By Larry Schnapf

Agency File Reviews: The Dark Secret Of Phase 1 Reports

Beginning with this column, we will be examining aspects of environmental due diligence to help property owners and non-environmental lawyers better understand and interpret Phase 1 reports, the limitations of these reports, and how to design these reports so they meet the particular risk tolerances of property owners and clients.

Before the era of electronic records, environmental consultants performing Phase 1 environmental site assessments routinely visited state and local offices to review regulatory files. Even after electronic databases became available in the 1990s, consultants often reviewed agency files to supplement or confirm information obtained from database reviews.

Agency files can contain a plethora of information that is not readily available from electronic databases. The information contained in agency files that can be critical to a decision to purchase or finance a particular site especially in this era of risk-based cleanups where regulators will allow residual contamination to remain at a site provided certain institutional or engineering controls (IC/ECs) are implemented. File reviews can yield information on the quality of the prior investigations, the type and depth of contaminants, areas where contamination remains, the conditions contained in no further action letters, the specific ICs/ECs that have to be implemented, whether those controls remain protective, and current groundwater monitoring data including groundwater flow and depth information.

Lawrence P. Schnapf is the principal of Schnapf LLC. He has over 25 years of national environmental experience with Fortune 500 corporations and a number of major New York-based law firms. He is also an adjunct professor of environmental law at New York Law School and a member of the faculty of the Center for Real Estate Studies at New York Law School. Larry has counseled corporate and industrial clients on compliance with the regulatory requirements of federal and state environmental laws such as RCRA, CWA, CAA and their state counterparts, has represented clients in federal and state environmental litigation, enforcement matters, administrative proceedings and CERCLA private cost recovery actions, and has assisted clients in developing corporate environmental compliance procedures. He has extensive experience performing environmental due diligence and negotiating environmental issues associated with corporate acquisitions, commercial lending and financing, workouts and bankruptcy, real estate transactions and brownfield redevelopment. He is chair of the Environmental, Energy and Resources Committee of the Business Law Section of the ABA, co-chairs both the NYSBA Brownfield Task Force and the NYSBA Hazardous Site Remediation Committee. He can be reached at larry@schnapflaw.com.

Yet despite this potential trove of valuable information, many environmental consultants no longer routinely review agency files as part of a standard Phase 1 environmental assessment even when they determine that a site has a "recognized environmental condition" (REC). These consultants, who often run high-volume "Phase 1 mills" or "commodity shops" feel that their obligation under a Phase 1 ESA is simply limited to identifying the presence or potential presence of RECs and that file reviews are not included in their Phase 1 proposal. Many clients have been surprised to learn that their Phase 1 report did not include a file review and are expected to pay an additional fee for this task.

The reason for this change is partly due to ambiguity in the Phase 1 standard practice that has been developed over the years along with changes in the business model of the environmental due diligence industry. Before explaining how we got to this point, it is important to understand the purpose and scope of environmental due diligence.

The practice of performing Phase 1 reports grew out of the 1986 amendments to the federal Superfund law which is formally known as the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). 42 U.S.C. §9601 et seq. This law imposes strict, joint and retroactive liability on four classes of parties (owners, operators, generators, and transporters), for the costs of addressing releases of hazardous substances. 42 U.S.C. §9607(a)(1)-(4). CERCLA originally only contained three affirmative defenses to liability: act of God, act of war, and the third-party defense. From a practical standpoint, the third-party defense was the only viable defense available to property owners or operators. To establish that defense, the owner or operator would have to show that the release was: (1) solely caused by a party; (2) whom it had no direct or indirect contractual relationship; (3) the defendant exercised due care with respect to the hazardous substances; and (4) took precautions against foreseeable actions or omissions of third parties.

Most courts broadly construed a direct or indirect "contractual relationship" to encompass most forms of real estate conveyances so that purchasers or tenants would be barred from asserting the defense even if they acquired title or possession of the property after the contamination occurred. To minimize this harsh result, Congress added the innocent purchaser defense in 1986 that provided that a landowner would not be considered to be in a "contractual relationship" with the person responsible for the contamination if the landowner performed an appropriate inquiry into the past use and ownership of the property. If as a result of this appropriate inquiry, the landowner did not know or have reason to know of contamination, it would be deemed not to have a contractual relationship but would still have to demonstrate compliance with the due care and precautionary elements of the defense.

The 1986 amendments contained five criteria that courts could use in determining if a landowner had implemented an all appropriate inquiry. Courts did not uniformly apply these criteria and often found that if a property owner did not identify contamination during a pre-acquisition investigation, it probably did not perform an appropriate inquiry and therefore could not assert the defense. To provide greater clarity and certainty to property owners and their lenders, ASTM developed the E1527 standard practice for conducting all appropriate inquiries.

In 2002, Congress again amended CERCLA to add two new defenses: bona fide prospective purchaser (BFPP), 42 U.S.C. §9601(40), and contiguous property owner (CPO), 42 U.S.C. §9607(q). Congress also instructed EPA to issue a rule defining what constituted all appropriate inquiries (AAI). Congress also provided that until EPA issued its AAI rule, the ASTM E1527 standard would act as an interim standard for conducting AAI. EPA published the AAI rule in 2005 and it became effective on November 1, 2006. 40 C.F.R. 312. ASTM revised the E1527 practice to reflect the AAI rule and EPA

determined that compliance with ASTM E1527-05 would constitute compliance with AAI.

What does AAI say about review of government records? Section 312.26(a) states that the Environmental Professionals (EPs) must review federal, tribal, state, and local government records or data bases of government records of the subject property and adjoining properties for the purposes of achieving the objectives and performance factors of the rule set forth at section 312.20(e) and (f). For the property that is the subject of the investigation, section 312.26(b) provides that the EP should review the following federal, tribal, and state government records or data bases of such government records and local government records and data bases of such records:

- Government records of reported releases or threatened releases at the subject property, including previously conducted site investigation reports;
- Government records of activities, conditions, or incidents likely to cause or contribute to releases or threatened releases, including records documenting regulatory permits that were issued to current or previous owners or operators at the property for waste management activities and government records that identify the subject property as the location of landfills, storage tanks, or as the location for generating and handling activities for hazardous substances, pollutants, contaminants, petroleum and petroleum products, or controlled substances;
- CERCLIS;
- Government-maintained records of public risks;
- Emergency Response Notification System (ERNS); and
- Government registries, or publicly available lists of engineering controls.

The preamble to the AAI rule goes on to say that "review of actual records is not necessary, provided that the same information contained in the government records and required to meet the requirements of this criterion and achieve the objectives and performance factors for these regulations is attainable by searching available data bases." 70 Fed. Reg. 66095 (Nov 1, 2005).

The language does not require the EP to review the actual government records when the same information is contained in databases. However, the electronic databases do not tend to contain the detailed information about the scope and extent of contamination that is included in remedial investigation reports, remedial action reports, and other documents prepared during the site remediation process.

Now let's turn to ASTM E1527-05 and see what it says about reviewing government records. Section 8.2.1 of ASTM E1527-05 provides that an EP shall review Standard Environmental Record Sources. The standard sources, in turn, are defined as publicly available "lists" that provide varying degrees of detail regarding information that may be relative to the Phase I ESA.

Section 8.2.2 (Additional Environmental Record Sources) provides that an EP shall review nonstandard "records" when, in the judgment of the EP, such additional records: (1) are reasonably ascertainable; (2) are sufficiently useful, accurate, and complete in light of the objective of the records review; and (3) are generally obtained, pursuant to local good commercial or customary practice. Section 8.2.2 is not limited to lists; rather it includes records or files that may be available through a variety of local agencies.

It would seem that if a review of the standard list review raises concerns about a "release" of hazardous substance or petroleum at a site and the EP is aware that relevant files are normally maintained by a local agency for such issues, then the consultant is required to review such records and this work

should not constitute an additional service with additional costs.

Consultants who claim their task is simply to identify RECs provide little useful information to a client. A file review may reveal that the issue may no longer be a REC or may reveal information that the REC does not present a material issue. Without reviewing any file records that might exist, the EP cannot reasonably determine if a former tank should be a REC. Any conclusion about the former tank by the EP without a file review would be nothing more than a guess.

The ASTM E1527-05 task group is currently proposing to change the language involving agency file reviews as part of a periodic update of the standard. The proposal would provide that there would be a presumption that agency files be reviewed when a REC is identified but that an environmental consultant could in the exercise of its professional judgment conclude that an agency file review is not necessary but the EP must explain its rationale why such a review is not necessary.

Regardless of how the proposal is resolved, parties ordering Phase 1 reports should consider if they want agency file reviews for RECs or suspected RECs at the properties. Many clients view Phase 1 reports as commodities with the only difference being price. However, because the ASTM E1527 and AAI are performance-based standards that rely heavily on professional judgment of the environmental professional, the quality of Phase 1 reports can differ considerably among firms and within firms depending on who is doing the work. Thus, clients and their attorneys should not simply rely on their environmental consultants to determine the appropriate scope of the Phase 1 but need to take into account their own risk tolerances.

Some clients may decide that such reviews are not necessary for certain types of uses such as commercial office properties or multifamily developments where there is no information suggesting a environmentally problematic prior use. There may also be situations in which a property may have utilized heating oil tanks or solvents, or may have been used by a former dry cleaner, that might warrant a file review.

Likewise, the client may be performing the Phase 1 not simply to comply with the CERCLA liability defenses but also to identify business environmental risks. In any event, the client and its lawyer should determine prior to engaging an environmental consultant if it wants to have agency file review performed as part of the Phase 1 and communicate this to the consultant. Likewise, if a client is bidding out projects, they should compare bids to make sure that the difference between a low bidder and a higher proposal is the absence of an agency review.

In our next column, we will discuss the meaning of the key conclusions in Phase 1 reports, RECs, HRECs, and de minimis conditions.