

Client Alert

From the
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New USEPA Standard on “All Appropriate Inquiry” Will Change Environmental Due Diligence Practices

Introduction

Near the end of 2005, the United States Environmental Protection Agency (USEPA) finalized its rule clarifying the standards and practices applicable to the conduct of “all appropriate inquiry” (AAI) under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). The new standard defines the due diligence required to be able to later assert certain defenses under CERCLA. Notwithstanding its limited purpose, the rule is certain to influence what will be considered best practices for environmental due diligence, generally. But compliance with the AAI standard alone should not be considered an adequate substitute for the “Phase I” environmental site assessment (ESA) customarily conducted in connection with commercial real estate transactions nor should the new AAI standard be seen as a reason to narrow the scope of an ESA.

History of AAI

Under CERCLA, owners and operators of real estate are potentially liable for cleaning up certain hazardous substances released on, from or under their property or operations. While CERCLA liability is generally reserved for the more severe cases of hazardous substance contamination, such liability can be catastrophic and can be imposed without fault.

Prior to 2002, the only defense to the strict, premises liability of CERCLA was the so-called “innocent landowner” defense. To assert the defense, the defendant had to prove that it conducted “all appropriate inquiry” in accordance with “generally accepted good commercial practices” prior to acquiring its interest in the real estate and that despite having done so, the defendant did not know and had no reason to know of the presence of hazardous substances at the property.

Understandably, buyers, lenders and others considering an ownership, security or operational interest in a piece of real estate wanted to limit potential CERCLA exposure and therefore sought to conduct due diligence in accordance with the innocent landowner standard. But when Congress created the “innocent landowner” defense, it provided no real guidance as to what constituted “all appropriate inquiry.” USEPA also expressly declined to provide any definition or other assistance. Instead, USEPA indicated that it would be up to the industry to determine what constituted generally accepted practices for “all appropriate inquiry.”

Over time, the commercial real estate industry, with input from all sectors, established a set of basic environmental due diligence practices and procedures. The basic due diligence involves primarily, on-site reconnaissance and review of various public databases and is often referred to as a “Phase I”, or environmental site assessment. The most widely accepted codification of the Phase I elements is the standard promulgated by ASTM and known as E1527. *(continued . . .)*

ESAs (Phase Is) are designed to accomplish more than satisfying the CERCLA “all appropriate inquiry” test. Environmental issues of concern go beyond CERCLA issues. Standard ESAs consider liability concerns that may arise under the common law and state law of toxic or hazardous materials tort liability, underground storage tank liability, compliance under clean air, clean water and worker safety laws, and health and safety issues relating to asbestos containing building materials, lead paint, radon and toxic or hazardous mold.

Development of AAI

Despite the fact that the real estate industry had developed widely accepted standards for ESAs, in 2002, Congress adopted amendments to CERCLA that, among other things, directed USEPA to promulgate a rule establishing the standards and procedures that would constitute “all appropriate inquiry”. The 2002 amendments also added certain new defenses to CERCLA liability, all of which are conditioned upon the defendant having conducted “all appropriate inquiry.” The AAI standards were finalized on November 1, 2005 and have been codified as 40 C.F.R. Section 312.

The AAI rule establishes due diligence requirements to satisfy one element of certain CERCLA defenses. The AAI standard does not purport to establish a standard of care for any other purpose. Nonetheless, now that USEPA has codified a standard there is every reason to expect that the market will gravitate to incorporating the AAI standard into all ESAs. Indeed, ASTM has already revised the E1527 standards such that the newest version of the standard, E1527-05, is fully compliant with the new AAI standard.

How will the new USEPA/E1527-05 standards be different from past practice? The differences between the new standard and the previous ASTM standard, while significant, are not exhaustive. A few of the more meaningful changes are as follows:

- The new standard requires that the investigation be conducted by an “Environmental Professional” and establishes specific qualifications that must be met for a person to be considered an Environmental Professional.
- The new standard imposes on the Environmental Professional a greater responsibility regarding recommendations for further investigation or inquiry.
- Interviews with the current owner and operator are now mandatory.
- Interviews of neighbors are mandatory if the subject property is abandoned.
- Historical sources must be researched as far back as when structures first were present on the subject site.
- Review of relevant governmental records is now mandatory.
- Consultant must identify “data gaps,” which are defined in the rule, and provide an opinion as to the likely significance of the data gaps.
- A report will have a shelf life of not more than one year; some updates may be required after 180 days.
- The Environmental Professional must include in his written report a declaration that he has met the qualifications of an “Environmental Professional” and an opinion as to whether in inquiry has identified condition indicative of releases or threatened releases of hazardous substances.

Conclusion

The USEPA rule on “all appropriate inquiry” clarifies due diligence that is prerequisite to certain defenses under CERCLA. ESAs were designed to be a due diligence tool for discovering a range of potential concerns, but one which might also satisfy the CERCLA due diligence standard. The commercial real estate market should be moving to incorporate the new AAI standard into the ESA scope as quickly as is practical. By following the AAI/E1527-05 standards, buyers, lenders and others will not only enhance their ability to be able to assert CERCLA defenses, they will also have the benefit of a higher quality, more comprehensive due diligence product.