CERCLA Amendments Will Impact How Due Diligence is Conducted

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On January 11, 2002, President Bush signed into law the Small Business Liability Relief and Brownfields Revitalization Act (the "Brownfield Amendments").[1] The law establishes new defenses under the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA")[2] for owners of contaminated property, creates new due diligence requirements, establishes a grant program to fund brownfield cleanups, and provides liability relief to certain kinds of CERCLA generators. This article will review the new defenses and discuss how due diligence may change to meet the requirements of the new defenses.

I. Defenses for Owners of Contaminated Properties

The Brownfield Amendments modified the existing CERCLA Innocent Purchaser Defense and established two new defenses: new Bona Fide Prospective Purchaser ("BFP") defense or the new Contiguous Property Owner defense. The Innocent Purchase Defense, BFP and Contiguous Property Owner defenses only immunize an owner from CERCLA liability and will not protect owners from EPA actions brought under other federal laws such as the Resource Conservation and Recovery Act ("RCRA")[3] or state environmental laws. The legislation also does not provide liability relief for owners of the numerous brownfield sites that are contaminated with petroleum or polychlorinated biphenyls ("PCBs").

A. Changes to the Innocent Purchaser Defense

The innocent landowner provides that a purchaser will not be considered to be in a "contractual relationship" and thus be able to assert the defense if the purchaser could establish that it did not know or had no reason to know about the contamination.[4] To establish that it had no reason to know of the contamination, a defendant must demonstrate that it took "*all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability.*" In determining whether there was an "appropriate inquiry," CERCLA requires that any specialized knowledge or experience of the innocent owner must be taken into account as well as the relationship of the purchase price to the contaminated property and whether the presence of contamination was obvious or could be detected by an appropriate site inspection.[5]

Prior to the enactment of the Brownfield Amendments, an owner qualifying as an innocent purchaser had continuing obligations after taking title to comply with the due care and precautionary requirements of the third party defense.[6] The Brownfield Amendments add the new obligations that an owner must comply with *after acquiring the property* to preserve its status as an innocent purchaser. The purchaser must:
Cooperate and provide access to persons authorized to conduct response actions or natural resource restoration at the property.[7]

- Comply with any land use restrictions ("LUCs") established at a site in connection with a response action and must not impede the effectiveness or integrity of the LUCs; and
- Provide access to persons authorized to operate, maintain or otherwise ensure the integrity of LUCs. [8]

B. The Bona Fide Prospective Purchaser Defense

Perhaps the principal drawback of the CERCLA innocent purchaser defense has been that for a landowner to successfully assert the defense, it had to establish that it had no reason to know that the property was contaminated. Since the problem with brownfields is the existence or suspicion of contamination, the defense was largely unavailable to prospective developers or tenants of brownfield sites.

To encourage the reuse of contaminated properties, EPA had been entering into PPAs. While the PPAs were helpful, the time and cost to negotiate these agreements often discouraged many prospective purchasers.

To eliminate this obstacle to redevelopment of brownfields, the Brownfield Amendments created the BFP defense. [9] The defense applies to property that qualifies as a "brownfield site" as well as NPL sites.

Under the new defense, landowners or tenants who knowingly acquire or lease contaminated property after January 11, 2002 can avoid CERCLA liability if they can establish the following conditions by a preponderance of the evidence that:[10]

- All disposal of hazardous substances occurred before acquiring title or leasing the property.[11]
- They conducted an "appropriate inquiry"[12]
- They complied with all reporting requirements.[13]
- They took "*appropriate care*" by taking by taking reasonable steps to stop any continuing release, prevent any threatened future release; and prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance.[14]
- They cooperated and provided access to persons conducting response actions or natural resource restoration at the property. [15]
- They have complied with LUCs and do not impede their effectiveness or integrity.[16]
- They provide access to persons authorized to operate, maintain or otherwise ensure the integrity of LUCs.[17]
- They comply with any EPA request for information or administrative subpoena issued under CERCLA.[18]
- The purchaser/tenant is not a PRP or affiliated with any other PRP for the property through any direct or indirect familial relationship, any contractual or corporate relationship, or as a result of a reorganization of a business entity that was a PRP.[19]

C. EPA Windfall Lien Authority For BFP

Prior to the Brownfield Amendments, CERCLA authorized EPA to impose a non-priority lien on property where it has performed response actions.[20] The Brownfield Amendments create a windfall lien in favor of EPA for property owned by BFPs. [21]

To impose a windfall lien, EPA must establish that it has performed a response action, has not recovered its response costs and that the response action increased the fair market value of the property above the fair market value of the facility that existed before the response action was initiated.[22] The windfall lien is to be measured by the increase in fair market value of the property attributable to the response action at the time of a sale or other disposition of the property. The lien will arise at the time EPA incurs its costs and shall continue until the lien is satisfied by sale or other means, or EPA recovers all of its response costs incurred at the property.[23] It should be noted that there is no requirement that the lien be recorded.

D. Contiguous Property Owner Defense

The CERCLA definition of a "facility" includes any area where hazardous substances have come to be located. As a result, property owners have been concerned that they could be held liable for contamination that has migrated onto their property from an adjoining parcel. This potential liability has discouraged development of brownfield sites. To eliminate these disincentives, EPA published its "Final Policy Toward Owners of Property With Contaminated Aquifers" in 1995.[24]

The Brownfield Amendments add a new section 107(q) that codifies this policy as an affirmative defense.[25] The new section provides that a person owning property that is contiguous to or otherwise "similarly situated" to a contaminated site and that is or may be contaminated by a release or threatened release of a hazardous substance from that contaminated site shall not be considered to be a CERCLA owner or operator solely by reason of the contamination if it can satisfy the following conditions by a preponderance of the evidence:

- The owner has not caused or contributed to the release or threatened release;[26]
- The owner it is not a PRP or affiliated with any other PRP for the property through any direct or indirect familial relationship, a contractual or corporate relationship, or the result of a reorganization of a business entity that was a PRP.[27]
- The owner takes reasonable steps to stop any continuing release, prevent any threatened future release, and prevent or limit human, environmental, or natural resource exposure to any hazardous substance released on or from property owned by that person;[28]
- The owner cooperates and provides access to persons authorized to conduct response actions or natural resource restoration at the property;[29]
- The owner complies with any LUCs established at the site and does not impede the effectiveness or integrity of any such LUCs. In addition, the owner must provides access persons authorized to operate, maintain or otherwise ensure the integrity of land use controls.[30]
- The owner must comply with all reporting requirements and other required notices;[31]

- The owner has complied with any EPA request for information or administrative subpoena issued under CERCLA;[32] and
- The owner conducted an "appropriate inquiry" at the time the person acquired title to the property.[33]

A person qualifying as an owner of a contiguous property owner shall not be required to conduct ground water investigations or to install ground water remediation systems unless it would otherwise be required to conduct such activity under the EPA 1995 policy.[34] If an owner cannot qualify for the contiguous property owner defense because for example it did not conduct an appropriate inquiry, it may still be able to qualify for the BFP defense. EPA is also authorized to issue assurance to a contiguous property owner that no enforcement action will be initiated under CERCLA and to provide protection against claims for contribution or cost recovery.[35]

Some might argue that this defense actually expands the liability of those contiguous property owners. It has been a rare instance when a property owner whose property has been impacted by a plume migrating from an off-site source has been held liable under CERCLA. The intent of the 1995 EPA policy was to eliminate barriers to the transfer of property. Under the policy, an owner or lessee of property with contaminated groundwater from an off-site source would not be liable if it did not cause or exacerbate the contamination. The owner or lessee was also not required to take any affirmative actions to investigate or remediate the groundwater contamination to satisfy the "due care" or "precautionary" elements of the third party defense.[36] Indeed, when PRPs have been required to conduct install monitoring wells on contiguous property or otherwise gain access to such property, they often have been required to pay the owner for such access as part of the PRPs' good faith obligation under a CERCLA administrative order on consent.

However, the defense now requires that the contiguous property owner take "appropriate care" to preserve its defense, something it was not required to do before the Brownfield Amendments. As explained below, "appropriate care" may be a more stringent standard than the "due care" requirement of the third party defense. If an owner or lessee fails to carry out these new responsibilities, there is an implication that the contiguous owner or lessee may be liable under CERCLA as the owner of a facility where hazardous substances have come to be located.

Presumably, a contiguous owner will have to allow access to PRPs to conduct response actions in order to be deemed to have exercised "appropriate care" and no longer be able to demand compensation as a condition for access to the property. It is possible that a court may conclude that a contiguous property owner who denies access to PRPs to conduct response actions or refuses to allow institutional controls to be placed on property because of inadequate compensation may have not exercised "appropriate care" and be liable under CERCLA.

Each of these defenses now requires a party to exercise "appropriate care" regarding the contamination at the site. It is not entirely clear what Congress intended when it used the term "appropriate care." One would think that these required actions would more resemble removal actions and not the full-fledged remedial action and there is some legislative history to support this view. Indeed, the Senate Committee Report indicated in the section discussing the contiguous property owner defense that owners

would not have to undertake full-scale response actions. Instead, reasonable steps such as notifying the government, and erecting or maintaining signs or other barriers would be sufficient to raise this affirmative defense. [37] Confusing the issue, though, is the fact that an innocent purchaser is required to exercise both "due care" and "appropriate care." This might suggest to some that the "appropriate care" standard might be more stringent than the "due care" requirement since there would be no reason to create this requirement if it was not a higher standard.

II. New Due Diligence Standards

The Brownfield Amendments not only extend the "appropriate inquiry" requirement to the BFP and Contiguous Property Owner defenses but also establish interim standards for satisfying this requirement. EPA is directed to promulgate permanent standards by January 11, 2004.[38]

For commercial property purchased before May 31, 1997, the Brownfield Amendments provide that courts shall take the following factors into account when determining if a defendant/owner conducted an appropriate inquiry:

- Any specialized knowledge or experience on the part of the defendant;
- The relationship of the purchase price to the value of the property, if the property was not contaminated;
- 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 of the defendant to detect the contamination by appropriate inspection. [39]

For property purchased on or after May 31, 1997 and until EPA promulgates its due diligence standards, owners or tenants may satisfy the appropriate inquiry requirement by performing a Phase I environmental site assessment ("ESAs") in accordance with the American Society for Testing and Materials ('ASTM") procedures including the ASTM E1527-97. [40]

As part of this interim standard, the purchaser must also exercise "*appropriate care*" with respect to hazardous substances found at the facility by taking reasonable steps to stop any continuing release, prevent any threatened future release, and prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance.[41]

In promulgating permanent due diligence standards, EPA is required to include the following criteria in its standard.

- The results of an inquiry by an environmental professional.
- Interviews with past and present owners, operators, and occupants of the facility for the purpose of gathering information about potential for contamination at the facility.
- Reviews of historical sources, such as chain of title documents, aerial photographs, building department records, and land use records to determine previous uses and occupancies of the real property since the property was first

developed.

- Searches for recorded environmental liens.
- Reviews of federal, state and local government environmental records.
- Visual inspections of the facility and of adjoining properties.
- Specialized knowledge or experience of the defendant.
- The relationship of the purchase price to the value of the property in an uncontaminated state.
- Commonly known or reasonably 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.

The Brownfield Amendments create a more relaxed standard of due diligence for non-governmental or non-commercial purchasers of residential property or similar use. These purchasers may qualify as an innocent purchaser or Bona fide prospective purchaser by conducting a site inspection and title search that reveal no basis for further investigation.[42]

The Brownfield Amendments authorizes $250 million to inventory, characterize, assess, and conduct planning and to perform targeted site assessments at brownfield sites.[43] The grants shall not exceed $200,000 per site though EPA may waive the $200,000 limitation and permit an eligible entity to receive a grant of up to $350,000. Site assessments that are performed using these funds must comply with ASTM E1527 until EPA promulgates standards for what constitutes an appropriate inquiry.[44]

III. Site Assessment Requirements Under State Response Programs

Approximately 45 states have enacted brownfield or voluntary cleanup programs that use risk-based cleanups. Purchasers of brownfield sites and their lenders have been concerned that EPA might determine that a site cleanup performed under a state program was inadequate. This has rarely occurred since most brownfield sites are not as seriously contaminated as NPL sites and are not on the federal enforcement radar screen.

The Brownfield Amendments added a new section to CERCLA that bars EPA from bringing enforcement actions under CERCLA when a cleanup is performed at an "eligible response site" and the state response program meets the minimum standards established in this section[45]:

- The State requests EPA to perform a response action;
- EPA determines that contamination has migrated or will migrate across a state line and further response actions are necessary to protect human health or the environment;
- EPA determines that contamination has migrated or is likely to migrate onto federal property and may impact the authorized purposes of the Federal property;
- EPA determines after taking into consideration the response activities already taken that a release or threatened release may present an imminent and substantial endangerment to public health or welfare or the environment, and that additional response actions are likely to be necessary to mitigate the release or threatened

release; or

- EPA determines that new information that was not known by the state when the response action was approved or completed has been discovered that indicates further remediation is necessary to protect public health or welfare or the environment.

The enforcement bar will help alleviate the concern of banks and purchasers that EPA may require additional cleanups. However, there is a potentially important and problematic provision that requires a state response program to also establish a mechanism where a persons working or living near a brownfield site may request that a site assessment be performed.[46]

It is unclear if this is simply a Phase I ESA or a risk assessment. It is unclear who must pay for this assessment. Moreover, because this provision applies to pollutants or contaminants, it can apply to sites that might not be covered by a state superfund program such as those contaminated with petroleum, asbestos or lead-based paint. In addition, the trigger for requiring a site investigation is a "threatened release" which is a very low threshold such as the mere presence of abandoned drums in the backyard of a facility or where an institutional control may no longer be operating properly. As a result, property owners may not only have to pay greater attention to neighboring properties during due diligence to determine if their may be sensitive populations but may feel constrained to perform more extensive cleanups than required under state risk-based cleanup standards.

IV. Implications For Due Diligence

The Brownfield Amendments may not only change the scope of due diligence but may also expand the role that consultants have played in transactions in a number of ways.

First, the legislation may reduce the recent popularity of so-called "commodity-style" ESAs that barely satisfied the "appropriate inquiry" requirements. The rationale for performing less than comprehensive ESAs was that the purchasers would be liable if they found any contamination. Now, however, because the BFP can provide real relief to prospective purchasers and the new interim federal due diligence standards specifically refer to the ASTM E1527, purchasers and their lenders may feel compelled to make sure that their Phase I ESAs satisfy ASTM requirements.

Second, prospective purchasers and lenders have not usually required Phase I ESAs on all properties contained within a portfolio but only those that might have the most value or that have the greater likelihood of environmental problems. The availability of the BFP defense and the requirement that appropriate inquiry requires an ASTM ESA may cause these parties to reconsider their approach to due diligence for multi-property transactions.

Third, the Brownfield Amendments will also likely change the focus of due diligence. Not only will purchasers or tenants have to perform ASTM-quality Phase I ESAs to avail themselves of the defense, they will need more detailed information to they will be in a position to exercise their post-closing or occupancy "appropriate care" requirements and other conditions of those defenses.

For example, because of the requirements of the contiguous owners defense, it may be necessary for purchasers to focus closer attention on the environmental

conditions of nearby properties during due diligence. If those properties are contaminated, prospective purchasers may want to develop more precise information on the extent of the contamination to make sure that they may not unwittingly be taking on obligations that could interfere with the use of their property such as consenting to the installation of groundwater wells or imposition of institutional or engineering controls.

In addition, owners/tenants will need to know more precisely if there are any conditions on a site that must be reported to EPA to comply with all federal reporting obligations. Many times, state governments will ignore technical failures to strictly comply with reporting requirements such as when the owner /operator notifies the agency a week or month after learning of a release if the owner/tenant agrees to perform some remedial actions. However, it is likely that PRPs seeking contribution from a contiguous property owner/tenant will strictly scrutinize the reporting obligations to determine if the owner/tenant has forfeited its immunity to liability.

Fourth, in the vast majority of transactions, an environmental consultant's role usually ends when it submits its Phase I ESA. This limited role has led to the creation of environmental consulting firms that only provide commodity-style reports and has discouraged full-service firms from competing for the Phase I ESA work. However, the Brownfield Amendments impose a host of obligations on owners or tenants that continue after they take title or occupy property. They will need the continued assistance of environmental consultants to make sure that they are not affecting the integrity of institutional controls, complying with EPA reporting requirements and exercising "appropriate care" for contaminants on the site. These post-closing obligations may create opportunities for consultants to establish continuing relationships with owners and tenants.

Conclusion

While the legislation does give relief to purchasers and owners of contaminated property, they can also easily lose their immunity from liability. The Innocent Purchaser, BFP and Contiguous Property Owner defense contain numerous requirements that are not well understood and which an owner or occupant will have the burden of establishing that they satisfy. Thus, purchasers of property and businesses will not only need to expand the focus of their due diligence bit also will need to seek advice from environmental consultants on an on-going basis to help them preserve the new defenses created by the legislation.

[1] P.L. 107-118
[2] 42 U.S.C. 9601 et seq
[3] 42 U.S.C. 6901
[4] (42 U.S.C. 9601(35)(A)).
[5] Id. at 9601(35)(B)
[6] 42 U.S.C. 9607 (b)(3).

[7] Id. at 9601(35)(B)(i)(I)
[8] Id.
[9] Id. at 9607(r)
[10] Id. at 9601(40)
[11] Id. at 9601(40)(A)
[12] Id. at 9601(40)(B)
[13] Id. at 9601(40)(C)
[14] Id. at 9601(40)(D)
[15] Id at 9601(40)(E)
[16] Id at 9601(40)(F)
[17] Id.
[18] Id. at 9601(40)(G)
[19] Id. at 9601(40)(H).
[20] 42 U.S.C. 9607(l). The lien becomes effective when EPA incurs response costs or notifies the owner of the property of its potential liability, whichever is later. Id. at 9607(2)(A)-(B). However, the lien is subject to the rights of holders of previously perfected security interests. Id. at 9607(l)(3)
[21] 42 U.S.C. 9607(r).
[22] Id. at 9607(r)(3)
[23] Id. at 9607(r)(4)
[24] 60 FR 34790 (July 3, 1995)
[25] 42 U.S.C. 9607(q)
[26] Id. at 9607(q)(1)(A)(i)
[27] Id. at 9607(q)(1)(A)(ii)
[28] Id. at 9607(q)(1)(A)(iii). The statutory language does not refer to "appropriate care" but the standard is identical to the "appropriate care" provisions in the BFP and innocent purchaser's defense.
[29] 42 U.S.C. 9607(q)(1)(A)(iv)
[30] Id. at 9607(q)(1)(A)(v)
[31] Id. at 9607(q)(1)(A)(vii)
[32] Id. at 9607(q)(1)(A)(vi)
[33] Id. at 9607(q)(1)(A)(viii). It should be noted that unlike the BFP defense, the contiguous property owner exemption does not refer to the interim due diligence standards that were added to the innocent purchaser's defense. Presumably, this is a drafting oversight and that the same inquiry standards will apply to the contiguous property owner defense. A property owner who does not qualify for the contiguous property defense because the person had, or had reason to have know of the contamination may still be able to qualify for the BFP defense. Id. at 9607(q)(1)(C)
[34] Id. at 9607(q)(1)(D)
[35] 42 U.S.C. 9607(q)(3)
[36] 42 U.S.C. 9607(b)(3)
[37] S.Rep. No. 107-2, 107th Cong., 1st Sess. Page 9, (March 12, 2001
[38] Id. at 9601(35)(B)(ii)
[39] Id. at 9601(35)(B)(iv)(I)
[40] Id. at 9601(35)(B)(iv)(II)
[41] Id. at 9601(35)(B)(i)
[42] Id. at 9601(35)(B)(v)
[43] 42 U.S.C. 9628(b)
[44] Id. at 9628(b)(2)
[45] Id. at 9629
[46] Id. at 9629(a)(2)(C)(iii)