
Be Careful What You Look For: EPA Updates “All Appropriate Inquiries” Environmental Diligence Standard

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On December 30, 2013, the U.S. Environmental Protection Agency (“EPA”) amended its “All Appropriate Inquiries” rule, which sets out the standard for environmental due diligence in commercial and industrial property transactions in order to qualify for certain defenses to liability under the federal “Superfund” law. The amended rule endorses ASTM standard E1527-13, which incorporates new requirements to report on vapor migration, review agency records as well as search databases, and distinguish controlled from historical conditions. Responding to objections that allowing a prior, less time-consuming and costly standard to remain in effect would cause confusion, EPA also announced that, in the near future, it will propose deleting the prior standard from the rule. Meanwhile, many purchasers and lenders are likely to require their sellers and borrowers to switch to the new standard in light of EPA’s announced intent.

Background

Generally, prospective purchasers of commercial and industrial property conduct environmental due diligence investigations in order to discover and disclose information on current and past uses of the site and the risk that hazardous substances have been released on-site or nearby. In the 1990s a private organization, the American Society for Testing and Materials (“ASTM”), developed a standard for conducting such investigations, the Phase I Environmental Site Assessment standard. Property purchasers and lenders soon began routinely requiring sellers and borrowers to produce “Phase I reports” in compliance with the standard, though originally it had no legal force. In 2002, Congress gave purchasers greater incentive to perform thorough environmental diligence by amending the Comprehensive

Environmental Response, Compensation, and Liability Act (“CERCLA” or “Superfund”). CERCLA imposes liability on current property owners (among others) for cleanup of hazardous substances released by former owners or operators or migrating from adjacent properties. However, property owners may qualify for defenses against CERCLA liability as “innocent landowners,” “bona fide prospective purchasers” or contiguous property owners if, before acquiring the property, they conducted “all appropriate inquiries” into its environmental condition and, after the acquisition, they took reasonable steps to prevent its condition from worsening.

The 2002 CERCLA amendments directed the EPA to establish due diligence standards for purposes of the defenses and grants. EPA finalized its All Appropriate Inquiries (“AAI”) Rule in 2005.¹ The 2005 AAI Rule was based on ASTM’s Phase I standard then in effect, but it added some more stringent elements, such as interviews with past and adjacent property owners and occupants, as well as updates of Phase I reports prepared more than one year prior to acquisition. ASTM then issued a revised standard E1527-05 to conform to the AAI Rule.

Effect on the Prior Phase I Standard

In 2013, ASTM (now known as “ASTM International”) undertook an update of its Phase I standard, which EPA proposed to add to its AAI Rule. Initially, EPA proposed merely to add the new standard E1527-13 while allowing purchasers the option of either utilizing it or continuing to rely on the existing E1527-05 standard. Commenters strongly objected that retaining both standards as alternatives would cause confusion and undercut the new standard, particularly since it incorporates additional stringent (and more costly) features as described below. ASTM issued E1527-13 in November 2013² and, on December 30, EPA amended the AAI Rule to incorporate the final standard.³ Nevertheless, EPA agreed with the comments and announced that, while it could not delete E1527-05 from the rule before separately proposing the deletion for public comment, it intends to propose deleting E1527-05 in the near future. Meanwhile, EPA “strongly encourages prospective purchasers of real property to use the updated ASTM E1527-13 standard when conducting all appropriate inquiries.”⁴ Accordingly, although in theory purchasers may rely on either E1527-13 or E1527-05 until EPA removes the latter, in practice many are likely to switch to the new standard without awaiting EPA’s action.

Key Changes in the New Phase I Standard

The E1527-13 standard is largely based on the prior standard, but it includes several more expansive requirements now incorporated into the AAI Rule:

Vapor Migration

Vapor migration – that is, the migration of hazardous substances in gaseous form through the soil and potential migration through the building floor into indoor air – has become a significant concern for property owners (and, in particular, for commercial landlords) in recent years. The new standard specifies that vapor migration must be addressed in Phase I investigations. Although EPA now asserts that “vapor

¹ 40 C.F.R. part 312.

² The new standard is available for purchase from ASTM at: <http://www.astm.org/Standards/E1527.htm>.

³ 78 Fed. Reg. 79319 (Dec. 30, 2013).

⁴ 78 Fed. Reg. at 79321.

migration has always been a relevant potential source of release or threatened release,”⁵ many practitioners did not regard it as a necessary component of Phase I reports under the prior standard. Property sellers, purchasers and environmental consultants are now on notice that vapor migration is a significant consideration and this analysis will become more commonplace. Vapor migration does not necessarily follow the same path as groundwater plumes, and preferred pathways such as utility corridors may complicate the analysis. In many instances, sufficient information may not be available to determine the risk of vapor migration from adjacent property.

Consultants may be more likely to identify a Recognized Environmental Condition (“REC”) based on vapor migration risk and to recommend vapor screening or other Phase II site investigations to assess the risk, requiring additional cost and time. These types of investigations often present complicated technical and legal issues for both buyers and sellers that should be carefully evaluated before proceeding. Because the AAI Rule and E1527-13 rely to a great extent on the professional judgment of consultants in identifying RECs and making recommendations for further assessment, buyers and sellers should give careful consideration to the selection of qualified consultants to perform their Phase I investigations. In addition, where contamination cleanup has already occurred, regulatory agencies may not have considered vapor migration when issuing “no further action” letters based on low concentrations remaining in soil or ground water. In some cases, under the new standard, Phase I ESA reports may identify vapor-related conditions despite the issuance of no further action letters.

Agency File Reviews

The new standard requires the consultants who prepare Phase I reports to conduct reviews of regulatory agency files and records, in order to document the validity of information obtained from online databases such as CERCLIS. In the past, some consultants have relied on database searches and not conducted follow-up agency file reviews. The new standard requires the Phase I report to include a specific explanation justifying the failure to conduct a review, if the consultant believes it is not necessary. Alternatively, information from other sources (such as interviews with regulatory agency staff) may be relied on if reviewing agency files is infeasible. Depending on the availability of agency files, the more rigorous review requirement may add significantly to the time and cost of preparing a Phase I report. If online databases indicate potential releases at the site or adjacent sites, and agency files are not available within the transaction timeframe, Phase I reports will be more likely to identify a REC and/or recommend follow-up agency file review.

Historical and Controlled Conditions

Under the prior standard, Phase I reports identified certain site conditions as “Historical” if past releases of hazardous substances have been addressed in accordance with regulatory requirements. This category included both property cleaned up to a level allowing unrestricted use and property where contamination was permitted to remain subject to ongoing controls, such as deed restrictions prohibiting residential development. The new standard divides the old “Historical” category in two: “Historical” where unrestricted use is permitted, and “Controlled” where institutional controls or restrictions must be maintained. For many commercial and industrial properties where prior cleanups were completed to non-residential standards, the Controlled Recognized Environmental Condition finding will apply, due to the prohibition on residential use.



⁵ 78 Fed. Reg. at 79322.

De Minimis Conditions

The new standard also adds a definition of “de minimis conditions” that do not present a threat to human health or the environment or trigger regulatory action. Such conditions should be disclosed in Phase I reports but are not considered RECs.

Implications for Real Property Transactions

Commentators were concerned that EPA’s original proposal, allowing reliance on either the old or the new standard, would lead to many property owners and lenders opting for the prior, less time-consuming and expensive version. This appears less likely now that EPA has announced its intent to eliminate confusion by deleting the old standard from the AAI Rule. Moreover, EPA strongly encourages use of the new standard and views the prior standard as no longer conforming to best practice as identified by ASTM.

Nevertheless, it is worth keeping in mind that the AAI Rule is intended to support specific statutory defenses to CERCLA liability for property owners, and it in no other way obligates purchasers or lenders to conduct any specific level of environmental due diligence. In circumstances where a prospective purchaser may not otherwise be able to qualify for one of the defenses, there may be less incentive to meet the more stringent new requirements, e.g., for review of regulatory agency files (especially when little time remains before a closing date). Lenders are covered by a separate provision of CERCLA for secured creditors, which does not require compliance with the AAI Rule. Ultimately, the behavior of parties to real estate transactions will be determined by their underlying reasons for seeking information about environmental contamination. For many, the largest motivating factor is the need for sufficient information to negotiate the purchase price and other terms reflecting the condition of the property. Market forces on purchasers, sellers, lenders, insurers and consultants led to the establishment of the original ASTM Phase I standard long before the 2002 CERCLA amendments. With all that said, though, those purchasers who can qualify for the CERCLA defenses may have good reason to comply with the new E1527-13 rather than the previous E1527-05 standard. When the new E1527-13 standard is used, greater scrutiny of vapor migration risk and increased lead time for regulatory agency file review should be anticipated as part of environmental due diligence.

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