

## Changing Standards Alter Environmental Site Assessment Requirements

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Prospective purchasers, developers, tenants and others in the commercial real estate industry who use Phase I Environmental Site Assessments (ESAs) should take note of an updated American Society for Testing and Materials standard (ASTM 1527-05) that is about to become the industry norm and will be required by lenders, investors, insurers and certain government regulators. As explained below, the relevant deadline is Nov. 1, 2006.

The new ASTM standard has expanded the scope of several traditional environmental due-diligence activities because of recent changes to federal law. Specifically, the 2002 Brownfield Amendments to the federal Superfund law (CERCLA, the Comprehensive Environmental Response, Compensation and Liability Act) established several new liability defenses (e.g. protection from third-party suits for recovery of cleanup costs) for “innocent” purchasers of contaminated properties, commonly known as brownfield sites. However, these liability protections are only available to prospective purchasers who have conducted “all appropriate inquiry,” or AAI, with respect to environmental issues prior to acquiring the property. Note: liability under state and local law varies, and most jurisdictions do not employ the federal AAI scheme. Independent liabilities under state law will generally not be affected by AAI compliance.

The U.S. Environmental Protection Agency (EPA) was tasked with promulgating regulations with criteria for conducting “all appropriate inquiry” at a property, and the ASTM 1527-00 standard, commonly used by most environmental consulting firms, was initially accepted by the EPA as an appropriate formulation of the AAI criteria. However, EPA’s final AAI regulations are effective as to any property purchased after Nov. 1, and a new ASTM standard (ASTM 1527-05) was developed to satisfy the AAI regulations. This new standard has now been approved by EPA.

Simply put, conducting pre-purchase environmental due diligence in accordance with the EPA’s AAI criteria is a prerequisite to certain environmental liability protections. The best way to satisfy this prerequisite is to have a Phase I Environmental Site Assessment report prepared that complies with the ASTM 1527-05 standard. In most situations, we recommend that our clients utilize the ASTM 1527-05 standard going forward.

The new standard still requires visual site inspections, interviews, records reviews and other inquiries into the history and use of a property to evaluate whether “recognized environmental conditions” are present. However, all ESA “users” (generally the entity commissioning and/or relying upon the investigation) need to understand that the ASTM 1527-05 standard contains subtle yet significant departures from the previous ASTM 1527-00 standard.

Qualifications and role of the “environmental professional” conducting the assessment is one important aspect to which attention should be paid. Minimum levels of education, professional licensure and experience for those conducting assessments have now been specified. Not all consultants who have been performing ESAs will be able to satisfy the new requirements. ESA users should ensure that the consultants they employ have qualified environmental professionals on staff and that these individuals will be appropriately involved in the assessment activities.

The new standard leaves environmental professionals with extensive discretion. For example, an environmental professional may decide whether certain inquiries have gone far enough or are needed at all in order to complete an assessment. ESA users should be sure to communicate with the environmental professional performing the inquiries and reviews so that both their business goals and the overall objectives of the ESA are realized.

The new standard requires interviews with present owners or operators of a property (i.e., the “key site manager”). This is a change from the previous requirement, which simply mandated reasonable attempts to perform interviews. Users will need to provide consultants with a contact (e.g. the current owner or manager of a property) who can respond to questions associated with possible environmental concerns.

The new standard does not specifically require a user to disclose confidential or potentially sensitive information to the environmental professional (i.e. purchase price information or any specialized knowledge about the property that might indicate contamination), although the user is required to consider these issues. If the user does not disclose the information to the environmental professional, they may decide that the lack of disclosure is a significant data gap that invalidates the overall conclusions in the ESA report.

Users should communicate with the environmental professional as to whether they intend to identify such a non-disclosure as a data gap. If they do, users have two options: 1) Providing enough information to satisfy the environmental professional, or 2) Assuring the environmental professional that the user has independently considered the information, and that the user did not identify any environmental conditions other than those identified by the professional.

Either option requires discussion with the consultant to ensure that appropriate provisions are included in the ESA report.

#### Costs and Controls

The new standard alters several of the requirements for review of public and historical records. Two are particularly noteworthy.

First, searches of historical records must be performed as far back as a structure existed on the property or the property was used for certain purposes (e.g. agriculture). This

extends the previous requirement significantly and is a good example of why ESAs may now cost more.

Second, search requirements for “activity and use limitations” or “environmental deed restrictions” and “environmental cleanup liens” have changed. Lien searches must now cover federal, tribal, state and local records. Previously they were limited to reasonably ascertainable land title records. Also, either the user or the environmental professional may conduct the research. These searches once were the sole responsibility of the user. ESA users should talk to consultants about who will do this research so efforts are not duplicated.

Although the new standard appears to indicate that the shelf-life of a report is one year, so many of the inquiries still must be updated after 180 days that the shelf-life of an ESA effectively is still only 180 days. The standard retains the option of utilizing information from previous reports, and this may reduce the effort needed for a new ESA report when it is outdated.

The new standard requires that reports include signed declarations by the environmental professional and demand that “significant” data gaps be specifically identified. As mentioned previously, the environmental professional may exercise discretion in making decisions about whether data gaps are significant, which is critical because data gaps could invalidate an ESA’s overall conclusions. If there are significant data gaps, ESA users may want to supply additional information or authorize further investigation.

All in all, the new standard expands some assessment activities and changes some overall requirements for ESAs. One expected consequence of the new standard is a moderate increase in the cost of a Phase I ESA. Additionally, because environmental professionals now have more discretion and control over the process and must account for missing information in their reports, the regulations warrant greater communication with environmental professionals.

Given the liability protections available with AAI and a renewed focus on environmental due-diligence activities, users may find certain parties to a transaction (e.g. lenders and tenants) requesting more significant input into the Phase I process. For example, several major retail tenants already have put their own revised Phase I specifications in place, and some of these specifications go beyond what is required under the new ASTM standard.

As always, we recommend that ESA users review a draft of the ESA report before it is finalized.

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