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# ENVIRONMENTAL CLIENT ALERT

## NEW RULES FOR PERFORMING PHASE I ENVIRONMENTAL SITE ASSESSMENTS

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### INTRODUCTION

New rules for performing Phase I Environmental Site Assessments (Phase I ESAs) went into effect November 1, 2006 when the U.S. Environmental Protection Agency (EPA) promulgated rules for performing All Appropriate Inquiry (AAI). The American Society for Testing and Materials (ASTM) also developed standards for conducting Phase I ESAs, standard E1537-05. Clients may follow either the EPA AAI rule or the ASTM standard to satisfy the AAI requirements described below. There are some differences between the standards but for the purposes of this Client Alert these differences are not important.

Clients now have an opportunity to limit potential liability for clean-up of contaminated soil and groundwater in asset transactions if clients' Phase I ESAs comply with the new rules and if clients take follow-up steps required by law. Clients should consider performing Phase I ESAs that comply with the rules in all transactions. Clients should note that (i) performing AAI-compliant Phase I ESAs alone does not limit liability without performing appropriate follow-up actions; and (ii) performing all necessary actions does not fully eliminate potential sources of liability.

### BACKGROUND

#### *CERCLA CREATED STRICT, JOINT AND SEVERAL LIABILITY FOR HAZARDOUS SUBSTANCE REMEDIATION*

Under the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), current owners and past polluters can be held jointly and severally liable regardless of fault for cleaning up abandoned hazardous waste sites. Any purchaser through contract of CERCLA contaminated property was a potentially liable party, regardless of whether it contributed to the release of hazardous substances or not.

#### *2002 CERCLA AMENDMENTS ALLOWED SOME PURCHASERS TO LIMIT POTENTIAL LIABILITY*

In 2002, Congress enacted the Small Business Liability Relief and Brownfields Revitalization Act which clarified the innocent land owner defense and created additional defenses for Bona Fide Prospective Purchasers (BFPP) and Contiguous Property Owners (CPO)*. Both defenses require that the purchaser (i) perform AAI prior to the transfer; (ii) not cause or contribute to the contamination; and (iii) comply with a list of continuing obligations (COs), including taking reasonable steps to stop a continuing release, prevent a future release and limit human and environmental exposure to the hazardous substances. There are no clear guidelines regarding specific actions that purchasers must take to comply with these COs. Purchasers must prove either to the regulatory authorities or, ultimately, in court, that they have complied with these requirements, proof of which will likely be a fact intensive battle of experts.

* BFPP are purchasers of contaminated sites that are aware of the contamination. CPOs are purchasers of contiguous properties that are unaware that contamination has migrated onto their properties from adjacent, contaminated properties.

## KEY PROVISIONS OF THE AAI RULE

> **Must have a written Phase I report that follows the requirements**. A Phase I ESA must be performed and its results must be included in a written report.

> **The investigation must be performed under the supervision of an Environmental Professional (EP) with a minimum combination of educational requirements and years of experience.**

*IN CONNECTION WITH THE INVESTIGATION, THE EP OR A PERSON UNDER HIS DIRECTION MUST:*

> **Visually inspect the property and interview the current owner and occupant**.

> **Interview past owners and occupants if it is likely that they have material information regarding releases or threats of releases at the site.**

> **Interview at least one neighboring property owner or operator if the subject property is abandoned.**

> **Review all government records, including tribal and local records**. This is a change from prior rules that required review of only federal and state records. Tribal and local records may be more difficult to find and review.

> **Visually inspect neighboring property from the subject property or any public right of way or similar vantage point.**

> **Perform a land title search, either by the EP or the purchaser**. The search must be sufficient to locate environmental lien and deed or other activity or use restrictions relating to the presence of hazardous substances.

> **Review commonly available knowledge, such as information available in local newspapers or websites, and any specialized knowledge of the purchaser or EP**. Specialized knowledge of the purchaser or EP includes the consideration of the relationship of the purchase price to the fair market value of the property if it were not contaminated.

## KEY COMPONENTS OF PHASE I REPORT

> **A statement by the EP whether the investigation revealed any releases or threat of releases.** The EP is not required to report extremely small releases that generally would not pose a threat to human health and the environment. Many consultants will report a broader category of findings known as Recognized Environmental Conditions (RECs).

> **Identify data gaps.** A data gap is defined as an inability, despite good faith effort, to obtain information required by the rule. The EP must report and comment on the significance of data gaps that affect its ability to determine if there has been a release or is a threat of release.

> **The EP's opinion as to additional inquiries necessary to determine whether there has been a release or threat of release**.

> **A certification by the EP that it meets the EP requirements and that the investigation followed the AAI rules**.

> **Reports may be relied upon only for 180 days.** Reports older than 180 days must be updated before they can form the basis of AAI.

## PURCHASERS CANNOT FULLY ELIMINATE POTENTIAL LIABILITY

### *MERGERS AND STOCK PURCHASERS CANNOT LIMIT LIABILITY*

Purchasers who take ownership by a merger or by acquiring stock of an entity which caused or contributed to the contamination probably will not be able to assert successfully the CERCLA defenses. However, purchasers of assets from an entity may be able to mount the defense if the purchasers did not cause or contribute to the contamination, provided they comply with the COs described above.

### *PURCHASERS MAY BE LIABLE UNDER OTHER LEGAL REQUIREMENTS*

Even if purchasers are able to mount successfully one of the CERCLA defenses, they may still be liable to remediate contamination under other applicable laws, such as the Resource Conservation and Recovery Act (RCRA) or state law. The defenses described above apply only to CERCLA and not to other federal laws, such as RCRA, that also make current owners or operators liable for remediating past contamination. Furthermore, the CERCLA defenses do not apply to state and local law sources of liability. Most states have statutes similar to CERCLA and most include contamination by petroleum products, which is exempt from CERCLA liability. Some state statutes, such as the New Jersey Spill Compensation and Control Act, allow defenses similar to the CERCLA defenses but have different inquiry requirements. Other states, Illinois for example, impose proportionate liability instead of joint and several liability so the defenses are not required. Likewise, the CERCLA defenses have no impact on potential liability under state common law actions for property damage or bodily injury from hazardous substances, such as nuisance, trespass, strict liability or negligence.

## PRACTICAL IMPLICATIONS OF THE AAI RULE

The costs of preparing a Phase I ESA have historically varied by as much as 100% among service providers and, thus far, it appears unlikely that the new AAI rules will narrow that cost range. However, it is not clear that AAI compliance will add material additional cost or time to the performance of Phase I ESAs. To comply with AAI requirements, some service providers have begun sending questionnaires to prospective purchasers, in addition to prospective sellers, to determine any specialized knowledge on the part of the purchaser.

The market standard is for seller to allow site visits and fully cooperate with buyer's environmental professional to perform a Phase I ESA. Sellers that do not fully cooperate are vulnerable to requests for extensive indemnification and escrows to cover unknown potential conditions.

As an AAI-compliant Phase I is optional, in theory, buyers would perform an AAI-compliant Phase I only if there is a likelihood that CERCLA liability is associated with the target. However, if there are no material additional cost, time, inconvenience or confidentiality concerns associated with performing an AAI-compliant Phase I ESA, buyers should consider using the standard as a default in all transactions to attempt to preserve CERCLA liability limitations. Almost everyone has heard a horror story of a site that was represented as clean by sellers only to have a Phase I ESA and subsequent investigations reveal significant contamination.

## FOR FURTHER INFORMATION, CONTACT:

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