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## GREEN AWARENESS

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# The Environment Surrounding the Purchase of Distressed Assets

As investors and developers navigate the troubled waters of the current real estate market, they are more and more frequently presented with opportunities to acquire economically distressed real estate assets, as well as bank notes related to such assets. Typically, investors are presented with these opportunities in a very expedited timeframe. While the discounted sales price of these troubled assets may prove to be promising investment opportunities, investors must still carefully evaluate the potential environmental liabilities triggered by such acquisitions.

Under federal environmental law, as well as analogous state environmental laws, a purchaser of contaminated property is generally liable for environmental contamination present at that property unless the purchaser can demonstrate that he or she qualifies for a defense to such liability. Under the federal Comprehensive Environmental Response Compensation and Liability Act (CERCLA), commonly referred to as Superfund, a purchaser of a known contaminated site can still qualify for a defense to liability if that purchaser qualifies as a "bona fide prospective purchaser," a defense that was added to Superfund in 2002. In order to qualify for this defense to liability, at a minimum, the purchaser must perform "all appropriate inquiry," consisting of a Phase 1 environmental site assessment (ESA) that complies with the ASTM Standard E1527-05. In addition, the Phase 1 ESA must be performed within six months of the purchaser's acquisition of the site. If the purchaser does not undertake all appropriate inquiry prior to acquisition, the purchaser cannot qualify for the bona fide prospective purchaser defense to Superfund liability.

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Although an investor who purchases a note and obtains a security interest in a contaminated asset is generally not an "owner" of the asset under environmental laws, if the purchaser forecloses on the note, the purchase will become an "owner" of the property, and thus generally be liable under federal and state environmental laws unless the purchaser qualifies for a defense to liability. Superfund contains a secured creditor exemption to liability, which protects a secured creditor from liability if the secured creditor forecloses on the property provided that the secured creditor seeks to divest the property "at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements." 42 U.S.C. § 9601(20)(D)(ii). In other words, an investor who forecloses on a note with the intention of retaining the property as an investment would not qualify for this defense to Superfund liability. In order for such an investor to qualify for a defense to Superfund liability, the investor would need to qualify for the bona fide prospective purchaser defense.

Most states, including Pennsylvania, New Jersey and Delaware, have laws analogous to the federal Superfund statute. Unlike the bona fide prospective purchaser defense to federal Superfund liability, however, state laws generally do not enable a purchaser of a known contaminated site to entirely avoid liability for such contamination, but instead require the purchaser to commit to completing required cleanup at the site in exchange for limited liability protections. Similarly, certain state statutes have defenses to liability similar to Superfund's secured creditor exemption, although such exemptions may not protect a secured creditor from liability under all state environmental laws. As with the federal secured creditor exemption, the state protections also require that a secured creditor attempt to divest the asset as soon as practicable after foreclosure.

While today's troubled real estate market may afford investors interesting investment opportunities in distressed real estate assets, such investors still need to be cognizant of potential environmental liabilities that may be imposed under state and federal law, and need to factor these risks into their investment decision-making.

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