

PUBLICATION

EPA Redefines All Appropriate Inquiry

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On November 1, 2006, EPA's new rule for conducting environmental due diligence became final. This new regulation has far-reaching impacts, including on real estate transactions, contract interpretations, and the government's enforcement capabilities.

A Little History First

In 2002, the Small Business Relief and Brownfields Revitalization Act took effect. Among other things, it directed EPA to promulgate regulations on potential environmental issues affecting real estate. The act swung the pendulum of Superfund back toward center. The original 1980 Superfund statute provided for strict, joint and several, retroactive liability, ensnaring real estate purchasers who had not polluted but were nonetheless liable for nearly any contamination on their newly-purchased properties. The 1986 amendments to Superfund allowed so-called "innocent purchasers" to escape liability, provided that certain criteria were met, including being able to establish that the purchaser conducted "all appropriate inquiry" (AAI) into the property's condition before purchase and still did not discover the existing contamination. Unfortunately, the phrase "all appropriate inquiry" was never defined and courts and agencies interpreted it using differing criteria including the privately developed ASTM standard for conducting site assessments. The 2002 statute amendment added two new defenses to Superfund's liability, the contiguous property owner and the bona fide prospective purchaser, both also requiring AAI in order to qualify (among other steps and duties). It also directed EPA to define the previously amorphous phrase pertaining to the innocent property owner, "all appropriate inquiry." EPA promulgated this new AAI rule through the regulatory negotiation (reg neg) process. Twenty-five stakeholders representing a cross section of interests met several times in 2003 and 2004 and drafted the regulation that EPA ultimately published for public comment. The rule became final on November 1, 2005, with an effective date of November 1, 2006. This new rule (and ASTM's recently-revised and similar industry standard) imposes heightened obligations on both the buyer and the buyer's consultant performing the diligence to qualify for a defense to Superfund.

AAI: Help or Harm?

EPA's new rule helps property purchasers because it provides more clarity to what they should look for in an environmental consultant and the consultant's Phase I Environmental Site Assessment to be obtained in order to constitute AAI. For example, the consultant must be an "environmental professional" with specific educational and experience requirements. Visual inspections not only of the property being purchased but also of adjoining properties are required, either from the property line, a right-of-way, or some other vantage point. Information must now be gathered from sources such as newspapers, local officials, community organizations or websites, as well as government and historical records, and interviews. And interviews must now be conducted with past owners or occupants, current or past facility managers, and owners and occupants of neighboring properties to the extent that the consultant believes necessary.

However, the new rule also imposes heightened responsibilities on the purchaser himself, probing into the underlying purchase. For example, the buyer must evaluate whether the purchase price has been reduced as a result of the presence (or potential presence) of hazardous substances. This proverbial red flag will preclude the buyer from obtaining a windfall in purchasing property and later claiming not to know why it was sold at a distressed price. The purchaser must also document any specialized knowledge that he may have about the property's environmental condition.

Data Gaps

Phase I assessments must now include any data gaps, "holes" in the diligence or fact finding. Examples include the inability to review a state file because it is temporarily unavailable, not being able to access a portion of a facility because it is locked, or not evaluating the property's purchase price as it relates to market value. The consultant must document all data gaps and comment on their significance.

Implementation

When will EPA begin enforcing this? While this new regulation is not a form of enforcement per se, EPA has already attempted to use this new standard to refute a property owner's attempt to assert the innocent purchaser defense. In *United States v. Domenic Lombardi Realty, Inc.* (290 F. Supp. 2d 198 (D.R.I. 2003)), EPA claimed in 2003 that the defendant did not qualify for the defense for the purchase of contaminated property. Indeed, EPA attempted to apply this new AAI standard retroactively to this case, despite the fact that the matter was in litigation at the time the Brownfield Act amendments were passed. The court, however, denied EPA's assertion.

The Bottom Line

Buyers should expect these requirements to increase the cost of Phase I assessments. While EPA estimates that the price of each should increase by approximately \$100, most consultants estimate much higher increases due to the newly enhanced requirements compared to the old ASTM practice. In addition, more Phase I assessments will be conducted than previously, as existing Phase I assessments have time limitations on their validity (without portions of them being updated). The bottom line is that today buyers desiring to establish an applicable defense to Superfund liability must carefully select a consultant and actively participate in environmental fact-finding and ensure that compliant, all appropriate inquiry has occurred.