

All Appropriate Inquiries—Are They Appropriate?

This article, the second in a series on EPA's final "all appropriate inquiries" rule, takes a critical look at the newly promulgated rule and suggests AAI may not be the appropriate means to conduct environmental due diligence for real estate transactions. Because AAI only focuses on CERCLA liability protections, the authors suggest strict adherence to AAI may prevent a prudent purchaser from considering other environmental issues that could impact a real estate transaction.

231.1685 Introduction *

On Nov. 1, 2005, the U.S. Environmental Protection Agency issued its final rule¹ establishing standards and practices for conducting "all appropriate inquiries" (AAI) under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or superfund).² Although the new rule has given rise to much hoopla and likely will set a new industry standard for environmental due diligence, AAI should set neither a floor nor a ceiling for the level of inquiry prudent parties to real estate transactions should conduct to identify, quantify, and manage environmental risks.

To understand why AAI is of limited utility, it is important to understand how it fits into the framework of CERCLA. This article briefly describes what AAI is, AAI's place in the CERCLA scheme, practical concerns with AAI, and why prudent parties will want to look at the big picture in scoping their environmental due diligence.

(a) All Appropriate Inquiries

AAI is a statutory prerequisite to taking advantage of certain superfund defenses. EPA explains AAI is similar to but legally distinct from "environmental due diligence"—a process for assessing properties for the presence or potential of environmental contamination. The Small Business Liability Relief and Brownfields Revitalization Act (Brownfields Amendments), signed Jan. 11, 2002, established

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¹ 70 FR 66070, 11/1/05. EPA had proposed rules on Aug. 26, 2004, based on input from a Negotiated Rulemaking Committee, comprising a range of stakeholder groups assembled by EPA (69 FR 52542).

² 42 USC 9601 et seq.

statutory elements for AAI and required EPA to promulgate regulations fleshing out those elements.³

The Brownfields Amendments required EPA to address each of the following: (1) results of an inquiry by an environmental professional; (2) interviews with past and present owners, operators, and occupants; (3) reviews of historical sources; (4) searches for recorded environmental cleanup liens; (5) reviews of governmental and other records; (6) visual inspection of the facility and adjoining properties; (7) specialized knowledge or experience on the part of the defendant; (8) the relationship of the purchase price to the value of the property if the property was not contaminated; (9) commonly known or reasonably ascertainable information about the property; and (10) the degree of obviousness of the presence or likely presence of contamination of the property, and the ability to detect the contamination by appropriate investigation.⁴

The Brownfields Amendments provided that until EPA promulgated final regulations, ASTM International's E1527-97 *Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process* would serve as the interim standard to satisfy AAI. EPA by rule authorized use of ASTM's 2000 standard—E1527-00—as well.⁵ ASTM, formerly called the American Society for Testing and Materials, an international standards-setting body, first published its voluntary standard in 1993. Although not officially sanctioned, E1527 became the generally accepted standard for performing environmental due diligence for real estate to satisfy AAI absent any statutory definition or formal guidance. EPA recognized this when it set forth its proposed rule in 2004.

When the final rule becomes effective Nov. 1, 2006, parties must use the new rule if they want to qualify for the pertinent CERCLA defenses. In the meantime, parties may use either ASTM E1527-00 or the new rule to satisfy AAI. ASTM has published a new standard, ASTM E1527-05, which conforms with and satisfies the requirements of the new rule. It should

³ 42 USC 9601(35)(B).

⁴ 42 USC 9601(35)(B).

⁵ 68 FR 24888, 5/9/03.

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be noted both the present and new ASTM standards go beyond AAI in requiring the investigation of petroleum products as well as superfund “hazardous substances.”⁶

EPA’s final AAI rule provides the details regarding each of the ten statutory criteria noted above. Key elements of the new rule include the following requirements:

- An environmental professional must supervise the investigation and preferably should perform the onsite portion of the investigation.
- The environmental professional must declare in their report that they meet the prescribed qualifications for an environmental professional and that the investigation satisfies AAI.
- The investigation must include interviews with the current property owners and occupants; interviews, if necessary, with current and past facility employees, managers, and occupants; and possibly interviews with owners and occupants of adjacent properties if the property is abandoned.
- The investigation must include a review of recorded engineering controls, e.g., maintenance of a cap; environmental cleanup liens; and institutional controls, e.g., deed restrictions.
- The investigation must include a review of local as well as federal and state records.
- The investigation must include, in addition to visual inspection of the subject property, a limited visual inspection of adjoining properties.
- The party commissioning the investigation is authorized and at least in one instance required to utilize its specialized knowledge for certain aspects of the investigation, and the environmental professional is authorized to rely upon that knowledge.
- The environmental professional must identify data gaps and the information reviewed to address those gaps and provide comments on the significance of those gaps to the environmental professional’s ability to identify conditions indicative of releases or a threat of releases.
- Parties seeking to rely on an investigation must meet shelf life and update requirements, i.e., the report generally must be conducted within one year prior to acquisition, but certain

⁶ ASTM E1527-05 explains “petroleum products are included because they are of concern with respect to many parcels of commercial real estate and current custom and usage is to include them.”

aspects must be conducted within 180 days prior to acquisition, e.g., environmental professional declarations, lien and record searches, visual inspections of the property and adjacent properties, and specialized knowledge of the party commissioning the study if that party is using previously collected information.

(b) Statutory Context for AAI

To evaluate whether and to what extent to conduct AAI, it is important to understand the statutory context in which it first arose—as an element of the innocent purchaser defense created by the 1986 Superfund Amendments and Reauthorization Act (SARA). To explain that context, some background information is helpful.

Before CERCLA, environmental statutes generally regulated conduct prescriptively, providing penalties for violations. In CERCLA, Congress created a new regulatory scheme, imposing liability based not on a violation of law, but rather on a person’s relationship to a site from which there has been a release or threat of release of a “hazardous substance.”⁷

Potentially responsible parties (PRPs) under CERCLA include present owners and operators of a site contaminated with hazardous substances, owners and operators of the site at the time hazardous substances were disposed, transporters who selected the site, and those who arranged for disposal of hazardous substances at the site.⁸ CERCLA liability is strict and generally joint and several.⁹ CERCLA liabilities include the costs of investigation and remediation of contaminated properties, as well as associated natural resource damages from the contamination.¹⁰ These costs often run into the millions of dollars. Unlike liabilities arising from violations, there is no limit on the monetary exposure, which easily could exceed the value of the subject property.

CERCLA contains a number of defenses, some of which were added specifically to provide protection to

⁷ Although superfund broadly defines the term “hazardous substance,” it excludes from that definition petroleum and petroleum products, and thus sites contaminated by gasoline and other petroleum products do not fall within its ambit. 42 USC 9601(14). As noted, however, both the present and new ASTM standards require the investigation both of petroleum products and hazardous substances.

⁸ 42 USC 9607(a).

⁹ Courts will not impose joint and several liability if there is a rational basis for allocating liability. *See In re Bell Petroleum Services Inc.*, 3 F.3d 889, 37 ERC 1601 (5th Cir. 1993). In addition, in contribution actions, as opposed to cost recovery acts, liability is several but not joint.

¹⁰ 42 USC 9607(a)(2).

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prospective purchasers and to encourage transactions involving brownfields. The concept of AAI was included as an element of the transaction-related defenses. Because the relationships among the various CERCLA defenses and their prerequisites are confusing, a chart is attached that provides a useful framework for the discussion that follows.

(1) *Original Liability Defenses*

When originally enacted, CERCLA provided three defenses to liability: an act of God, an act of war, and an act or omission of a third party. To claim one of these defenses, a PRP must show the release or threat of release of hazardous substances and the resulting damages were caused solely by one or a combination of these three acts.¹¹ Of these three original defenses, the most frequently asserted was the third-party defense.

To claim the third-party defense, the defendant not only must show the release or threat of release was caused solely by the act or omission of a third party, but also: (1) the third party was not the defendant's employee or agent, or one whose act or omission occurred in connection with a contractual relationship existing directly or indirectly with the defendant; (2) the defendant exercised due care with respect to the hazardous substances; and (3) the defendant took precautions against the foreseeable acts or omissions of the third party and the consequences that foreseeably could result from the acts or omissions. Case law is split on the contractual nexus necessary to preclude use of the third-party defense, with some courts ignoring the requirement of an act or omission "in connection with" a contractual relationship and finding that merely being in the chain of title creates the prohibited contractual relationship.¹²

(2) *Innocent Landowner Defense*

In 1986, Congress enacted SARA, which modified the third-party defense with the innocent landowner (ILO) defense—the first defense to focus on parties to a real estate transaction. Under this defense, even if the proscribed contractual relationship were present, the PRP nonetheless could take advantage of the third-party defense if it could show it satisfied the requirements for being an innocent purchaser: the PRP acquired the property after disposal of the

hazardous substances and, at the time of acquisition, the PRP did not know and had no reason to know any hazardous substances were disposed at the facility.¹³ SARA placed the defense in a carve-out from the definition of "contractual relationships" and defined contractual relationship to include land contracts, deeds, easements, leases or other instruments transferring title or possession, without addressing the nexus requirement.¹⁴

AAI is an alternative formulation for the innocent purchaser prerequisite of "had no reason to know." To show at the time of the acquisition that a party "had no reason to know," the party must prove it "carried out *all appropriate inquiries* . . . into the previous ownership and uses of the facility in accordance with generally accepted good commercial and customary standards and practices."¹⁵

(3) *New Protection Under Brownfields Act*

In 2002, the Brownfields Amendments added to CERCLA two new defenses for purchasers of brownfields—the bona fide prospective purchaser (BFPP) defense and the contiguous landowner (CLO) defense.¹⁶ These two defenses, like the ILO defense, require the performance of AAI. The attached chart is helpful in clarifying relationships among the three transaction-related defenses and their various elements.

To help the regulated community understand each of the three transaction-related defenses, EPA published a *Common Elements Guidance* (the guidance).¹⁷ The guidance explains the common elements comprise both threshold criteria and continuing obligations.

The Brownfield Amendments establish two threshold criteria: (1) demonstrating no affiliation with a liable party (applicable only to the BFPP and

¹³ 42 USC 9607(b)(3) and 9601(35)(A)(i). Also included within the ILO defense were governmental entities who acquired property involuntarily or through the exercise of eminent domain, and those who acquired property by inheritance. These parties were not required to demonstrate they had conducted AAI.

¹⁴ 42 USC 9601(35).

¹⁵ 42 USC 9601(35)(B)(i)(I) (emphasis added).

¹⁶ See Civins and Phillippi, "Who's Liable Now? New Federal Brownfields Legislation," Texas Bar Journal, December 2002; re-printed in Minnesota Real Estate Law Journal, March/April 2003, and Real Estate Issues, Winter 2003-2004.

¹⁷ Memorandum from S. Bromm, Office of Site Remediation and Enforcement, U.S. Environmental Protection Agency, *Interim Guidance Regarding Criteria Landowners Must Meet in Order to Qualify for Bona Fide Prospective Purchaser, Contiguous Property Owner, or Innocent Landowner Limitations on CERCLA Liability* (March 6, 2003), EDDG Section 501:1931.

¹¹ 42 USC 9607(b).

¹² See Civins, Mendoza, and Fernandez, "The Third Party and Transactional Related Defenses of CERCLA," ABA SEER Environmental Litigation and Toxic Torts Committee Newsletter, July 2005.

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CLO defenses)¹⁸ and (2) performing AAI. The statute and guidance require conducting and completing the inquiry before acquisition of the property.¹⁹ If AAI uncovers contamination, then the ILO and CLO defenses no longer are available because they require the purchaser to have no knowledge of the contamination, and therefore the purchaser is left only with the BFPP defense. Given the fact actual knowledge does not preclude use of the BFPP defense, the ILO and CLO defenses should be superfluous for transactions occurring after Jan. 11, 2002—the effective date of the BFPP defense.

The continuing obligations purchasers must satisfy consist of five specific requirements: (1) complying with land-use restrictions and not impeding institutional controls; (2) implementing reasonable steps with respect to hazardous substances on property to stop and prevent releases and prevent or limit exposure; (3) providing access, assistance, and cooperation to persons authorized to conduct response actions; (4) complying with EPA information requests and subpoenas; and (5) providing legally required notices regarding the discovery of hazardous substances.

The guidance provides some indication of EPA's position regarding the various continuing obligations. In discussing a landowner's obligation concerning institutional controls, EPA would require a landowner seeking a defense not only to comply with land-use restrictions and institutional controls in place at the time of purchase, but also to implement institutional controls in the future. EPA also requires a landowner to look at all places where CERCLA-type land-use restrictions might be documented, such as in orders or consent decrees, permits, remedy decision documents, remedy design documents, risk assessments, and other documents developed in conjunction with the response action. EPA further states that a failure to grant an easement or a covenant necessary to implement a response action in some cases could constitute a failure to satisfy the continuing obligations.

The guidance is not particularly helpful on the issue of a landowner's obligation to stop continuing releases, prevent threatened future releases, and prevent or limit exposure to hazardous substances. The guidance states that EPA views the requirement

as “consonant” with common law principles and CERCLA's existing “due care” requirement. While acknowledging legislative history and statutory requirements indicating that absent “exceptional circumstances” a landowner would not be required to investigate or remediate contamination, EPA states Congress “did not intend to allow a landowner to ignore the potential dangers associated with hazardous substances on its property.” EPA goes on to state that because a BFPP buys with knowledge, as opposed to an innocent purchaser and CLO who purchase without knowledge, a BFPP may have a greater “reasonable steps” obligation.

The guidance certainly suggests a landowner, even if a BFPP, CLO, or ILO, must take “some positive or affirmative steps” in relation to contamination on its property, regardless of source or culpability. EPA's examples of reasonable steps include repairing damaged containment systems, maintaining elements of an existing response action to prevent migration, and repairing a damaged institutional control, such as a cap over contaminated soils. When addressing the question of whether remediation of ground water is a “reasonable step,” EPA equivocates. If remediation of ground water is a reasonable step, the requirement to stop or prevent a release therefore could be a costly one.

The lack of clear guidance from EPA and the significant potential costs associated with continuing obligations should cause prospective purchasers of brownfields to question whether the effort to attempt to obtain any of the transaction-related defenses is worthwhile. This uncertainty and these potential costs undermine the objective of the Brownfields Amendments to encourage redevelopment of brownfield properties.

(c) Practical Concerns with AAI

Although the new AAI rule is likely to set an industry practice, blind reliance on that standard is inadvisable. For a number of reasons, prudent purchasers instead should consider each particular transaction in light of their own risk management objectives.

The AAI procedures entail a measure of subjectivity and therefore create uncertainty whether the specific requirements have been satisfied. Although developed through a regulatory negotiation involving numerous stakeholders, some of the requirements also may create practical difficulties. For example, the so-called shelf-life requirement concerning the freshness of the investigation can create transaction

¹⁸ Statutory language, however, dictates the ILO comes into play only if the act or omission giving rise to the contamination occurs in connection with a contractual relationship with the third party, rendering the third party defense unavailable.

¹⁹ 42 USC 9601(40)(B).

timing issues. The interview requirement can compromise the confidentiality of a transaction. And the strong suggestion to use an environmental professional to perform the onsite inspection, in addition to the requirement to use an environmental professional to supervise the investigation, is likely to drive up the costs of the investigation significantly despite EPA's suggestion to the contrary.

The rule requires the prospective purchaser to perform one aspect of the investigation and authorizes it to perform others, and it allows the environmental professional, to whom that information has been provided, to rely upon it.²⁰ Aspects of the investigation the purchaser may conduct include searches for liens, assessment of any specialized knowledge or experience of the purchaser, assessment of the relationship of the purchase price to fair market value of the property if not contaminated, and assessment of commonly known or reasonably ascertainable information about the property.²¹ Presumably, the assessment of any specialized knowledge of the purchaser cannot be delegated to the environmental professional and must be supplied by the purchaser. Because the AAI requirement ultimately is the purchaser's responsibility, the purchaser does not have to provide information it has to the environmental professional. However, the purchaser's failure to provide such information to the environmental professional may result in a data gap upon which the environmental professional must comment.

EPA's AAI rule identifies the procedures a prospective purchaser must follow to satisfy only one of the prerequisites to taking advantage of the transaction-related defenses under superfund. The burden is on the purchaser to prove it satisfied all of the prerequisites of the defense, including the continuing obligations as well as AAI. As noted, at least one of those obligations—the requirement that the purchaser take reasonable steps with respect to hazardous substances on the property to stop and prevent

releases and prevent and limit exposure—may cause the purchaser to incur significant expense to establish the defense.

In some instances, there may be no need to establish the transaction-related defenses. Although court opinions are split on this issue, the better view is that the third-party defense should be available unless the act or omission giving rise to the contamination occurs in connection with a contractual relationship with the defendant. If the third-party defense is available, it is unnecessary to prove AAI was conducted.

Because the transaction-related defenses only apply to purchases of land, as a practical matter they provide no protection in mergers, stock acquisitions, or other transactions with the potential for successor liability. Nor do they provide any protection against claims for petroleum contamination because petroleum and petroleum products are excluded from the CERCLA definition of "hazardous substance." Similarly, because the defenses only relate to federal superfund liability, they do not protect against liability under other federal laws, including other federal environmental laws; state environmental laws; or the common law, such as negligence, nuisance, and trespass, which may include claims for diminution in property value, personal injuries, and property damages.

Although the new rule generally does not require addressing petroleum or petroleum products,²² which are excluded from the CERCLA definition of "hazardous substance," both the present and new ASTM standards do. However, because the investigation that AAI contemplates is focused on hazardous substances, it does not address other concerns that should be addressed as part of a meaningful environmental due diligence, including, among other things, asbestos; ongoing compliance; endangered species; historical sites; indoor air quality, including mold issues; lead in drinking water; lead-based paint; and wetlands.

(d) Looking at the Big Picture

Because of these practical concerns with AAI, a prudent purchaser in a transaction involving real estate will look at the unique circumstances of its particular transaction to ensure all potential significant

²⁰ The AAI rule requires the person seeking the defense to perform the inquiry into the relationship of the purchase price to the fair market value of the property if uncontaminated. 40 CFR 312.22(a)(3). Section 312.22 does not provide an exception when this inquiry is conducted by the environmental professional, as it does for inquiries into liens and commonly known information. *Id.* Sections 12.22(a)(1), (4). The preamble, however, indicates a purchaser either can perform the inquiry itself, have it performed by a qualified third party, or have it performed by the environmental professional. 70 FR at 66099.

²¹ Discussing the ascertainable information criterion, EPA suggests a court might conclude sampling and analysis, although generally not required, may be required in particular case. 70 FR at 66101.

²² The new rule draws a distinction between those performing AAI to obtain a defense and those performing AAI as a condition of a grant and requires the investigation of petroleum only in the case of a grant. 70 FR at 66108, to be codified at 40 CFR 312.19(c)(2).

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environmental concerns are addressed and not focus only on AAI. Pertinent considerations in scoping an environmental due diligence investigation are suggested below.

A critical factor in determining potential environmental liabilities, and thus the appropriate due diligence that should be conducted, is how the transaction is structured. In a stock acquisition, the company essentially is unchanged, so the liabilities are unchanged as well and superfund defenses are not available. The prospective purchaser, therefore, should look at past as well as present liabilities, e.g., instances of noncompliance, and offsite as well as onsite liabilities. Offsite liabilities include liabilities related to formerly owned or operated facilities, as well as superfund liabilities for offsite disposal. Of course, the purchaser always retains the protection of the corporate shield, absent a merger or some grounds to pierce the corporate entity to reach it.

In an asset acquisition, the liabilities relate to existing conditions of the acquired assets, specifically, the risks of contamination being present and the current compliance status of the assets. Generally liabilities of the seller, other than those relating to onsite conditions, are not of concern. But even in an asset acquisition, if there is the potential for successor liability, e.g., based on de facto merger, mere continuation, or continuing business enterprise, these other liabilities of the seller become relevant and should be investigated and accounted for.²³

When the properties contain buildings, the prudent purchaser will want to look at indoor air quality, including the potential for mold. The prudent purchaser also will want to look for, among other things, asbestos, lead paint, lead in potable water, and radon. For properties with ongoing operations, the prudent purchaser will want to conduct a compliance assessment to be sure the facilities are in compliance with

pertinent requirements, including having all necessary permits, and, if they are not, to have those instances of noncompliance cured before closing.

For properties that are to be developed and facilities that are to be expanded, the purchaser will want to identify pertinent land-use restrictions, indirect as well as direct, to determine how those might affect future development. Pertinent programs include those related to air quality endangered species, historical sites, protected watersheds, and wetlands. For permitted facilities, the purchaser will want to look at limitations that may hinder expansion or modification.

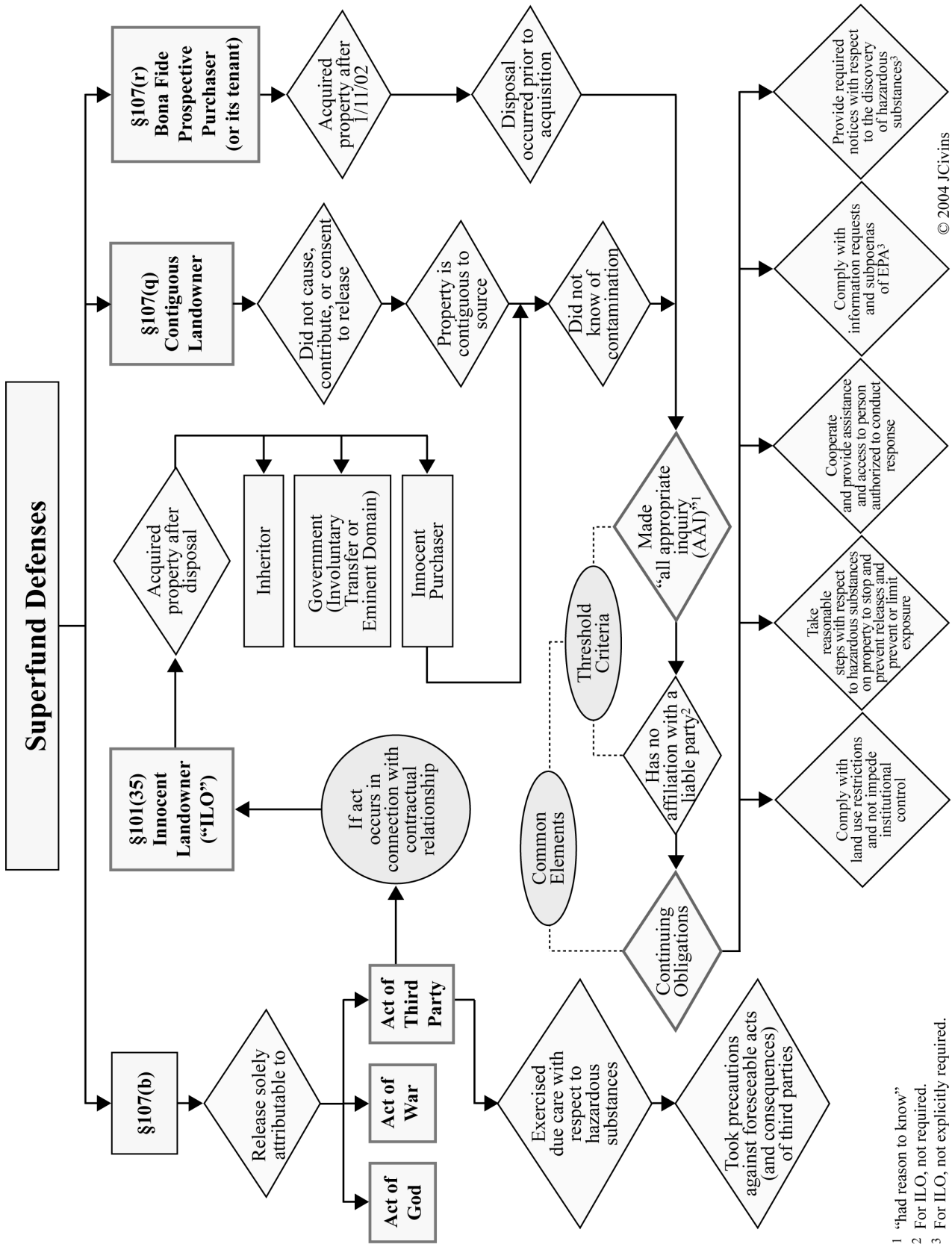
For real estate generally, purchasers will want to consider AAI. All things being equal, the various transaction-related defenses of superfund are worth taking advantage of. But the availability of those defenses should be weighed against the burdens associated with AAI, such as issues relating to confidentiality, cost, and timing.

(e) Conclusion

Although it creates a benefit—satisfying one of the prerequisites to taking advantage of the transaction-related defenses of superfund—AAI also entails a detailed set of practices that may not be appropriate, taking into account considerations such as confidentiality, cost, and timing. Additionally, AAI is but one prerequisite to use of the superfund defenses; there are significant continuing obligations, especially the obligation to address releases, that must be satisfied as well. More significantly, CERCLA defenses, even if available, provide no protection against other environmental risks and concerns. Furthermore, the procedures of AAI fail to address significant non-CERCLA concerns.

The bottom line is that AAI, although useful as a starting point, should not drive an environmental due diligence investigation. A prudent purchaser, in scoping its environmental due diligence, will instead consider the potential environmental concerns associated with each transaction in light of that purchaser's own risk management objectives.

²³ The U.S. Court of Appeals for the Third Circuit recently decided to apply federal common law rather than state law in determining whether to impose successor liability under CERCLA. *U.S. v. General Corporation Inc.*, 423 F.3d 294, 61 ERC 1001 (3d Cir. 2005).



1 "had reason to know"
 2 For ILO, not required.
 3 For ILO, not explicitly required.

[§231.1685(e)]

