

Law Trends

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The New EPA Due Diligence Rule: Major Changes in Property Assessment Standards

By David W. Nunn and Andrea B. Smoktonowicz

On November 1, 2005, the U.S. EPA promulgated the long-coming final rule for conducting “all appropriate inquiries” under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) better known as the Superfund Law. This new “Due Diligence Rule” will impact the sale of potentially contaminated properties, commonly termed “brownfields,” when it becomes effective on November 1, 2006. Sellers, purchasers, developers, lenders and other persons involved in commercial real estate and the revitalization of local and regional urban areas all need to be aware of the changes. However, the new Due Diligence Rule is not a panacea for avoiding CERCLA’s draconian liability scheme and adherence to the Rule’s requirements is expected to result in increased transactional costs. Therefore, caution is advised in determining whether following the Due Diligence Rule (which is not a legal requirement) makes sense in all industrial or commercial property transactions.

Under CERCLA, current property owners (and in some cases past property owners) can be held liable for the cleanup of hazardous substances on their properties simply by virtue of their property ownership and regardless of fault. The harshness of the Superfund Law was purposeful, but brought about an unintended consequence: the deterrence of property investment for fear of CERCLA liability. Congress has repeatedly tried to mitigate this fear by passing amendments to CERCLA’s liability scheme in 1986, 1996 and 2002. These amendments created defenses for owners of property (and safe harbors for their lenders) to assert against CERCLA liability claims, including the “innocent landowner,” “contiguous property owner” and “bona fide prospective purchaser” defenses. Historically, the “innocent landowner” defense has received the most focus. It relieves a property owner of CERCLA liability if at the time of sale the purchaser had “no knowledge and no reason to know that the property was contaminated.”

To assert a successful innocent landowner defense, purchasers of industrial or commercial property must demonstrate that they undertook “all appropriate inquiries” or “due diligence” at the time of acquisition and found no evidence of property contamination. Prior to 2002, the only national standards available for conducting due diligence were found in private sector guidance developed by the American Society of Testing and Materials (ASTM). The ASTM standards outline how to complete so-called “Phase I” environmental site assessments to determine if any “recognized environmental conditions” exist on properties that may require further study or testing. Phase I investigations generally involve site inspections, document review and interviews of knowledgeable persons, but no intrusive sampling. The discovery of any recognized environmental conditions during the Phase I process oftentimes triggers follow up “Phase II” studies that include invasive testing of soil, groundwater or other media.

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In its 2002 amendment to CERCLA, Congress compelled the U.S. EPA to adopt its own administrative rule laying out the standards for completing all appropriate inquiries. Until the promulgation of the agency's new rule, both Congress and U.S. EPA said the ASTM standards met the necessary level of environmental due diligence in non-residential property transactions.

The new Due Diligence Rule is a more stringent performance-based standard than the old ASTM standards for completing all appropriate inquiries. Some of the more significant changes and additions to existing due diligence practices found in the new rule are:

- **Qualifications:** To qualify as an “environmental professional” capable of conducting due diligence studies, there are greater education and experience requirements.
- **Document Review:** The new rule has greater document review requirements that include undertaking a more thorough review of historical property-related records. Also, conducting a more comprehensive review of government records (including recorded public records), particularly looking for environmental liens, is another requirement.
- **Interviews:** Broader interview requirements now exist, consisting of potentially interviewing both current and past owners of the property under study, occupants likely to have used hazardous substances at that property and/or owners or occupants of neighboring properties.
- **Inspections:** The U.S. EPA clarifies onsite inspection requirements in its rule, such as better defining the extent of required visual inspection and alternatives for when the ability to perform visual inspections is limited.
- **Data Gaps:** Environmental professionals will be required under the rule to provide greater analysis of data gaps encountered during their investigation and the effect, if any, of those data gaps on the environmental professional's ability to provide opinions on site conditions.
- **Specialized Knowledge and Purchase Price Inquiry:** The due diligence process must now take into account the “specialized knowledge” of the prospective purchaser, including his or her knowledge relating to the property under study and/or adjoining properties, as well as consideration of whether the purchase price adequately reflects the fair market value of the property.

The upside of the new Due Diligence Rule is, in the words of the U.S. EPA, “an increased level of certainty with regard to CERCLA liability.” However, the Agency acknowledges that its rule will increase the burden and cost for conducting environmental property assessments. Further, if the Due Diligence Rule results in the discovery of more contaminated sites, the “innocent landowner” defense will not be available at those sites, and other mechanisms for shielding or allocating potential CERCLA liability will have to be considered (e.g., pursuit of the “bona fide prospective purchaser” defense, voluntary cleanup, environmental insurance and contractual indemnification). Only time will tell whether the Due Diligence Rule will substantially assist the commercial real estate market and facilitate brownfield redevelopment.

For more information on the Due Diligence Rule, Mr. Nunn and Ms. Smoktonowicz are available to assist you. They can be reached by calling 419-241-6000.

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