

New Developments in Environmental Due Diligence for Commercial Real Estate Transactions

by Kianna (Kia) L. Moore

Due Diligence in Commercial Real Estate

Real property purchasers in a commercial setting should be apprised of any potential environmental liabilities they may assume upon purchase. Purchasers typically conduct environmental due diligence that involves a range of potential risks impacting the property's value. Due diligence can reveal issues such as contaminated soil and groundwater, operational issues such as permit compliance, and threats to human health and the environment. Conducting due diligence provides clarity for remedial measures, the costs of which can sometimes be prohibitive. Due diligence affects numerous parties involved in real estate transactions, such as developers, financial lenders, owners, operators, and insurance providers. The value of a company or property can be significantly affected by the issues that are discovered through environmental due diligence. Accordingly, purchasers of commercial real property are advised to plan ahead and determine if and how it will identify issues and miti-

gate environmental risks. Risk is typically driven by potential liability under state and federal environmental requirements.

Of the environmental statutory schemes, the most prominent is the federal Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") as amended by the Superfund Amendments and Reauthorization Act, commonly known as "Superfund" due to its strict joint and several liability.¹ Because of the heavy burden of Superfund liability, Congress carved out liability defenses for prospective purchasers who conduct a good faith examination of the considered property. One of the primary ways for purchasers to fulfill Superfund compliant diligence is through a Phase I Environmental Site Assessment ("Phase I").

Superfund Liability Defenses

Superfund establishes that owners and operators of a facility can be held strictly liable for the costs to remediate any hazardous substances released at a facility. This includes any owner or operator in the chain of title subsequent to the release of the hazardous substance. Superfund classifies such owners and operators as Potentially Responsible Parties ("PRPs"). There are four categories of PRPs, each of which can be held jointly and severally liable, strictly liable, or retroactively liable.² As such, present owners or operators may be held liable for property contamination even if they played no part in the underlying contamination and even if they have only recently acquired the property.

Due to this burdensome potential liability, Congress created certain federal statutory defenses to environmental liability. To avoid categorization as a PRP, purchasers can rely on one of the statutory landowner liability protection defenses. Of these landowner liability protections, the best known is the Bona

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Fide Prospective Purchase (“BFPP”) defense.³ If a purchaser has made “all appropriate inquiries” before it acquires property, it can avoid PRP classification.⁴ The federal Environmental Protection Agency’s (“EPA”) All Appropriate Inquiry Rule (“AAI Rule”) establishes what is necessary for a purchaser to have made an appropriate inquiry and therefore rely on the self-implementing BFPP defense.⁵ It should be noted that the BFPP defense and reliance on Phase Is as appropriate due diligence only applies to federal Superfund law and does not apply to state or local environmental liability laws. In order to bring certainty to the AAI rule, the EPA has endorsed the ASTM E1527 standard and renews its endorsement when ASTM International (“ASTM”) periodically updates the standard.⁶ Since 2013, the ASTM E1527-13 version has been used to meet the AAI rule. ASTM has recently published a new version, E1527-21 (the “Standard”) and the EPA has issued a direct final rule to adopt the new version.⁷

New ASTM Standard Practice for Phase I Environmental Site Assessments

In November 2021, ASTM, the preeminent standards organization for testing and materials, approved the Standard for conducting Phase Is. The new Standard contains updates that purchasers and other parties involved in commercial real estate transactions should be aware of. The purpose of a Phase I is to “define good commercial and customary practice” for conducting site assessments of commercial real estate “with respect to the range of contaminants within the scope of CERCLA and petroleum products.”⁸ The Standard is anticipated to be adopted by the EPA as part of the AAI Rule in May 2022 unless adverse comments are received during the comment period.⁹ Once it is incorporated by the EPA, parties seeking liability relief under the BFPP defense “will be considered in compliance with the requirements” of the AAI Rule if they comply with the new Standard.¹⁰ However, the EPA has clarified that even once it adopts this revision to the AAI Rule, it does not require the use of the new Standard. That is, any party conducting all appropriate inquiries to comply with Superfund’s liability defenses can continue to use the ASTM E1527-13 standard. This proposed action “merely will allow for the use of” the new Standard.¹¹ As the AAI Rule currently allows and will continue to allow purchasers to rely on a prior version of the ASTM E1527 standard to be complaint, it is important to understand how the revised Standard differs from the previous version.

Key Changes

The key changes to the Standard include the following: (1) a new definition of a Recognized Environmental Condition (“REC”); (2) the inclusion of emerging contaminants such as Per- and Polyfluoroalkyl Substances (“PFAS”) as a non-scope item; and (3) the standardization of historical sources.

The first key change to the Standard clarifies what is categorized as an REC. RECs are environmental risks identified by the environmental professional who conducts the Phase I. RECs are significant because they are findings of potential environmental issues that vary in their degree of severity and risk posed to the property and require the purchaser to determine if additional investigation is warranted. If there are no RECs identified at a property, there is usually no reason to conduct environmental sampling or other additional investigation. However, one or more RECs in a Phase I require the purchaser to evaluate each circumstance and decide next steps. There is an element of subjectivity in making REC determinations which can cause inconsistency in Phase I reports. The previous REC definition included “the presence or *likely presence* of hazardous substances or petroleum products in, on or at a property” for three different categories (emphasis added).¹² The new definition removes “likely presence” as a modifier for each of the three different categories and is now only listed in the second category as: “the likely presence of hazardous substances or petroleum products in, on or at the subject property due to a release or likely release to the environment.”¹³

Removing “likely presence” from all three categorizes is an attempt to standardize the environmental professional’s review of what constitutes an REC at the subject property. To further clarify, the Standard includes the Appendix X4 to provide additional examination and a step-by-step breakdown of the definition. The goal of these changes is to promote consistency in an environmental professional’s assessment, which is beneficial for all parties involved in real estate transactions.

The second key change in the Standard incorporates emerging environmental contaminants in the Non-Scope consideration of the Phase I. Non-Scope considerations are common items which may lead to liability issues that are outside the area of Superfund liability and accordingly are not considered hazardous substances.¹⁴ Under this category, the Standard now includes PFAS as contaminants about which human understanding is evolving. These contaminants are found in numerous products such as food packaging, personal care products, fire fighting foams, and many other common items. Because of the wide range of products containing PFAS, minute amounts of these chemicals are frequently discovered in the environment.¹⁵ The EPA has not designated PFAS as hazardous substances under federal law, although the EPA has stated its intent to do so.¹⁶

It is important to note that PFAS, as emerging contaminants, are only within the Non-Scope considerations of the Standard. To the extent the subject property has a historic use that could have involved the use of PFAS, it may be advisable to expand the scope of the Phase I to include their evaluation. As previously mentioned, the EPA will likely categorize PFAS as hazardous substances at some point, so an

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evaluation of PFAS in a Phase I may be helpful to assess potential future risks. Additionally, certain states have already taken regulatory action of some type involving PFAS which may guide decisions to include PFAS as part of the Phase I's scope depending on the particular state's activity.

The third key change is the standardization and expansion of review of historical sources for the subject and adjoining properties. Under the prior standard, it was within the environmental professional's discretion to review as many historical sources as was necessary to determine the presence of potential RECs. These sources ranged from aerial photographs, topographical maps, Sanborn fire insurance maps, city directories, zoning maps, or property tax records, among others. The Standard now requires the environmental professional evaluate at least the following four sources: aerial photographs, topographical maps, Sanborn fire insurance maps, and city directories (collectively, "Standard Historical Resources").¹⁷ It also requires that Standard Historical Resources are evaluated for *both* the subject property and adjoining properties, "if reasonably ascertainable."¹⁸ If the report fails to evaluate each of the four Standard Historical Resources, then it must include an affirmative statement as to why. This additional effort may lead to slightly increased costs of Phase Is. It may also take an environmental professional longer to conduct and draft the Phase I because of the expanded scope of required historical sources and research of adjoining properties, especially in complex commercial or industrial areas.

Conclusion

The new Standard does not change the fundamental approach to due diligence in commercial real estate transactions to satisfy the AAI rule and obtain the Bona Fide Prospective Purchaser landowner defense. The revisions are an effort to improve consistency in REC determi-

nations, expand and acknowledge emerging contaminants as Non-Scope considerations, and clarify the range of historical sources in property use searches. By adding PFAS as a Non-



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Scope item, the Standard recognizes that these chemicals will likely be categorized under Superfund as hazardous substances in the near future. The way in which the EPA has structured the transition from the 2013 version to the new Standard may cause some confusion. At the time of this article, the EPA has yet to adopt the revised Standard as part of its AAI Rule.¹⁹ Hopefully this will be clarified soon once the EPA issues the final rule. Going forward, the Standard will provide greater certainty in meeting the AAI Rule since it is more comprehensive and therefore is the recommended version for use in Phase I assessments. 

Endnotes

- ¹ 42 U.S.C. § 9601 et seq.
- ² 42 U.S.C. § 9607(a).
- ³ 42 U.S.C. § 9601 (40)(A)(i). Additional landowner liability defenses include the Innocent Purchaser defense and the Contiguous Property Owner defense. 42 U.S.C. § 9601(35)(A)(i).
- ⁴ 42 U.S.C. § 9601(35)(B)(i).
- ⁵ 40 C.F.R. § 312; ASTM E1527-13, Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process, ASTM International, West Conshohocken, PA, 2013.
- ⁶ 70 C.F.R. § 66081.
- ⁷ Federal Register, Proposed Rules, Vol. 87, No. 49 issued Monday, March 14, 2022, 14225.
- ⁸ ASTM E1527-21, Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process, ASTM International, West Conshohocken, PA, 2021, <https://www.astm.org/e1527-21.html>.
- ⁹ InsideEPA.com, *Adverse Views Likely to Delay EPA's Plan to Adopt ASTM's PFAS Measure* (March 23, 2022), <https://insideepa.com/daily-news/adverse-views-likely-delay-epa-s-plan-adopt-astm-s-pfas-measure?s=em>.
- ¹⁰ Federal Register, Proposed Rules, Vol. 87, No. 49 issued Monday, March 14, 2022, 14227.
- ¹¹ Federal Register, Proposed Rules, Vol. 87, No. 49 issued Monday, March 14, 2022, 14227.
- ¹² ASTM E1527-13 § 1.1.
- ¹³ ASTM E1527-21 § 1.1.1.
- ¹⁴ Examples of non-scope items include: building materials, naturally-occurring substances, and potential tort liabilities for hazardous conditions. The Standard's new appendix lists familiar non-scope items such as asbestos-containing building materials and lead-based paint and also includes other new items under "Substances Not Defined as Hazardous Substances" such as PFAS. ASTM E1527-21 Appendix X6.10.
- ¹⁵ EPA, *Our Current Understanding of the Human Health and Environmental Risks of PFAS*, <https://www.epa.gov/pfas/our-current-understanding-human-health-and-environmental-risks-pfas> (last visited March 30, 2022).
- ¹⁶ EPA, *PFAS Strategic Roadmap: EPA's Commitments to Action 2021-2024*, <https://www.epa.gov/pfas/pfas-strategic-roadmap-epas-commitments-action-2021-2024> (last visited March 30, 2022).
- ¹⁷ ASTM E1527-21 § 8.3.4.
- ¹⁸ ASTM E1527-21 § 8.2.4(1).
- ¹⁹ InsideEPA.com, *Adverse Views Likely to Delay EPA's Plan to Adopt ASTM's PFAS Measure* (March 23, 2022), <https://insideepa.com/daily-news/adverse-views-likely-delay-epa-s-plan-adopt-astm-s-pfas-measure?s=em>.