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More Questions Than Answers

The EPA's New 'All Appropriate Inquiry' Regulation

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On Nov. 1, the U.S. Environmental Protection Agency promulgated regulations (to be published at 40 C.F.R. Section 312 and currently found at 70 Fed. Reg. 66070) titled "Standards for Conducting All Appropriate Inquiries." In layperson's terms, this rule establishes the regulatory and industry standard for performing environmental due diligence in real property transactions and for establishing a critical element required by three liability defenses under the Comprehensive Environmental Response Compensation and Liability Act (CERCLA).

This article summarizes the rule's "all appropriate inquiry" requirements. Close examination of those requirements reveals that despite the EPA's protestations to the contrary, the rule presents a fundamentally different approach to environmental due diligence. This article also highlights the potential unresolved issues and difficulties raised by the rule.

THE REQUIREMENTS

The rule applies to those persons seeking to establish the innocent landowner defense, the bona fide prospective purchaser defense and the contiguous property owner defense under CERCLA. The rule also applies to persons conducting site assessments using CERCLA Brownfields grant funds.

Of those liability defenses, the rule is most important in establishing the



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bona fide prospective purchaser defense. Simply put, if a purchaser performs due diligence and identifies contamination, the purchaser cannot establish the innocent landowner and contiguous property owner defenses. By contrast, a purchaser that discovers contamination is not disqualified from establishing the bona fide prospective purchaser defense, as long as the purchaser performed "all appropriate inquiry" and satisfies the other elements of that defense. As a result, as a practical matter, the rule is designed most often for bona fide prospective purchasers.

Separate and apart from establishing liability defenses, the rule will establish the industry standard for environmental due diligence. Purchasers and lenders will seek to follow the rule in evaluating the risks from potentially contaminated property.

The rule specifies that most tasks required as part of "all appropriate inquiry" must be undertaken by an "environmental professional" or someone under the direct supervision of one.

The category of "environmental professional" includes a person who holds a professional geologist's license and has three years of relevant experience; holds a license to perform environmental inquiries and has three years of relevant experience; has a baccalaureate or higher degree in engineering or science and has five years of relevant experience; or has the equivalent of 10 years of full-time relevant experience.

Most significantly, the rule rejects a "checklist" approach to due diligence whereby the environmental professional must perform carefully scripted tasks and review specifically identified documents. Instead, the rule adopts a more discretionary, subjective standard based on identified objectives and performance factors. This is the heart of the rule — and it has the potential to cause mischief.

First and foremost, the rule is intended to result in the identification of conditions "indicative of releases and threatened releases" at the subject property. The rule repeats this phrase frequently. To meet this objective, the rule requires that the purchaser and/or environmental professional evaluate the following: current and past property uses and occupancies; current and past uses of hazardous substances; waste management and disposal activities; current and past remediation at the subject property; engineering controls (e.g., caps, paving); institutional controls (e.g., restrictions on groundwater for drinking purposes); and properties adjoining or located nearby the subject property.

All of the specified tasks in the rule are measured against performance factors. Since the performance factors by definition require exercise of discretion and subjective decisions, they create a central and controversial element of the rule. The performance factors include the following:

- Gathering information that is “publicly available, obtainable from its source within reasonable time and cost constraints and which can practicably be reviewed.”

- Reviewing and evaluating “the thoroughness and reliability of the information” gathered.

- Identifying “data gaps” in the information gathered, commenting on the significance of the data gaps and potentially recommending sampling and analysis to develop information to address the data gaps.

- Identifying releases and threatened releases discovered, unless the quantities of the releases individually and in the aggregate “would not pose a threat to human health or the environment.”

Generally, all appropriate inquiries must be conducted within one year prior to the date of acquisition of the property. However, the following components of the inquiry must be completed or updated within six months of acquisition: interviews with past and present owners and occupants; searches for environmental liens; review of government records; visual inspection of the property; and completion of the declaration by the environmental professional.

Results of previous all appropriate inquiry conducted by the same person at the same property may be used and relied upon if they are conducted in compliance with the “all appropriate inquiry” standards in effect at the time and updated within a year of the date of acquisition, or, for the factors discussed in the paragraph above, updated within six months of acquisition.

Similarly, results of previous inquiry conducted by other persons may be used and relied upon if the report meets the objectives and performance factors above and the environmental professional and/or purchaser reviews the report and updates all of the inquiries discussed above.

The rule sets forth in detail the basic components of the inquiry. All of these components are expressly identified in

terms of achieving the objectives and performance standards. These components include the following:

- Interviews with the current owner and all current occupiers of the subject property likely to handle hazardous substances.

- To the extent necessary to meet the objectives and performance factors, interviews of current and past facility managers, past owners and operators, and past and current employees thereof.

- In the discretion of environmental professional, a review of historical sources of information must cover a period of time as far back in history that the property contained structures, or when the property was first used for any residential, agricultural, commercial, industrial or governmental purposes

- Searches for recorded environmental cleanup liens.

- Reviews of federal, state, tribal and local government records.

- A visual inspection at the subject property, except if physically impossible, in which case the environmental professional should document why inspection was not possible and attempt to review the property from another location.

The rule requires additional inquiries to demonstrate all appropriate inquiry. These include the following:

- Taking into account the purchaser's specific knowledge of the property and the surrounding area.

- Considering whether the purchase price of the subject property reflects the fair market value of the property if uncontaminated.

- Taking into account commonly known or reasonable ascertainable information about the property within the local community.

- Taking into account, based on all of the above inquiries, the degree of obviousness of the presence of contamination and the ability to detect that contamination.

The results of the inquiry must be documented in a written report prepared by the environmental professional containing the following:

- The environmental professional's opinion as to whether conditions indicative of a release or threatened release exist.

- A list of data gaps and the significance of the data gaps on the ability to express the above opinion.

- The qualifications of the environmental professional.

- A declaration by the environmental professional that he or she meets the definition of that term and has complied with the rule.

ISSUES RAISED

At every turn, the rule requires the exercise of discretion and subjective judgment (e.g., data gaps, records review, date of historic sources, scope of interviews). While this may be fine for ensuring the quality of the inquiry, it creates ambiguity and substantial litigation risk for both the environmental professional and those seeking to establish the CERCLA liability defenses. For example, those seeking to establish the bona fide prospective purchaser defense will face fact-specific inquiries as to whether they did everything necessary to meet the objectives and performance factors. At a minimum, these inquiries will require extensive fact and expert witness discovery and provide a basis for defeating a purchaser's summary judgment motion regarding the defense. At a maximum, the inquiries may defeat the claimed defense itself. This alone creates risk for the rule.

Another uncertainty relates to purchase price inquiries. The rule's preamble states that no formal appraisal is required to determine the relationship of the purchase price to the fair market value of the property. However, the preamble also states, “A determination of fair market value may be made by comparing the price for a particular property to prices paid for similar properties located in the same vicinity . . .”

If it looks like a duck, and quacks like a duck, it's an appraisal.

As a result of all of these concerns, the cost of due diligence just went up. Not by \$50, as the rule's preamble states, but in an amount, as yet unknown, sufficient enough to reflect the risks discussed above.

In addition, there are a series of questions begged by the rule that simply have not yet been answered. For example, while the rule will be considered industry standard for real property transfers, will it be required for asset and/or stock acquisitions? Are environmental professionals the best to conduct interviews? What basic training do they need in typical Q&A? How will data gaps be handled? When is sampling and analysis required to fill data gaps? What records do purchasers need to create and retain to evidence the

“additional inquiries” they are required to undertake? When should a purchaser not share the result of the additional inquiries with its environmental professional? How

should the environmental professional treat the absence of this information in his or her report and declaration? What steps must an environmental professional take to review

the “reliability” of data he or she gathers?

The rule is the new sheriff in town. The question is what type of protection will the sheriff provide? •