

## **Real Estate and Business Transactions: 2003 Due Diligence Update**

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2003 saw three significant due diligence developments, all of which relate to the 2002 Comprehensive Environmental Response Compensation and Liability Act (CERCLA) Amendments. As you recall, among other things, those amendments created three new liability exemptions, which the bill described as liability “clarifications”: for bona fide prospective purchasers, innocent landowners and contiguous property owners. These exemptions were described using a raft of new terminology, including requirements that the landowner undertake “all appropriate inquiry,” and take “reasonable steps to stop continuing releases.” Unfortunately, many of these phrases were not defined, leaving the extent of the “clarifications” far from clear.

In 2003 and early 2004, the United States Environmental Protection Agency (EPA) shed some light on these terms.

### **EPA “Common Elements” Guidance Memorandum**

First, in March, EPA issued an interim guidance memorandum providing its interpretation of some of the more commonly used terms in the new exemptions:

1. Neither a prospective purchaser nor a contiguous property owner may take advantage of an exemption if they are “affiliated with” a responsible party. In the March memo, EPA stated that it would not interpret this term as broadly as it could be, instead using it to prevent a responsible party from “contracting away” its liability.
2. An element of all three of the new exemptions is that the individual be in compliance with land use restrictions “established or relied on” with respect to any response action on the subject property. EPA presented its position that a restriction is “relied upon” by the government if it is identified as a component of the site’s remedy. In so doing, EPA gave several examples of such instances.
3. EPA also provided extensive detail about another requirement for all three exemptions – that the entity “not impede the effectiveness or integrity of any institutional controls.” In the interest of brevity, this analysis will be saved for another time.
4. All three exemptions also require a landowner to “take reasonable steps” to stop continuing releases, prevent future releases, and prevent exposure to earlier

releases. EPA's memo clarifies that these steps do not impose the same type of response obligations required of a liable party. However, some response is required, and the memo provides some parameters as to what EPA will consider to be "reasonable."

### **Progress on Defining "Appropriate Inquiry"**

The next significant development occurred in December. One of the most fundamental questions arising out of the 2002 Amendments was the degree of inquiry required of a property owner; in other words: how diligent must one's due diligence be? Congress punted on this question, establishing the 1997 ASTM Phase 1 standard as an interim test and requiring that EPA develop a new standard by January of 2004. EPA has missed the statutorily-mandated deadline, but nevertheless has made significant progress on the question.

In the summer of 2003, EPA convened a nonpartisan committee consisting of industry and environmental group representatives with the goal of developing a negotiated rulemaking proposal. Under this approach, if the committee reaches consensus, offers EPA a proposal, and EPA publishes it as a proposed rulemaking, any party involved proposal is prohibited from commenting negatively on the proposed rulemaking.

The Negotiated Rulemaking Committee was successful in reaching consensus and, on December 5, 2003, provided EPA with proposed language for a rulemaking. While EPA has not signaled its intent to adopt the Committee's language, it seems likely that either the proposal or something very similar to it will be the ultimately be presented as the Administration's proposed rulemaking.

The Committee's proposal is interesting in that it both expands on the items which must be included in a due diligence review but affords the reviewer with a greater flexibility as to how to achieve its ends. Among the changes which would occur if the rule were adopted:

- The standards for individuals who could perform due diligence ("Environmental Professionals") would be strengthened.
- The range of items which the Environmental professional should review would be expanded, including more document review, more interviews, and a slightly wider geographic scope.
- More aspects of Phase 1 reports would have to be updated and some would have to be updated more frequently.
- The Environmental Professional would have to indicate where data gaps exist which affect his or her analysis.
- The potential purchaser would have to provide certain information to the Environmental Professional.
- The Environmental Professional would have to specifically search for environmental liens on the property.

- Any potential reduction in the purchase price as a result of environmental concerns would be examined.

As with any proposed rulemaking, when and if this proposal is published, interested parties will have an opportunity to review and comment on the proposal.

### **Contiguous Property Exemption Guidance**

Finally, on January 13, 2004, EPA issued guidance concerning its interpretation of several provisions of the contiguous property owner exemption. This guidance supplements EPA's Common Elements memorandum and provides EPA's interpretation of two elements which apply only to this exemption and not to the prospective purchaser or innocent landowner exemptions: (1) that the landowner did not cause, contribute or consent to the release, and (2) that the property is contiguous to the release.

As to the latter, EPA has determined to take a broad view of the term "contiguous" and apply the exemption to all contamination migrating onto a landowner's property, even if it is not from directly next door. As to the former, the terminology is fairly well understood by this point, although EPA clarified that in circumstances where a party might otherwise be liable – where contamination for which the party is not responsible mixes with that for which it is – EPA may exercise its enforcement discretion and not pursue the landowner.

Finally, EPA stated that it may allow former landowners to take advantage of the exemption even though, on its face, the language of the exemption only applies to current landowners.