Phase 1 Environmental Investigations: Is "All Appropriate Inquiries" Appropriate?

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On December 15, 2022, the United States Environmental Protection Agency ("EPA") authorized use of the latest version of the ASTM International ("ASTM") standard for performing Phase 1 environmental site investigations—E1527-21, as an option for satisfying the all appropriate inquiries ("AAI") requirement of the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA" or "Superfund"), which the EPA spells out in its rules in 40 CFR Part 312. The new ASTM standard revises the prior version (E1527-13) in a number of ways, which are described in an EPA comparison memo published on their website. Among other things, the new standard refines certain definitions, provides more details on how environmental professionals should perform historical research and report conclusions, and identifies what data gaps are significant and how they are to be addressed. It also explains how emerging contaminants, like perfluoroalkyl and polyfluoroalkyl substances ("PFAS")[1], can be addressed.

In light of these updates and the renewed focus on the ASTM standard, now is a good time to take a closer look and (1) reflect on whether either the ASTM standard or AAI itself is in fact the appropriate inquiry for parties to a particular real estate transaction, (2) revisit their limitations, and (3) consider additional areas of environmental-related due diligence that may be worth exploring.

As satisfaction of the AAI requirement is a prerequisite to taking advantage of Superfund's transactional defenses[2], and because the EPA has authorized reliance upon the various iterations of the ASTM standard to meet such requirement, over the years the ASTM standard has become the real estate industry's gold standard for environmental due diligence. This article suggests that while the ASTM standard is certainly a good starting point for environmental diligence, it may not necessarily address all of the relevant potential environmental concerns. Rather, parties to real estate transactions should consider tailoring their environmental site investigations to make sure that all concerns pertinent to their decision-making and the specific facts at hand are addressed.

The general objective of an AAI Phase 1 investigation is to identify the presence (or potential presence) of hazardous substances. Although AAI is a prerequisite to Superfund's transactional defenses, it is critical to keep in mind that AAI is only one of three such prerequisites. To succeed in asserting the defenses, a purchaser defendant must also demonstrate (1) that it has no affiliation with any potentially responsible parties (commonly referred to as PRPs) and (2) that it satisfies certain continuing obligations, including taking reasonable steps with respect to hazardous substances on the property to stop and prevent releases and prevent and limit exposure. Moreover, because the Superfund protections are defenses, the burden of proof is on the defendant, and, in contrast with the case of a pre-transaction bona fide prospective purchaser agreement, there is both a cost to asserting such a defense and uncertainty as to whether the defendant will ultimately prevail in litigation.

Additionally, real estate purchasers and lenders should be reminded that the Superfund transaction-related defenses do not protect against liability under other federal laws (including federal environmental laws), state environmental laws (unless they have similar defenses), or the

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common law, such as trespass, negligence, and nuisance. So, for example, these defenses would not protect against liability arising from trespass or nuisance actions by adjacent property owners for the migration of onsite contaminants onto their properties. Moreover, because the transaction-related defenses apply only to acquisitions of fee title to real property (including acquisitions by foreclosure or deed-in-lieu of foreclosure)[3], they provide no protection in transactions that involve the acquisition of equity interests (such as the purchase of membership and partnership interests and stock, or mezzanine loan foreclosures) or mergers.

Unlike purchasers, real estate lenders are independently protected by the pre-and post-foreclosure safe harbors established by amendments to Superfund added by the Asset Conservation, Lender Liability and Deposit Insurance Protection Act of 1996.[4] Thus, the transaction-related defenses are primarily of relevance to lenders because their availability may serve to lessen the potential environmental exposure of their borrowers. Despite the standalone protection afforded to real estate lenders under Superfund, many lenders will still commission a Phase 1 as a matter of course in order to take advantage of the additional protection afforded by a transaction-related defense, and more significantly, similar to other parties to real estate transactions, to (1) identify environmental concerns that are not addressed by Superfund protections but nevertheless affect their underwriting and (2) be able to rely on the environmental consultant's work product.

The investigation prescribed by the ASTM standard seeks to identify recognized environmental conditions ("RECs"), which are generally defined to include the presence or likely presence of (1) hazardous substances, as prescribed by CERCLA, and (2) petroleum products. However, while a Phase 1 performed in compliance with the ASTM standard will investigate petroleum products, the performance of such Phase 1 in and of itself does not provide protection against liability relating to contamination by petroleum products, because petroleum is not within the universe of hazardous substances addressed by Superfund; rather, they fall within the act's so-called petroleum exclusion.

Similarly, while both the ASTM standard and Superfund focus on regulating "hazardous substances," there are many contaminants of concern that do not fall within that rubric for Superfund purposes and, consequently, for which Superfund defenses are not available. The category of contaminants that are not included within the Superfund protections include PFAS, although it should be noted that the EPA has proposed to designate two types of PFAS — perfluorooctanoic acid ("PFOA") and perfluorooctane sulfonate ("PFOS") — as hazardous substances prescribed by CERCLA.[5]

It is also important to keep in mind that while an inquiry focusing on identifying the presence of RECs is certainly a critical baseline approach when engaging in real estate transactions, there are other possible environmental concerns that could arise with respect to a property and should be considered as well. A Phase 1 that merely satisfies the ASTM standard and AAI will not address these other concerns unless the environmental professional conducting the investigation is expressly asked to do so. For example, if a property has been improved with buildings or other structures, a potential purchaser or lender may want to explore (among other things) the presence of lead paint, lead in potable water, polychlorinated biphenyls (commonly referred to as PCBs), toxic mold, and asbestos containing materials, as well as indoor air quality, including the potential presence of radon and vapor intrusion. Note that the presence of radon and vapor intrusion may also pose concerns for development sites and other properties where construction is contemplated. Furthermore, in the case of properties with ongoing operations, historical and present compliance with applicable environmental and other governmental requirements (both by the owners as well as any tenants or other occupants) is yet another significant potential concern.

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Additional related environmental concerns outside the scope of an ASTM- and AAI-compliant Phase 1 that may be overlooked when purchasing or financing undeveloped properties include pertinent land use restrictions—for example, those relating to endangered species, wetlands, protected watersheds and aquifers, and flood plains. In addition, if there is any potential for successor liability (e.g., in the case of an acquisition of an entity or other equity interest, or a merger), then the possibility of both past and present liabilities, and offsite as well as onsite liabilities (e.g., for formerly owned or operated properties and for offsite disposal), are also of potential concern.[6]

With an understanding of these additional concerns, as well as the relevance and limitations of AAI, the ASTM standard, and pertinent transaction-related defenses, parties to real estate transactions can decide what level of environmental inquiry is appropriate for each specific transaction, how best to employ AAI, and how to tailor site investigations to address pertinent environmental risks. Given the complexities involved in environmental matters and the scope of potential liability, prudent real estate purchasers and lenders should consult with appropriate environmental professionals in connection with all real estate transactions.

This article should not be construed as legal advice because, among other things, it does not take into consideration specific facts of any particular transaction or situation. If you have any questions about its content or about issues specific to your concerns, please contact one of the authors listed above or another Haynes Boone Real Estate or Environmental attorney.

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[1] PFAS are certain long-lasting chemicals that are widely used in many consumer products and in firefighting foam, the components of which break down very slowly over time, which is why they are referred to as “forever chemicals”.

[2] We intend to provide further details on the applicable Superfund defenses, as well as the various requirements that must be satisfied in order for an affected party to avail themselves of such defenses, in a future article.

[3] Note that there are also certain limited circumstances where a tenant may be entitled to Superfund transaction defenses. See 2012 EPA Tenant Guidance.

[4] These amendments are more particularly described in this 1996 EPA Explanatory Memorandum.

[5] The EPA has advised on its website that the public comment period for the proposal to designate PFOA and PFOS closed on November 7, 2022, and it is in the process of reviewing public comments.

[6] Note that the various environmental concerns and issues listed in this article are not intended to be (and should not be construed as) a complete or exhaustive list of all potential environmental matters.

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