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On November 1, 2006, the Environmental Protection Agency final rule for conducting ''all appropriate inquiries'' when purchasing real property became mandatory. Many clients are asking what they need to do to implement these new requirements. This article sets forth a practical approach to implementing these new guidelines. It also evaluates some of the due diligence questions that remain unanswered and assesses the impacts that this new rule will have on superfund litigation.

EPA's New All Appropriate Inquiry Standard

By Albert M. Cohen

A. BACKGROUND

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The Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) (42 U.S.C. § 9601 et seq.) imposed liability upon current owners of real property for releases of hazardous substances. Therefore, purchasers of contaminated properties were potentially liable even if they did not cause or contribute to the releases.

CERCLA did have a limited ''third party defense'' (42 U.S.C. § 9607(b)(3)) which applied if a person demonstrated that the release was ''caused solely by . . . (3) an act or omission of a third party'' with whom that person did not have a contractual relationship. Innocent purchasers argued that they were not liable because the releases were caused by third parties. Most courts, however, disagreed, holding that the deed or other form of conveyance created a contractual relationship which

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abrogated the defense. See *e.g. United States v. Hooker Chemicals & Plastics Corp.*, 680 F. Supp. 546 (W.D.N.Y. 1988).

In 1986, Congress added 42 U.S.C. § 9601(35) which amended the definition of ''contractual relationship'' to exclude instruments of conveyance of land when the purchaser did not know and had no reason to know that any hazardous substance was disposed on the property. In order to show that it did not know or have reason to know, the purchaser had to demonstrate that at the time of acquisition it made ''all appropriate inquiry into the previous ownership and uses of the property.,'' 42 U.S.C.§ 9601(35)(B).

While this so called ''innocent purchaser'' defense was a step forward, problems remained. Most importantly, if a person conducted ''all appropriate inquiry'' and found an environmental release or threat of release, that person would still be liable if it purchased the property. Therefore, it only protected persons from liability in the relatively rare instances where the inquiry did not find any potential for a release but, after closing, an unexpected release was discovered. There was also some question as to what constituted ''all appropriate inquiry,'' although this problem was largely addressed by ASTM which developed standard practices for performing environmental site assessments.

Congress addressed both of these issues when it enacted the ''Small Business Liability Relief and Brownfield's Revitalization Act of 2002'' which added new defenses to CERCLA liability. The most important of these exempts ''bona fide prospective purchasers'' from liability. A party which acquires property after enactment of this provision is considered a ''bona fide purchaser'' if (1) the disposal occurred prior to acquisition and (2) it made ''all appropriate inquiries'' prior to acquisition (42 U.S.C. § 101(40)). That is, a person who purchases after conducting ''all appropriate inquiry'' is not liable, even if the inquiry finds a release or a threat of a release. Congress then enacted statutory criteria for performing ''all appropriate inquiries'' and required EPA to promulgate regulations setting forth standards for performing AAI. See 42 U.S.C. § 901(35)(B). On November 1, 2005, EPA promulgated its final rule (the ''AAI Rule''). That rule provided that the new standards for performing AAI would become mandatory on November 1, 2006.

B. WHY AAI IS NECESSARY

The most obvious reason for performing AAI is to take advantage of the statutory defenses. In addition, conducting such inquiry is critical to understanding the potential environmental risks associated with the property. Lenders will undoubtedly also require completion of AAI before agreeing to fund a loan. Similarly, insurers who provide coverage for environmental risks are likely to require such an assessment.

C. PRACTICAL TIPS FOR IMPLEMENTING AAI: ESTABLISHING FORMAL AAI PROCEDURES

Entities which purchase real estate should consider implementing formal procedures for insuring that AAI is followed for any real estate purchase. The following is a list of items to consider including in such procedures.

1. *Explanatory Guidelines*

These should impress upon your employees the reason for and importance of performing AAI and should make it clear that acquisition may be completed without the person responsible certifying that AAI has been completed.

The guidelines should also identify what type of information will be collected and why. For example, it should note that the purpose of conducting AAI is to identify potential environmental risks by identifying such things as:

a. current and past property uses and occupancies;

b. current and past uses of hazardous substances;

c. waste management and disposal activities that could have caused releases;

d. current or past corrective actions and response activities;

e. engineering controls;

f. institutional controls; and

g. nearby properties that have environmental conditions that could impact the subject property.

The guidelines should specifically address some of the unique features of the rule. For example, the rule requires that AAI be conducted or updated within one year of the date of acquisition of a property and that certain aspects of such inquiries be updated within 180 days prior to acquisition. The guidelines should identify these requirements and make it clear that it may be necessary to update the AAI report before closing. This is of particular concern in complicated transactions which take many months to complete.

In addition, while most aspects of AAI will be undertaken by an environmental professional who you retain to perform the inquiry, some aspects are normally undertaken or must be undertaken by the prospective purchaser. For example, the prospective purchaser is the one that normally performs a title search. The AAI Rule requires that you determine whether there are any environmental cleanup liens against the subject property that are filed or recorded. The guidelines should require the title company to search for such liens and report them to the environmental professional.[1] The AAI Rule also requires that the purchaser's specialized knowledge or experience be considered in conducting AAI. Therefore, the guidelines should generally require that any such knowledge should be transmitted to the environmental professional. The AAI rule also requires that the inquiry consider any commonly known or reasonably ascertainable information about the subject property. Since this information is likely to be more accessible to the purchaser than to the environmental professional, the guidelines should require that such information be transmitted to the environmental professional.

One issue which the new rule does not address is what to do where a Phase I is essentially superfluous because considerable Phase II testing has already been performed. In such a case, since information is already available regarding the actual environmental conditions on the property, a Phase I may add little or no useful information. Nevertheless, the Brownfields law and the new rule seem to require that a Phase I be performed.

[1] You may want to develop standardized instructions requiring your title company to search for and immediately report any such liens.

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When questioned about this, at least one EPA employee acknowledged this dilemma and suggested documenting this fact in the record with an explanation of why performing a Phase I was unnecessary. However, the more prudent approach would be to perform the Phase I in any event.

2. *Standard Contract Provisions for Purchase and Sale Agreements*

In order for the environmental professional to conduct AAI, it will need to do such things as inspect the property, interview past and present owners, operators and occupants, and review records. Entities should consider developing standard contract language or purchase and sale agreements which require the seller to provide sufficient access to permit the environmental professional to complete the AAI requirements.[2]

3. *Standard Contract Provisions to Include in Contract With an Environmental Professional*

Entities should also consider developing standard contract provisions to include in contracts with environmental professionals who will be performing AAI.[3] These provisions should require that the person supervising or conducting the AAI be a qualified environmental professional within the meaning of the regulations. They should also require the environmental professional to comply with all of the AAI requirements and to append the required certifications to the final report. In addition, consider requiring the environmental professional to (a) maintain sufficient levels of insurance, (b) name your entity and the seller as additional insureds under its policies and (c) indemnify you and the seller for risks associated with the inquiry.

4. *Procedures to Deal With Situations Where Environmental Risks or Data Gaps Are Identified*

The most important reason for performing AAI is to make sure that the AAI Report is properly evaluated. While in some instances the report may conclude that there are no conditions indicative of releases or threatened releases of hazardous substances, in others, the report may either identify such conditions or the environmental professional may report that it could not properly assess such conditions because of data gaps. In such circumstances someone will need to decide not to proceed with the transaction, seek additional information, or make a determination, at an appropriate level of responsibility, to proceed with the transaction. Therefore, consider establishing procedures for evaluating situations where releases or threatened releases or data gaps are identified.

5. *Checklist to Insure That All AAI Requirements Are Met*

Also consider developing a checklist to be initialed by the person responsible for the transaction to make sure that you have a record that all AAI requirements have been made. This checklist could require such things as:

a. The purchase and sale agreement provides access to conduct AAI.

b. The environmental professional is a ''qualified professional'' within the meaning of the AAI rule, has the requisite insurance, and agrees to meet all AAI requirements.

c. The entity considering the purchase has:

1. provided the environmental professional with title report showing any environmental cleanup liens;
2. informed the environmental professional of any specialized knowledge or experience it has;
3. informed the environmental professional of any commonly known or reasonably ascertainable information about the subject property.

d. The final AAI Report includes all required elements:

1. discussions of interviews with past and present owners, operators and occupants;
2. report of searches for recorded environmental cleanup liens;
3. report of reviews of government records;
4. report of visual inspections of the facility and adjoining properties;
5. report of reviews of historical sources of information;
6. discussion of specialized knowledge or experience of purchaser;
7. discussion of relationship of purchase price to the value of the property uncontaminated;
8. identification of commonly known or reasonably ascertainable information about the property;
9. discussion of the degree of obviousness of the presence or likely presence of contamination at the property, and the ability to detect the contamination by appropriate investigation;
10. identification of any data gaps;
11. opinion as to whether the inquiry has identified conditions indicative of releases or threatened releases of hazardous substances;
12. qualifications of the environmental professional; and
13. declaration of environmental professional.

f. The final AAI Report was completed and updated within the requisite period of time prior to the acquisition.

g. If the AAI Report identifies any concerns, entity criteria for evaluating such risks were followed and requisite approvals for the transaction were obtained.

D. LITIGATION ISSUES

CERCLA relieves ''innocent purchasers,'' and the Brownfields Act relieves ''bona fide prospective purchasers'' of liability if those persons made all appropriate inquiries. The new rule strives to eliminate future litigation regarding whether a party conducted all ap-

[2] If the environmental professional is unable to obtain information then it must identify such ''data gaps'' and comment upon their significance. See 40 CFR § 312.20(g). However, it is generally in the purchaser's interest to avoid having to deal with such gaps.

[3] Entities may also want to have a list of approved environmental professionals whom they feel comfortable relying upon.

propriate inquiry, and therefore qualifies for these defenses, by delineating, in very specific terms, what constitutes ''all appropriate inquiry.''

However, the potential for litigation regarding whether someone has, in fact, complied with the rule and performed adequate inquiry still exists. Thus, someone seeking to impose liability on a purchaser could attempt to argue that the purchaser is not entitled to the exemption because the purchaser did not comply with the rule. Unlike the National Contingency Plan (NCP) which only requires a party to achieve ''substantial compliance'' in order to comply with the NCP,[4] the ''all appropriate inquiry'' rule does not contain any such limitation. Rather, it contains ''performance factors,'' see 40 C.F.R. 312.20(f)(1). Thus, when gathering information, the person conducting the inquiry must search for information which is ''obtainable from its source within reasonable time and cost constraints, and which can practicably be reviewed.'' However, parties may well differ on what are ''reasonable'' time and cost constraints and regarding what can ''practicably'' be reviewed.

In some cases, non-compliance may be obvious—the inquiry simply might not include a required element or might not have been performed within the requisite period of time. However, in some cases, evaluating whether a person complied or did what was ''reasonable'' may be more difficult. For example, the rule requires a discussion of the relationship between the purchase price and the value of the property uncontaminated. A party may argue that the purchaser did not conduct an adequate inquiry because the discussion of the relationship between the purchase price and value was not sufficient or accurate. The rule requires identification of commonly known or reasonably ascertainable information, a discussion of the obviousness of the presence or likely presence of contamination and the identification of data gaps. A party may argue that the purchaser did not conduct adequate due diligence because the report did not look to all reasonably obtainable information or did not contain an adequate discussion of these items. The rule requires the identification of data gaps in the information developed and comments regarding the significance of such data gaps. A party may argue that the report did not assemble all reasonably obtainable data, did not adequately identify data gaps or that the comments on the significance were inadequate. One can expect creative litigators to raise these types of issues when a dispute arises in which someone seeks to hold a property owner liable. It is therefore important for purchasers to make all reasonable efforts to make sure that the inquiry is performed as carefully and comprehensively as possible consistent with the requirements of the rule.

In sum, the EPA rule, which went into effect on November 1, 2006, establishes regulations for conducting all appropriate inquiries. Performing such inquiries can shield an entity from environmental liability under CERCLA. In addition, performing such inquiries can assist an entity in evaluating the environmental risks it faces when acquiring a piece of property. However, although the rule attempts to eliminate future disputes regarding what constitutes adequate due diligence, areas of potential dispute remain. Prospective purchasers should consider implementing procedures to insure that all appropriate inquiry is conducted for all real estate transactions and that the inquiry is comprehensive and as consistent as possible with the new rule.

[4] *See e.g.* 40 C.F.R. § 300.700(c): ''For the purpose of cost recovery under Section 107(a)(4)(B) of CERCLA: (i) A private party response action will be considered 'consistent with the NCP' if the action, when evaluated as a whole, is in substantial compliance with the applicable requirements in paragraphs (5) and (6) of this section, and results in a CERCLA-quality cleanup;'' and ''(4) Actions under § 300.700(c)(1) will not be considered 'inconsistent with the NCP,' and actions under § 300.700(c)(2) will not be considered not 'consistent with the NCP,' based on immaterial or insubstantial deviations from the provisions of 40 CFR part 300.''

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