[27] 69 Federal Register 165 at 52571-72.

likely require compliance with AAI standards as part of the closing requirements.

2. Lenders may also wish to consider revising the loan documents to allow sufficient access to conduct an AAI and add covenants, where applicable, that require borrowers to comply with on-going requirements to maintain their status as an innocent landowner, bona fide purchaser or contiguous property owner.

C. AAI leaves many questions unanswered

1. The EPA's draft rules strive to contain all encompassing criteria. However, at times the rules are littered with such vague standards that whether or not a landowner has engaged in the all appropriate inquiry will be determined ultimately by the courts on a case-by-case basis. What is clear is that affected parties will initially have sleepless nights worrying about whether or not they have taken actions "to the extent necessary to achieve objectives" or if a particular gap in data will eventually lead to the forfeiture of the protected status.

2. The draft rules have also opened the proverbial Pandora's box to a host of other questions which will need the benefit of time and experience before being answered:

a. How much more time and money will be required to perform an AAI report as opposed to an ASTM based report?

b. Will environmental insurance underwriters require an AAI review or continue to rely on ASTM reports?

c. Will the EPA or the courts require strict or substantial compliance with the AAI rules?

d. In Michigan, what impact will the AAI rules have on the Baseline Environmental Assessment ("BEA") and will the EPA

forego enforcement actions on BEAs that do not comply with the AAI rules?