

A Progress Report On The Promulgation Of Rules For “All Appropriate Inquiry” Under CERCLA

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This article originally appeared in the Winter 2004 edition of the Michigan Environmental Law Journal.

Congress in 2002 required the U.S. Environmental Protection Agency (“USEPA”) to promulgate regulations defining how prospective purchasers of property should perform “all appropriate inquiry” into potential contamination on real property. After a negotiated rule-making process, a USEPA-appointed committee recommended a set of rules to USEPA. On August 26, 2004, USEPA published a Notice of Rulemaking in the Federal Register based on the draft rules from the negotiated rule-making process¹ and initiated a public comment period that closed November 30, 2004.² The draft rules are accompanied by a lengthy preamble that should be regarded as required reading. The recommended rules include a number of small but significant changes in the current process, put additional burdens on the preparer of the environmental assessment, and establish the professional qualifications for individuals who perform assessments. However, it is not clear that the rules, if adopted, will improve either the accuracy or quality of the assessment process.

1. A Brief History of Environmental Due Diligence

CERCLA as originally enacted provided for strict liability for owners and operators of facilities for clean-up costs incurred by federal and state governments.³ Current owners and operators were liable even if the property was contaminated before the current owner or operator acquired or occupied the property. To ameliorate the draconian effect of this liability, CERCLA was amended in 1986 by the Superfund Amendment and Reauthorization Act of 1986 (“SARA”).

As amended by SARA, CERCLA had several exceptions to its strict liability scheme, one of which is known as the “innocent purchaser” or “innocent landowner” defense. The term innocent purchaser is not used in CERCLA and the defense arises out of the interplay between the liability section, §107⁴ and the definition of “contractual relationship.” § 101(35)(A).⁵ One liability exception arises if a potentially liable person (either an owner or an operator) can establish by a preponderance of the evidence that the release and resulting damages “were caused solely by an act or omission of a third party other than ... one whose acts or omission occurs in connection with a contractual relationship with the defendant.”⁶ Typically preexisting contamination is caused by a third party, so at first glance it would appear that a

new owner or operator should not be liable for preexisting contamination caused by another. But there is no protection if this third party had a contractual relationship with the new owner or operator. CERCLA defines deeds, leases and other instruments transferring ownership or possession as contractual relationships.⁷ Because a new owner or operator typically has a deed or lease from a prior owner or operator, that contractual relationship brings the new owner or operator back into the liability scheme. However, there is an exception to the definition of contractual relationship that excludes from that definition transactions where the contaminated property was acquired or occupied after the hazardous substance was disposed on the property and the new owner or occupant, at the time the owner/operator acquired the property, “did not know and had no reason to know” that a hazardous substance had been disposed of at the property.⁸ A new owner can only claim not to know or have had no reason to know if the new owner undertook “all appropriate inquiry” (“AAI”) before acquisition.⁹ The new owner who performs all appropriate inquiry and discovers nothing to suggest hazardous substances were disposed of at the property is the elusive innocent purchaser.

SARA, which amended CERCLA to create the innocent purchaser defense, requires an inquiry that is “consistent with good commercial or customary practice in an effort to minimize liability,” taking into account

“[A]ny specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property if uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the ability to detect such contamination by appropriate inspection.”¹⁰

This amendment to CERCLA spawned a major environmental due diligence industry. The customary environmental due diligence practice that developed became known as a Phase I Environmental Site Assessment and a rough standardization developed. Typically a Phase I did not include environmental sampling. Instead, if the Phase I study resulted in the conclusion that there had been or might have been a release of hazardous substances, environmental sampling was recommended to verify whether a release had occurred. That typically was done under a separate scope of work that became known as a Phase II Environmental Assessment. Although the scopes of work for Phase Is and Phase IIs converged on fairly similar practices, there were concerns that there was not a clearly-defined and agreed-upon standard that regulators and courts would recognize as meeting CERCLA’s requirements for “all appropriate inquiry.”

As the result of this concern, the American Society for Testing Materials developed a standard-setting process. That culminated in ASTM’s adoption of Standard E 1527-97, “Standard Practice for

Environmental Site Assessment: Phase I Environmental Assessment Process.” That standard was updated in 2000 and reissued as E 1527-00. The purpose of E 1527 is to determine whether a piece of property is affected by “Recognized Environmental Conditions.” A Recognized Environmental Condition (“REC”) is defined as “the presence or likely presence of any hazardous substances or petroleum products on a property under conditions that indicate an existing release, a past release, or a material threat of a release of any hazardous substances or petroleum products”¹¹ If a property is subject to a REC as discovered and reported by the environmental due diligence, then the prospective purchaser/occupant would have reason to know that a release or threat of release might have occurred or exist on the property, disqualifying the prospective purchaser from status as an innocent purchaser. The converse is also true; a “clean” Phase I would support an innocent purchaser defense even if pre-existing contamination were discovered after acquisition. In some cases, a REC identified in the Phase I would be based on the possibility of a prior release - for example, soil staining that might be residue of the release of a hazardous substance. It has been accepted practice that some RECs can be eliminated by further inquiry (i.e., by a Phase II), including, where appropriate, sampling that demonstrated that the condition giving rise to the REC was not in fact associated with a release or threat of release, although E 1527 does not specifically provide that a Phase II may be used to eliminate RECs identified by a Phase I.

2. In 2002, Congress Stepped Into the Due Diligence Debate

There remained some concerns whether the ASTM standard would be recognized by the regulators and the courts as “all appropriate inquiry.” That led to the effort in the Brownfields Act to mandate a standard by regulation to provide, at least in theory, more certainty as to the level of environmental due diligence that would be deemed to satisfy all appropriate inquiry. While only time will tell whether this legislative intent to provide more certainty than that provided by E 1527 will be successful, the language is not without ambiguity and thus is unlikely to provide absolute certainty as to the necessary scope of AAI.

In January 2002, Congress amended CERCLA with the Small Business Liability Relief and Brownfields Revitalization Act of 2001 (the “Brownfields Act”).¹² The purpose of Title II, Subtitle B, *Brownfields Liability Clarifications*, of the Brownfields Act is to address liability issues affecting potential owners and operators of contaminated property. The Brownfields Act attempts to bring some clarification to the level of due diligence required of potential owners and operators attempting to qualify for the “innocent purchaser” exemption to CERCLA’s strict liability scheme. The Brownfields Act requires that USEPA undertake rule making to define the “all appropriate inquiry” that a potential owner

and operator must undertake.¹³ The Act adopted the current ASTM Phase I standard as an interim standard for AAI pending adoption of a final rule.¹⁴

AAI is relevant not only to the innocent landowner defense but is also relevant to new liability exemptions created by the Brownfields Act, known as the contiguous property exemption and the bona fide prospective purchaser exemption¹⁵ respectively, and to brownfields site characterization and assessment grant programs.¹⁶ Note that the three liability exemptions and the draft AAI rules are written in terms of the landowner. They do not acknowledge that prospective tenants who could become CERCLA “operators” have a similar need and interest in obtaining exemptions from liability for historic contamination.

3. *The New Liability Scheme For Prospective Purchasers*

(a) Elements of AAI

The Act sets forth 10 elements for AAI.¹⁷

- (i) Preparation by an environmental professional;
- (ii) Interviews with past and present owners and occupiers of the property and in some instances, neighbors;
- (iii) Review of historical information to determine previous uses and occupancies since the property was first developed;
- (iv) Searches for recorded environmental liens;
- (v) Review of federal, state, tribal and local records;
- (vi) Visual inspection of the property and adjacent properties
- (vii) Incorporation of specialized knowledge or information by the property acquirer;
- (viii) Relationship of the purchase price to the value of the property if uncontaminated;
- (ix) Commonly known or reasonably ascertainable information about the property; and
- (x) Degree of obviousness of contamination and the ability to detect contamination by appropriate investigation.

The Act directs USEPA to effectuate these criteria by adopting implementing rules by January 2004.¹⁸ USEPA missed this deadline and the final rule is still months away.

(b) Concepts Added by the Brownfields Act to the Scope of Due Diligence

The Brownfields Act includes as criteria for AAI several inquiries/factors that go beyond the ASTM standard (which standard failed to incorporate these statutory elements defined by SARA):

[T]he specialized knowledge or experience of the prospective purchaser, the relationship of the purchase price to the value of the property if the property were not contaminated, commonly known or reasonable ascertainable information about the property, 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.¹⁹

The Brownfields Act also grafted a remedial requirement onto the definition of due diligence. Once an innocent purchaser discovers, notwithstanding due diligence, that the property has had a release, the innocent purchaser (as well as the contiguous owner and the bona fide prospective purchaser) must stop any continuing release, prevent any threatened future release and prevent or limit exposure to any previously-released hazardous substance.²⁰ This requirement is similar to the “due care” requirements under Part 201 of Michigan’s Natural Resources and Environmental Protection Act.²¹ This aspect of AAI was discussed in the Michigan Environmental Law Journal,²² and will not be discussed further here except to note the following. The preamble to the proposed rules warns repeatedly that data gaps not appropriately addressed in the AAI process can create a circumstance where a purchaser otherwise qualified as an innocent landowner or a bona fide prospective purchaser can lose its exemption from liability because it will not have enough information to meet the statutory requirement that it take reasonable steps to stop on-going releases after acquiring the property.

(c) The Process for Developing the AAI Rules and Status of the Rulemaking

In April 2003, USEPA gave notice in the Federal Register²³ that it was establishing a Negotiated Rulemaking Committee on All Appropriate Inquiry pursuant to § 9(a)(2) of the Federal Advisory Committee Act.²⁴ The USEPA appointed a wide variety of stakeholders to the Committee and charged with recommending a set of rules by December, 2003. The Committee included representatives from about 25 non-federal organizations, including associations representing the banking, real estate, housing, environmental, and environmental consultant industries and representatives from a number of federal agencies - for example, the Department of Housing and Urban Development. The first committee meeting was held on April 29 and 30, 2003.²⁵

At its sixth meeting on November 12 to 14, 2003, the Committee adopted a consensus draft of rules for AAI (the “Consensus Draft”). The Consensus Draft is envisioned as a new regulatory section, 40 C.F.R. 312, “Standards For Conducting All Appropriate Inquiries.” The USEPA will now review the recommendations, potentially modify them, write a preamble and initiate the rulemaking process. It is expected that the proposed rule will follow the Consensus Draft, given the process in developing the draft and that a draft was adopted by consensus of diverse stockholders. It was expected that formal rule making would begin in June 2004,²⁶ but USEPA did not publish the draft rule until late August 2004.

4. Summary of the Consensus Draft AAI Rule

For properties purchased before May 31, 1997, the Brownfields Act provides that a court must consider the defendant's specialized knowledge or experience, the relationship of the purchase price to the value of the property if uncontaminated, commonly-known information about the property, the obviousness of the contamination, and the ability of the defendant to detect contamination by appropriate investigation.²⁷ For properties purchased after May 31, 1997, the Brownfields Act adopted E-1527-97 as an interim standard until USEPA promulgates the new AAI rules.²⁸ USEPA then adopted E-1527-00 as an interim AAI standard until the new AAI rule is promulgated.²⁹

The procedures recommended in the Consensus Draft have much in common with the ASTM standard in terms of general scope and record review. Those parts of the Consensus Draft will not be discussed in any detail here. The focus here will be on several areas that go beyond or differ from the ASTM standard. It must be emphasized there are many differences that, although minor and beyond the scope of this article, must be carefully observed in performing the new AAI process.

(a) The Scope of AAI

The Consensus Draft applies to persons attempting to qualify for the exemptions of innocent purchaser, bona fide prospective purchaser and contiguous property owner (hereinafter "qualifying persons").

A qualifying person must commission an inquiry "to identify conditions indicative of releases or threatened releases on, at, in, or to the subject property" (a "CIR").³⁰ The recommended standards "are not intended to require identification of quantities or amounts, either individually or in the aggregate, of hazardous substance ... that because of said quantities and amounts, generally would not pose a threat to human health or environment."³¹ In other words, a qualifying person is not charged with determining whether a *de minimis* level of contamination is present. By comparison, E-1527 excludes from the definition of RECs, those concentrations that are so small as to be unlikely to pose a material risk of harm or lead to environmental enforcement.³²

The required investigation consists of an inquiry by an environmental professional pursuant to a scope of work set forth in Proposed Rule ("PR") 312.21, collection of additional information by qualifying persons under a scope of work defined at PR 312.22, and a search for recorded environmental liens by the qualifying person which is provided to the environmental professional. In carrying out the standards and practices, the responsible person (either the qualifying person or the environmental

professional, depending on the task) must gather all information that is publicly available, obtainable within a reasonable time and cost and which can practicably be reviewed, and review and evaluate the thoroughness and reliability of the information gathered.³³ Data gaps must be identified, sources of information consulted to fill in the data gap must also be identified, and the environmental professional must comment on the significance of the data gap.³⁴ Sampling may be conducted to address data gaps but is not required.³⁵

The environmental professional must prepare a written report, including 1) an opinion whether the inquiry has identified a CIR on, at, in or to the subject property, 2) a discussion of any data gaps and whether they have affected the ability to identify a CIR, and 3) the qualifications of the environmental professional and a certification that the environmental professional has the qualifications required by the regulations and that the professional has followed the AAI standards and procedures.³⁶ We anticipate that AAI reports will frequently conclude that data gaps prevent the environmental professional from opining that there are no CIR's on the Property.

The scope of the environmental professional's inquiry is set forth in PR 312.21(b) and subsequent rules and includes interviews with present and part owners and occupants,³⁷ review of government records,³⁸ visual inspection of the property and adjoining properties,³⁹ commonly known or reasonably ascertainable information,⁴⁰ and the degree of obviousness and ability to detect contamination.⁴¹ In addition, the inquiry must take into account information provided to the environmental professional as the result of inquiries conducted by the qualifying person, including the presence of recorded liens and information available because of the qualifying person's specialized knowledge or experience.⁴²

(b) Differences With ASTM E1527

There are minor differences between the AAI and E1527 that include but are not limited to:

- (i) Educational and experiential qualifications for an environmental professional are established;
- (ii) There is a requirement to check local and tribal regulatory records as well as state and federal records;
- (iii) Use history goes back to first developed use, not 1940, but the proposed regulation leaves it to the environmental professional's judgment as to which historical sources are reviewed;
- (iv) Search distances for various environmental indicators vary from the ASTM standard;
- (v) Registries of environmental land use restrictions and engineering controls applicable to the property must be reviewed;

- (vi) Neighboring property owners must be interviewed when assessing abandoned properties; and
- (vii) AAI applies to residential properties in commercial use, not just rentals of more than four units.

The reader is encouraged to compare ASTM E1527 and PR 312 carefully because the above list does not capture all differences.

Given the size of the environmental due diligence industry, it should be no surprise that of the foregoing criteria, it was the criteria defining the minimum qualifications of the environmental professional that generated the most debate. After months of debate, the Consensus Draft recommended the criteria based on several combinations of education, licensure, training and experience.

(c) The Purchaser's Specialized Knowledge or Experience

The Brownfields Act and the Consensus Draft put a new obligation on the qualifying person. Past practice has been to put the burden solely on the environmental professional performing the Phase I to identify RECs. Now the qualifying person must add to the inquiry any information available because of the qualifying person's specialized knowledge or experience. This could be extensive. A manufacturing company acquiring another company's plant could be expected to have substantial knowledge of potential causes and locations of releases of hazardous substances. Presumably, such a qualifying person would be expected to apply its own knowledge of the typical use, handling and disposal of hazardous substances in its industry when evaluating the likelihood of a CIR. In some cases, the qualifying person might even have more industry-specific knowledge than the environmental professional about the general likelihood of releases and disposals.

In addition, the Consensus Draft places the responsibility on the qualifying person, not the environmental professional, to determine whether there have been recorded environmental liens.⁴³

(d) Shelf Life of an AAI Inquiry

The recommendation provides that an AAI inquiry may be relied upon if conducted within one year before purchase, provided that the interviews, visual inspections and record review obligations were conducted or updated within 180 days prior to purchase.⁴⁴ The results of an AAI inquiry can be transferred to someone other than the original user and can be included in the new user's AAI inquiry so long as the new user meets its AAI obligations and has appropriately updated the interview, visual inspections and record review if necessary.⁴⁵

(e) Degree of Obviousness of Contamination and Ability to Detect It by Appropriate Investigation

In scoping an inquiry to meet the proposed AAI regulations, the environmental professional and the qualifying person must consider the degree of obviousness of contamination and the ability to detect it. In other words, what is the likelihood the property is contaminated and how hard would it be to discover the contamination through sampling or other means? The proposed regulation directs the environmental professional and qualifying person to consider the information discovered through record review, visual inspection, etc.

The Consensus Draft does not require sampling as part of an AAI inquiry and the committee specifically declined to adopt such a requirement. The Consensus Draft does require that data gaps be identified and that the environmental professional comment on the significance of data gaps with regard to the ability to opine whether CIRs are present.⁴⁶ The qualifying person and the environmental professional must consider "the ability to detect contamination by appropriate investigation."⁴⁷ Further, it requires the environmental professional to include "an opinion regarding additional appropriate investigation, if any."⁴⁸ Again, at several locations in the Preamble, USEPA warns of the consequences of not identifying on-going releases on the property and advises purchasers to keep that in mind when deciding whether to sample. Taken together, these proposed regulations will certainly lead to conclusions that there are data gaps that can be filled by sampling and analysis.

For any property where solvents or hazardous substances were used in any kind of volume or for any duration, it is possible that in hindsight a trier of fact would conclude that a purchaser who knew of that use was on notice before acquisition of the likelihood of contamination, even if the AAI report is equivocal because of data gaps. The currently-prevailing practice of performing Phase IIs to fill in data gaps is strong evidence of the ability to detect much suspect contamination by sampling and analysis and that it is accepted commercial practice to do so. Thus, although the regulations duck the question of whether sampling is "required," many qualifying parties will have to answer the question and the answer will frequently be "yes."

5. Summary

The proposed AAI rules are a fairly straightforward implementation of the 10 factors set forth in the Brownfields Act. The Act itself creates several burdens and obligations that go beyond current practice. Potentially most troublesome is the requirement that the due diligence take into account the qualifying person's specialized knowledge or experience. This will increase the risk of 20/20 hindsight: "Given your

knowledge, experience and/or prior history, you should have known....” Time will tell whether the new AAI regulations will provide the prospective purchaser with any more comfort or certainty than ASTM E 1527-00. The author is not optimistic on this point.

ENDNOTES

¹ 69 Fed. Reg. 51541 (August 26, 2004). For detailed information on specific aspects of the proposed rule, contact Patricia Overmeyer of EPA’s Office of Brownfields Cleanup and Redevelopment at 202-566-2774, overmeyer.patricia@epa.gov. Extensive information on the development of the rule is available at <http://www.epa.gov/brownfields/regneg.htm>.

² 69 Fed.Reg. 56016 (September 17, 2004).

³ 42 U.S.C. 9607(a).

⁴ § 107, 42 U.S.C. 9607.

⁵ § 101(35)(A), 42 U.S.C. 9601(35)(A).

⁶ 42 U.S.C. 9607(b)(3).

⁷ 42 U.S.C. 9601(35)(d).

⁸ 42 U.S.C. 9601 (35)(A)(i).

⁹ *Id.*

¹⁰ 42 U.S.C. 9601 (35)(B) (before amendment by the Brownfields Act).

¹¹ ASTM 1527-00, ¶ 1.1.1.

¹² Small Business Relief and Brownfields Revitalization Act of 2001, Pub.L. 107-118, 115 Stat.2356 (2002).

¹³ Brownfields Act, § 223(2)(B)(ii).

¹⁴ Brownfields Act, § 223(2)(B)(iv)(II).

¹⁵ Brownfields Act, § 221, codified at 42 U.S.C. 9607(q) and (r)(1).

¹⁶ Brownfields Act, 42 U.S.C. 104(k)(2).

¹⁷ Section 223 of the Brownfields Act, 42 U.S.C. 9601(35)(B).

¹⁸ Brownfields Act, § 223(2)(B)(ii), 1§ 223.

¹⁹ 42 U.S.C. § 101(35)(B)(iii)(VII-X).

²⁰ Brownfields Act § 223(2)(B)(i)(I), codified at 42 U.S.C. 9601(35)(B)(I).

²¹ MCL 324.20107a.

²² Dunsky, Progress Report on EPA’s Implementation of The Small Business Liability Relief and Brownfields Revitalization Act, 20 Mich. Env’tl. L.J. (3), p. 11 (2002).

²³ 68 Fed Reg. 10747 (April 7, 2003).

²⁴ 5 U.S.C. 9(a)(2).

²⁵ Background on the Committee and its recommendations can be found at <http://www.epa.gov/swerosps/bf/regneg.htm>.

²⁶ To stay current with the Brownfields Act and the AAI rulemaking, the ASTM is updating E 1527-00 through its E 1527 Task Group.

²⁷ Brownfields Act, § 223(2)(B)(iv)(I).

²⁸ Brownfields Act, § 223(2)(B)(iv) (II).

²⁹ 68 Fed. Reg. 24888-891 (May 9, 2003).

³⁰ Proposal Rule (“PR”) 312.20(d).

³¹ PR 312.20(g).

³² ASTM E 1527-00, ¶ 1.1.1.

³³ PR 312.20(e).

³⁴ PR 312.20(f).

³⁵ *Id.*

³⁶ PR 312.21(c) and (d).

³⁷ PR 312.23.

³⁸ PR 312.26.

³⁹ PR 312.27.

⁴⁰ PR 312.30.

⁴¹ PR 312.31.

⁴² PR 312.25, 312.28.

⁴³ Note that under CERCLA and Part 201, environmental liens arise upon the government's expenditure of funds. 42 U.S.C. 9607(l); MCL 324.20138(1). Thus the more conservative inquiry, although not required by the Consensus Draft, is whether remedial funds have been spent and not whether an environmental lien has been recorded.

⁴⁴ PR 312.20(b).

⁴⁵ PR 312.20(c).

⁴⁶ PR 312.21(c)(2).

⁴⁷ PR 312.31.

⁴⁸ PR 312.31(b).