

## **ENVIRONMENTAL DUE DILIGENCE AT THE CROSSROADS: GOODBYE PHASE I, HELLO AAI**

**By Arthur J. Clarke, Esq,**

When the Brownfields Revitalization and Environmental Restoration Act<sup>1</sup> (the “Act”) was signed into law in 2001, radical changes were made to the way the Federal government handled Brownfields<sup>2</sup> sites.<sup>3</sup> However, the Act and new regulations recently promulgated change the way pre-acquisition due diligence is performed by replacing the ASTM Phase I Environmental Site Assessment, relied on for a number of years by the real estate community as the “gold-standard” due diligence tool, with a new Federal due diligence procedure that satisfies the All Appropriate Inquiry (“AAI”) standard established under CERCLA.

### **Effective Date**

The final AAI regulations are effective November 1, 2006. Until then both the AAI standard and ASTM’s standard will be acceptable to achieve the standard. Recently, ASTM conformed its standard to the new AAI requirements through the issuance of ASTM Standard E1527-05.

### **Expanded Use of the AAI Standard**

The Act contains a mandate to USEPA to establish a Federal due diligence standard within 2 years of January 11, 2002. Accordingly, on August 26, 2004, USEPA promulgated its draft AAI regulations within this deadline. The regulations will replace the ASTM Phase I ESA as the tool by which parties demonstrate they have achieved AAI. The proposed rule establishes specific regulatory requirements for conducting all appropriate inquiries into the previous ownership, uses, and environmental conditions of a property for the purposes of qualifying for three distinct landowner liability protections under CERCLA.

- First, AAI is used as the due diligence standard for parties seeking to prove they “did not know and had no reason to know” of releases or threat of releases of hazardous substances prior to purchasing a property. Once this knowledge standard has been achieved, parties may avail themselves of the “innocent purchaser” defense.
- Second, AAI is also used to demonstrate that a party is a “bona fide prospective purchaser,” which qualifies it for protection as a Brownfields developer.

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<sup>1</sup> The Act is an amendment to the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. 9601 et seq. (“CERCLA”).

<sup>2</sup> “Brownfields” are generally considered to be urban or former industrial sites that are abandoned and contain low levels of contamination. They generally have economic value if cleaned up.

<sup>3</sup> The Act creates financial and legal incentives to facilitate the redevelopment of Brownfields. It also limits liability for those who acquire such sites. The Act promotes acquiring contaminated properties and profoundly impacts their redevelopment. Business transactions involving all types of real property are also impacted.

- Third, AAI is a qualification for a party to prove that it is a “contiguous property owner” under CERCLA Section 107(q)(1)(A)(viii).

### **Multiple Time Frames**

In accordance with the Act, the regulation establishes how AAI is defined during three distinct time periods.

- For property purchased after the promulgation of the new Federal AAI regulations (expected some time next year), the new Federal AAI rule would apply. This will now include ASTM standard E1527-05 which has been conformed to the new AAI rule.
- For property purchased on or after May 31, 1997 but before the promulgation of the new Federal AAI standard, all appropriate inquiry is satisfied by ASTM Standard E1527-97, entitled, “Standard Practice for Environmental Site Assessment: Phase I Environmental Site Assessment Process.”
- For property purchased prior to May 31, 1997, AAI is defined as carrying out all appropriate inquiries into the previous ownership and uses of the property in accordance with generally accepted good commercial and customary standards and practices.

AAI work must be completed within one year of an owner taking title to a property and does not need to be contemporaneous with the transfer of title. The AAI report can rely on previously conducted due diligence studies conducted at the site as long as the data is no older than 180 days old. Therefore, for all intents and purposes, the AAI report cannot contain information older than 6 months.

### **Environmental Professional Required**

In addition to establishing three distinct AAI definitions for three different time periods, the new Federal AAI standard requires “an inquiry by an environmental professional.” “Environmental Professional” has a lengthy definition under the proposed rule. An Environmental Professional is generally defined as “[a] person who possesses sufficient specific education, training, and experience necessary to exercise professional judgment to develop opinions and conclusions regarding the presence of releases or threatened releases to the surface or subsurface of a property.” Specifically, an “Environmental Professional” includes persons that possess:

- A professional engineering, professional geologist or state/federal environmental assessment licenses and three years of experience;
- A Bachelor’s degree in engineering, environmental science or earth science and 5 years of experience;

- A Bachelor's degree in a non-engineering, science or environmental discipline and 10 years of experience; or
- Ten (10) years of relevant experience with no degree or license in an engineering or scientific discipline.

Persons not qualifying as an environmental professional may nonetheless "assist in the conduct of all appropriate inquiries . . . if such person is under the supervision or responsible charge of [an] environmental professional."

### **AAI Or ASTM, Or Both?**

The largest question raised by the new AAI standard is how much does it change the previous ASTM standard? Gone are "Recognized Environmental Conditions", replaced by "conditions indicative of releases or threatened releases." Additionally, the scope of the new AAI standard is broader and more comprehensive than the ASTM Phase I. Under the new Federal standard, a party must inquire as to:

- (i) The past and present uses of the property;
- (ii) Current and past uses of hazardous substances;
- (iii) Waste management and disposal activities that could have caused as release or threat of a release of hazardous substances;
- (iv) Current and past corrective actions and response activities;
- (v) The presence of engineering controls;
- (vi) The presence of institutional controls; and
- (vii) Properties adjoining or located nearby the subject property that have environmental conditions that could have resulted in a release of hazardous substances at the subject property.

The regulations apply "performance factors" to each of these inquiries that requires parties to apply a significant amount of diligence when conducting their inquiry including pursuing publicly available information and evaluating the thoroughness and reliability of the information. Parties must also fill in data gaps as best they can, which may include sampling to address the data gaps, although the standard does not require the identification of quantities or amounts of hazardous substances that were released at a site.

### **Reports**

The Environmental Professional must provide the results of the AAI in writing. The written report must include an opinion by the Environmental Professional as to whether the inquiry has identified conditions indicative of a release or threatened release of hazardous substances; an identification of data gaps and the significance of such data gaps relative to the professional's ability to render its opinion; and the qualifications of the environmental professionals performing the AAI. Additional inquiries that must be reported by the Environmental Professional include whether environmental liens have been filed against the property, what specialized knowledge the party seeking the AAI has, and the relationship of the

purchase price of the property to the fair market value of the land if the property was not contaminated.

### **Interviewing**

A key element of the AAI process will interviewing past and present owners, operators and occupants of the property. The proposed rules have a strict standard that the current owner and current occupants must be interviewed by the Environmental Professional. If multiple occupants are present on the property, then only the “major” occupants must be interviewed as well as those occupants “likely to use, store, treat, handle or dispose” of hazardous substances. In addition to the mandatory interviewing of current owners and operators, the AAI standard states that the Environmental Professional should interview: (1) the current and past facility manager; (2) past owners, operators or occupants; or (3) employees of current and past owners/occupants. If the property is defined by USEPA as an “abandoned property,” then the Environmental Professional must interview one or more owners/occupants of neighboring or nearby properties.

### **Government Records Research**

Under the proposed Federal AAI standard, government records will need to be thorough researched and an on-site visual inspection of the property is required. Historical documents, including aerial photographs, fire insurance maps, building department records chain of title documents and land use records, must be reviewed dating back to when the property first contained structures or from the time the property first was used for residential, agricultural, commercial, industrial or governmental use. There is no set time frame for the historical record search and the Environmental Professional is left with the discretion as to how far back in time the search should go. The proposed regulation also calls for the review of governmental records on the property. This requirement appears to allow for the use of a database instead of retrieving and reviewing the filed government record. This is a significant requirement as thousands of dollars would be added to the cost of an AAI report if the rule required the review of the actual governmental record through a Freedom of Information Act, request, or similar State disclosure statute. Records concerning adjoining properties must also be reviewed. The proposed rule requires minimum search distances to check for sites where a release or threat of a release of a hazardous substance may have occurred.

### **Visual Inspections**

Visual inspections are another key element of the AAI report. An inspection of all on-site facilities and improvements is required. Any physical limitations on the inspection must be noted. The new standard also requires the visual inspection of adjoining properties. Unlike the visual inspection of the subject property, the inspection of adjoining properties does not need to be on-site. Inspections may be performed from the property line, public access ways or other vantage points, including aerial photographs. It is unclear whether the aerial photographs can be historical photographs, such as those available from an archivist, or whether they need to be contemporaneous with the AAI report. On-site visual inspections of the target property must be conducted unless good faith efforts to gain access fail. If such efforts do fail, the on-site

inspection will not be required. USEPA does not consider the mere denial of access by a property owner to be a valid reason for not conducting an inspection. However, the proposed rules do not provide parties who are denied access a legal remedy for gaining access.

### **Potential Impacts on End Users**

Many other questions still remain regarding the scope and breadth of the new AAI standards. The proposed regulation impact end users in states that already have their own due diligence standard. In New Jersey, for example, a party must demonstrate that all appropriate inquiry has been achieved by conducting a preliminary assessment, and a site investigation (“PA/SI”), if required. These investigations were largely viewed as more comprehensive than the ASTM Phase I ESA and many parties substituted the PA/SI for the Phase I in order to achieve the innocent purchaser defense under both CERCLA and New Jersey’s Spill Compensation and Control Act. Thus, the new Federal AAI standard may require that elements of both the PA/SI and the Federal AAI be performed to create a “hybrid” investigation. Other concerns raised by end-users such as banks, investment companies and real estate firms include:

- Cost - ASTM Phase I ESA’s were obtainable at very competitive prices, some as low as \$1,500. The new AAI reports may cost more.
- Timing - A Phase I Report could be delivered within two weeks on an expedited basis. The new AAI report may take substantially longer to complete due to new requirements to retrieve government records and interview people with knowledge.
- Competition - In the new marketplace for AAI reports, certain minimum professional qualifications will now be required. This will shrink the pool of consultants who are qualified to conduct an AAI thereby increasing competition, and costs, for their services.
- Expansion of CERCLA Liability – CERCLA liability has recently expanded to include Natural Resource Damages, and indoor air problems such as vapor intrusion. The AAI may not be sufficient to address these problems and separate investigations may be required.
- On-Site Studies - One criticism of the ASTM Phase I ESA was that it did not focus enough on the actual target property. The new AAI standard may provide more insights into the actual property being acquired.
- User-Friendly – Many parties did not know how to use a Phase I Report. Given the amount of technical data required, the new AAI report may be even less meaningful for real estate owners, investors and professionals.

## **Conclusion**

The proposed rule provides a number of changes to the way real estate due diligence is currently being conducted. These changes are anticipated to facilitate the redevelopment of Brownfields. However, the new rule is also intended to provide parties with a means of achieving AAI as a defense to CERCLA liability. How well the new Federal AAI standard achieves this latter goal will ultimately be a matter for the Courts to decide.