Environmental Due Diligence In Real Estate Transactions

By MARC E. GOLD AND MICHAEL C. GROSS[1]

Montgomery County
Members of the Pennsylvania Bar

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INTRODUCTION

There are a myriad of environmental issues to evaluate in connection with the proposed purchase of real estate because of the breadth of environmental liability and the significant costs associated with addressing that liability. Thus, practitioners must fully understand the nature of potential environmental liabilities, being sensitive to the factual nuances that matter, and avail themselves of the appropriate tools to gather the necessary facts on which to provide meaningful legal advice to their clients. As an initial matter, this article will detail the federal regulatory standard for due diligence in the context of certain Superfund defenses, aimed at evaluating environmental conditions that may be indicative of releases or threatened releases of hazardous substances at a property. This article will also identify other issues of environmental concern outside the realm of site contamination that need to be considered, including the presence of wetlands, the location of a property in a flood plain, the presence of streams in and around the property and the availability of sewage treatment capacity to serve new development. This article will then address the critical issues associated with permit transfers and conditions that must be met when an entity purchases an ongoing industrial concern that will continue to be operated by the new owner.

"ALL APPROPRIATE INQUIRY" REQUIREMENTS UNDER FEDERAL LAW

Background

On November 1, 2005, the United States Environmental Protection Agency ("EPA") promulgated regulations entitled "Standards for Conducting All Appropriate Inquiries" (the

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1 Marc E. Gold is a founding partner of Manko, Gold, Katcher & Fox, LLP, a firm which concentrates its practice exclusively in environmental law and litigation. He currently serves as the firm's Managing Partner. Mr. Gold has more than thirty years of experience in environmental law. His practice focuses on all aspects of environmental regulation and counseling covering solid waste, site remediation and water pollution issues. Mr. Gold assisted in developing the Pennsylvania Land Recycling and Environmental Remediation Standards Act of 1995, the cornerstone of Pennsylvania's brownfields and site remediation program. As part of that work he participated in developing the regulations and policy guidance that supports the Pennsylvania remediation program. In addition, Mr. Gold has handled the environmental aspects of major national and international corporate transactions and has been involved in multi-facility environmental audits. Michael C. Gross is an associate with Manko, Gold, Katcher & Fox, LLP where he focuses his practice on brownfields redevelopment, transactional and regulatory compliance matters. Mr. Gross was appointed to serve on Pennsylvania Governor Edward G. Rendell's environmental policy transition team and serves on the Board of Directors of the nonpartisan Pennsylvania League of Conservation Voters. Mr. Gross was also recently appointed to serve on the Vapor Intrusion Task Group of ASTM International to craft a uniform standard for assessing vapor intrusion risks in commercial real estate transactions.

"AAI Rule").[2] The AAI Rule establishes the regulatory and industry standard for performing environmental due diligence in real property transactions and for establishing the factual predicate to qualify for any one of three liability defenses under the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA").[3] (The AAI Rule became effective on November 1, 2006.) The AAI Rule applies to those seeking to establish the following liability defenses under CERCLA: (1) the innocent landowner defense,[4] (2) the bona fide prospective purchaser defense[5]; and (3) the contiguous property owner defense.[6] The AAI Rule also applies to persons conducting site assessments using CERCLA Brownfields grant funds. In those instances, the AAI Rule requires the inquiry to focus on identifying releases of hazardous substances and petroleum products. Of these liability defenses, the AAI Rule is most important in establishing the 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. In 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.

Mandatory Requirements and Allocation of Functional Responsibilities

The AAI 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 an environmental professional. As discussed in greater detail below, certain AAI Rule tasks can (and must) be performed by the purchaser of property rather than the environmental professional. An environmental professional includes a person who either: (1) holds a professional engineer's or geologist's license and has three years of relevant experience; (2) holds a license to perform environmental inquiries and has three years of relevant experience; (3) has a baccalaureate or higher degree in engineering or science and has five years of relevant experience; or (4) has the equivalent of ten years of full time relevant experience.[7]

The AAI Rule rejects a "checklist" approach to due diligence whereby the environmental professional must perform carefully scripted tasks and review specifically identified documents. Instead, the AAI Rule adopts a more flexible, subjective standard based upon identified objectives and performance factors.[8] This is the heart of the AAI Rule and, as discussed below, has the potential to cause problems in its implementation. Regarding objectives, first and foremost, application of the requirements of the AAI Rule is intended to result in the identification of conditions "indicative of releases and threatened releases" at the subject property. To meet this objective, the AAI Rule requires that the purchaser and/or environmental professional must evaluate 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 AAI Rule are measured against specified performance factors. Since the performance factors, by definition, require the exercise of discretion and subjective decision-making, they create a central and controversial element of the AAI Rule. The performance factors include: (1) gathering information that is "publicly available, obtainable from its source within reasonable time and cost constraints and which can practicably be reviewed;" (2) reviewing and evaluating "the thoroughness and reliability of the information" gathered; (3) 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; and (4) identifying in

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[2] *See* 40 C.F.R. §312; 70 Fed. Reg. 66070 (November 1, 2005). The procedures of the ASTM International Standard E1527-05 "Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process" have been incorporated by reference into the AAI Rule and may be used to comply with the requirements of 40 C.F.R. 312.23 through 40 C.F.R. 312.31. Thus, the ASTM E1527-05 Standard is anticipated to be looked upon by environmental professionals and users of the practice, as the practice that constitutes "all appropriate inquiry" into the previous ownership and uses of the property consistent with good commercial or customary practice.

[3] 42 U.S.C. §6901 *et seq.*

[4] 42 U.S.C. §§9602(35) and §9607(b)(3).

[5] 42 U.S.C. §§9601(40) and 9607(r).

[6] 42 U.S.C. §§9607(q).

[7] 40 C.F.R. §312.10(a).

[8] 40 C.F.R. §312.20(e) and (f).

the report 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."[9]

Another issue created by the adoption of the AAI Rule focuses on the shelf life of environmental due diligence reports, including the use of reports prepared by other parties. Generally, all appropriate inquiry 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: (a) interviews with past and present owners and occupants, (b) searches for environmental liens, (c) review of government records, (d) visual inspection of the property, and (e) completion of the declaration by the environmental professional.[10] Results of previous "all appropriate inquiry" conducted by the same person at the same property may be used and relied upon if conducted in compliance with the "all appropriate inquiry" standards in effect at the time, and if the results are updated within a year of the date of acquisition, or for certain factors listed set forth in the AAI Rule, updated within six months of acquisition. Similarly, results of previous "all appropriate inquiry" conducted by other persons may be used and relied upon if the report meets the objectives and performance factors of the AAI Rule and the environmental professional and/or purchaser reviews the report and updates all of the inquiries as required by the AAI Rule.

The AAI Rule requires the environmental professional and/or the purchaser to perform a defined list of activities.[11] The environmental professional must perform the interviews, review historical sources, review government records, perform the visual inspections and evaluate the degree of obviousness of the presence of contamination. Either the purchaser or the environmental professional may search for environmental liens on the property and determine the commonly known or reasonable or ascertainable information about the property. The AAI Rule also sets forth new requirements regarding interviews which must now include interviews with the current owner of the subject property and all current occupiers likely to handle hazardous substances.[12] To the extent necessary to meet the objectives and performance factors of the AAI Rule, this may include interviews of current and past facility managers, past owners and operators and past and current employees thereof. For abandoned properties, the AAI Rule mandates interviews of at least one occupant of a neighboring or nearby property from which one can observe the abandoned property. Similarly, the AAI Rule contains new provisions regarding the review of historical sources of information. This includes, but is not limited to, review of aerial photos, fire insurance maps, chain of title records and building records.[13] Further, in the discretion of environmental professional, this review must cover a period of time as far back in history that property contained structures, or when property was first used for any residential, agricultural, commercial, industrial or governmental purposes. The AAI Rule also contains new requirements regarding searches for recorded environmental cleanup liens,[14] reviews of governmental records,[15] and the parameters for visual inspections of properties.[16]

For the first time, the AAI Rule mandates that certain aspects of the environmental due diligence process must be performed by the prospective purchaser, rather than the environmental professional. For example, the "Additional Inquiries" section of the AAI Rule indicates that the purchaser must take into account its specified knowledge of the property, the surrounding area and other experience relevant to the inquiry.[17] Further, the purchaser must consider whether the purchase price of the subject property reflects the fair market value of the property if uncontaminated.[18] If the purchase price is not at fair market value, the purchaser must determine whether the price differential is due to environmental impacts. Some tasks falling under the "Additional Inquiries" section can be performed by either the prospective purchaser or the environmental professional. The purchaser and/or environmental professional must take into

[9] 40 C.F.R. §312.20(e).
[10] 40 C.F.R. §312.20(a), (b), (c) and (d).
[11] 40 C.F.R. §312.21(b) and §312.22(a).
[12] 40 C.F.R. §312.23.
[13] 40 C.F.R. §312.24.
[14] 40 C.F.R. §312.25.
[15] 40 C.F.R. §312.26.
[16] 40 C.F.R. §312.27.
[17] 40 C.F.R. §312.28.
[18] 40 C.F.R. §312.29. No formal real estate appraisal is required to determine the relationship of the purchase price to the fair market value of the property. However, the preamble to the AAI Rule states that: "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." *See* 70 Fed. Reg. 66070 at 66098-66099 (November 1, 2005).

account commonly known or reasonable ascertainable information about the property within the local community.[19] This could include information from owners or occupiers of neighboring properties, local government officials, newspapers, websites, community organizations, local libraries or historical societies. In addition, the purchaser and/or the environmental professional must take into account, based on all of the inquiry, the degree of obviousness of the presence of contamination and the ability to detect that contamination.[20] In any event, care must be taken to assure that the responsibilities of the AAI Rule are undertaken by the appropriate party.

Following the completion of the investigation, the results of the inquiry must be documented in a written report prepared by the environmental professional that contains: (1) the environmental professional's opinion as to whether conditions indicative of a release or threatened release exist at the subject property; (2) a list of data gaps and the significance of the data gaps on the ability to express the above opinion; (3) the qualifications of the environmental professional; and (4) a declaration by the environmental professional that it meets the definition of that term and has complied with the AAI Rule.[21]

Practical Considerations and Dilemmas

The AAI Rule is legally significant for many reasons, particularly because it codifies for the first time the level of environmental due diligence that must be performed by prospective purchasers of contaminated property. However, the AAI Rule also presents many unresolved issues and potential difficulties for prospective purchasers and their lawyers. The AAI Rule requires the exercise of discretion and subjective judgment particularly those provisions addressing data gaps, records review, date of historic sources and the 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 potentially provide a basis for defeating a purchaser's summary judgment motion regarding the defense. At worst, these inquiries may defeat the claimed defense itself.

Further, while the AAI Rule will be considered industry standard for real property transfers, questions persist as to whether the AAI Rule should be required in other transaction scenarios, such as asset and/or stock acquisitions, where CERCLA liability protection is not of primary concern. Another common dilemma encountered since the effective date of the AAI Rule concerns whether environmental professionals are sufficiently qualified to conduct the required interviews, and at a minimum, what sort of basic training does the environmental professional need in typical "Q & A". With respect to data gaps, questions have emerged as to how the data gaps be handled and when sampling and analysis is required to fill the data gaps. Other unresolved issues presented by the AAI Rule include: what records do purchasers need to create and retain to evidence the "additional inquiries" they have undertaken; when should a purchaser not share the result of the "additional inquiries" with their environmental professional; how should the environmental professional treat the absence of this information in its report and declaration; what steps must an environmental professional take to review the "reliability" of data it gathers; and when is a release so *de minimis* that it need not be identified in the report.[22] Indeed, nearly 18 months after the publication date of the final AAI Rule, prospective purchasers and most environmental professionals remain unclear as to how to best comply with the AAI Rule while meeting business objectives. Another complicating factor concerns the fact that many of these issues are considered in a "deal time" scenario where complex issues of environmental liability are not properly weighed due to timing constraints. Accordingly, it is beneficial for the prospective purchaser to tackle issues presented by the AAI Rule as early as possible in the transaction process.

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[19] 40 C.F.R. §312.30.
[20] 40 C.F.R. §312.31.
[21] 40 C.F.R. §312.21(c).

[22] *See* ASTM International Standard E1527-2005, Section 3.3.21: "The term [Recognized Environmental Condition] is not intended to include *de minimis* conditions that generally do not present a threat to human health or the environment and that generally would not be the subject of an enforcement action if brought to the attention of appropriate governmental agencies. Conditions determined to be *de minimis* are not recognized environmental conditions."

Environmental due diligence evaluations in a real property transfer scenario should also contemplate potential contamination and health risks presented by the subject property, which are not covered by the AAI Rule. For example, typical "non-scope" health concerns falling outside the realm of the AAI Rule include the potential presence of asbestos, radon and lead-based paint.[23] Moreover, the AAI Rule does not assess the potential presence of mold or other impacts to indoor air quality. In addition, the presence of lead in drinking water can be a major impediment that exists in transactions involving aged properties. Prospective purchasers, their counsel and their environmental consultants should strategize collectively to determine whether additional investigation is warranted to address these concerns.

WATER AND SEWER CONSIDERATIONS[24]

While the AAI Rule has received significant attention from the environmental and real estate communities, many environmental conditions arising in the context of real estate development have nothing to do with environmental contamination. These conditions include the presence of floodplains, wetlands and streams/waterways; and the availability of public sewage treatment capacity. Since each of these water-related conditions has the ability to delay or derail a proposed development, significant time and resources should be devoted to assessing the impacts of these conditions during the nascence of the project. A summary of these potential issues is set forth below.

Floodplains

If a property is located within a floodplain, development of the property will be a complex endeavor. Pursuant to the National Flood Insurance Act of 1968,[25] the Federal Emergency Management Agency ("FEMA") has identified the 100 year flood plain—the highest level of flooding that, on average, is likely to occur once every 100 years. Pennsylvania has similarly enacted the analogous Flood Plain Management Act[26] to "encourage planning and development in flood plains which are consistent with sound land use practices."[27] The maximum area of land that is likely to be flooded by a 100 year flood is identified on FEMA flood plain maps.[28] Structural development that would cause an increase in the 100 year flood elevation is barred by federal minimum standards. This could necessitate elevating or flood proofing non-residential structures to the 100 year flood elevation or elevating residential structures. Municipalities are required to implement the Flood Plain Management Act by passing ordinances to restrict development in flood plains.[29] Issues related to flood protection are particularly important in southeastern Pennsylvania because of the recent frequency of serious flood events.

Wetlands and Streams

Pennsylvania and federal law both regulate the development of areas deemed to be wetlands. Section 404 of the Federal Clean Water Act regulates the discharge of dredge and fill materials into waters of the United States.[30] Jurisdictional wetlands are included in the definition of waters of the United States.[31] Accordingly, both the EPA and the United States Army Corps of Engineers ("Corps") have jurisdiction over wetlands that are waters of the United States. Permits must be obtained from by the Corps to fill wetlands.[32] In Pennsylvania, wetlands are regulated under the Dam Safety and Encroachment Act,[33] the Pennsylvania Clean Streams Law[34] and Pennsylvania's Dam Safety and Waterway Management

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[23] *See* ASTM International Standard E1527-2005, Section 13.1 "*Additional Issues*—there may be environmental issues or conditions at a property that parties may wish to assess in connection with commercial real estate that are outside the scope of this practice (non-scope considerations)." Section 13.1.5 sets forth an extensive list of potential non-scope issues that may be considered when appropriate.

[24] This section is adapted with permission from materials prepared by Howard J. Wein, Esquire, Buchanan Ingersoll & Rooney, P.C. entitled "Environmental Due Diligence: It's Not Only the Contamination That Can Sink Your Ship" presented at the Pennsylvania Bar Institute's Seminar *Due Diligence In Real Estate Transactions*, September 2006.

[25] 42 U.S.C. §4121.

[26] 35 P.S. §§679.101 *et seq.*

[27] 35 P.S. §679.103.

[28] 35 P.S. §679.104 and 25 Pa. Code §113.

[29] These ordinances are to be adopted pursuant to the Pennsylvania Municipalities Planning Code, 53 P.S. §10101 *et seq.*

[30] 33 U.S.C. §1314.

[31] 33 C.F.R. §328.1 *et. seq.*

[32] *But see Rapanos* v. *United States*, (128 S.Ct. 2208, 165 L.Ed. 2d 159, 74 USLW 4365, June 19, 2006) (holding certain wetlands may not be regulated under Federal Law).

[33] 32 P.S. §693.1 *et seq.*

[34] 35 P.S. §691.1 *et seq.*

regulations,[35] also known as "Chapter 105." Wetlands are defined in Chapter 105 as "areas that are inundated or saturated by surface water or groundwater at a frequency and duration sufficient to support, and that under normal circumstances do support, a prevalence of vegetation typically adapted for life in saturated soil conditions including swamps, marshes, bogs and similar areas."[36] State permits issued by the Pennsylvania Department of Environmental Protection ("PaDEP") are also required to either fill wetlands or encroach on waters of the Commonwealth.[37] While the presence of wetlands on a subject property will always create issues in the context of real estate development, certain wetland areas are more prohibitive than others. Pennsylvania recognizes that there are exceptional value wetlands[38] and "other wetlands."[39] Potential purchasers need to bear in mind that different standards apply to permitting structures and activities in wetlands deemed to be of higher value.[40]

The presence of streams and other watercourses on a property also presents development challenges. The Dam Safety and Encroachment Act and Chapter 105 regulations require a permit for any encroachment on a stream. Examples of activities likely requiring a permit include filling in a stream or installing a culvert to convey a stream. In addition, if the proposed development will dam a watercourse, a permit is required as well. Changing or impeding a watercourse would also require a permit. It is also extremely difficult to obtain the requisite approvals to impact any stream classified as high quality ("HQ") or exceptional value ("EV"). During the permitting process, PaDEP will require an "alternatives analysis" which mandates that the applicant must evaluate whether the property can be developed without filling the wetland or causing a stream encroachment.

Stormwater Management

National Pollutant Discharge Elimination System ("NPDES") stormwater permits are required for essentially all construction activities. Such permits are issued by PaDEP under the authority of the Pennsylvania Clean Streams Law and pursuant to a delegation of authority from EPA under the Clean Water Act. NPDES permits are required if greater than one acre is disturbed and there will be a point source to surface waters or if more than five acres are disturbed.[41] The NPDES permit could be either a general permit or individual permit, although individual permits may also be required by PaDEP where there is evidence of site contamination. Projects affecting less than one acre do not require a NPDES permit but PaDEP regulations regarding Erosion and Sedimentation ("E&S") control must be met.[42] The NPDES permit applicant is also required to conduct a Pennsylvania Natural Diversity Inventory ("PNDI") project planning environmental review to ensure that the proposed construction activity will not harm threatened and endangered plants and animal species.[43] Various E&S planning requirements must also be identified in the NPDES permit application including: (1) any previous uses of the land proposed for construction; (2) potential pollutants; (3) the type, source and location of fill materials; (4) receiving water or watershed name; and (5) receiving water classification.[44]

An often overlooked regulatory program that can impact NPDES permitting is Pennsylvania's stream classification scheme, codified at 25 Pa. Code Chapter 93. Pursuant to Chapter 93, discharges to HQ or EV streams mandate additional stringent controls and an analysis under Pennsylvania's anti-degradation regulations.[45] Chapter 93 requires the water quality of HQ waters must be maintained, unless there is a social or economic justification for the project. Non-discharge alternatives to a point source discharge must first be analyzed and if a non-discharge alternative is not environmentally sound and cost-effective, alternative technologies must be employed. An applicant must be prepared to demonstrate that the proposed discharge will maintain and protect existing water quality if no environmentally sound and cost effective non-discharge alternative exists. Because there is no social and economic justification for discharges to EV waters, EV waters create a greater challenge.

Sewage Treatment Capacity

The availability of public sewers at a subject property can drastically alter the course of a planned development. To the extent public

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[35] 25 Pa. Code Chapter 105.
[36] 25 Pa. Code §105.1.
[37] *See* 25 Pa. Code §105.11 *et seq.*
[38] 25 Pa. Code §105.17(1).
[39] 25 Pa. Code §105.17(2).
[40] *See* 25 Pa. Code §105.18a(a) for permitting exceptional value wetlands and 25 Pa. Code §105. 18a(b) for other wetlands.
[41] 25 Pa. Code Chapter 102.
[42] *Id.*
[43] 25 Pa. Code §102.6(a)(2).
[44] 25 Pa. Code Chapter 93.
[45] *See* e.g. 25 Pa. Code §93.4a(c).

sewers are lacking, a series of expensive and time consuming measures to obtain approval to construct a private treatment system must be pursued. Such measures must be consistent with the municipality's Official Plan[46] under the Pennsylvania Sewage Facilities Act,[47] and the implementing regulations thereto.[48] The approval of the municipality and PaDEP is required through a sewage facility official plan revision where the proposed development is not identified in the Official Plan. Operation of such systems require an NPDES permit as well as a Part II construction permit. NPDES permits for these facilities also impose discharge limits premised upon the more stringent of either water quality based or technology-based limits. Other relevant factors in establishing effluent limits placed on the discharge include the size of the receiving waterway and whether it can assimilate treated sewage. HQ and EV waterways also pose a unique set of issues in the context of sewage discharges, based upon the PaDEP's anti-degradation requirements.[49]

If public sewers exist, such sewers must be capable of handling the additional flow from the proposed development. New developments that are not in the Official Plan and are not exempt must be added to a municipality's Official Plan. This "plan revision" process involves "planning modules" that are specific to individual projects. A broad change to the Official Plan is known as an "update revision" as may be required by PaDEP. However, a plan revision for a new development will not be approved by PaDEP if (1) a municipality has not completed its Chapter 94 Report (a report required by Pennsylvania's wasteload management regulations[50] that must be submitted to the PaDEP annually to determine whether sewage facilities are currently overloaded or have the potential to be overloaded), (2) the information in an Act 537 planning module is inconsistent with wasteload management information, (3) the municipality's sewage facilities (e.g. sewer lines, pump stations and/or sewage treatment plant) are already overloaded and an acceptable plan and schedule have not been submitted by the municipality to PaDEP to address the situation, or (4) the municipality has already been given allocations beyond its capacity (known as sewer tapins) and an acceptable plan and schedule have not been submitted to the PaDEP.[51]

Municipalities are also required to prohibit new connections to overloaded facilities.[52] This connection ban does not apply to a structure that received a building permit within one year of the sewer ban. Also, exceptions exist where a source replaces another source on the same property or the connection is necessary to the operation of a facility of public need.[53] In such scenarios, a Corrective Action Plan ("CAP") must be submitted to PaDEP. PaDEP will ban new connections to all or part of the system if a satisfactory CAP is not submitted or if the obligations of the CAP are not met by the municipality. If the municipality can show that the overloads have been reduced substantially and the limited number of connections will not cause additional pollution, exceptions to the ban can also be granted by PaDEP.[54] Submission of a CAP is further required if any overload to the sewer system is projected in the next five years. In such a scenario, the municipality also needs to identify how it will control connections and extensions to the system based upon remaining capacity.[55]

BUSINESS REGULATORY COMPLIANCE FOR ONGOING OPERATIONS

In certain instances, prospective purchasers will acquire an existing industrial facility with the intent of continuing existing operations. In such scenarios, the prospective purchaser must fully assess all of the environmental permits presently held by the operator and analyze all legal obligations necessary for continued operations. It is also critical to assess the facility's compliance with all applicable legal requirements and historic violations if any, so as to minimize the new owner's potential liability after the sale.

Numerous Pennsylvania environmental laws and regulations have explicit provisions governing permit transfers when there is a change of ownership of an operating facility. Each specific permit held by a facility may have its own conditions regarding permit transfers and these documents must be carefully analyzed by counsel well in advance of the anticipated transfer to define the applicable requirements. For example, the NPDES

[46] Act 537 requires municipalities to develop an official sewage plan ("Official Plan") to address both present and future sewage disposal needs. 35 P.S. §750.5(a).

[47] 35 P.S. §750.1 *et seq.*

[48] 35 Pa. Code Chapters 71 and 73.

[49] 25 Pa. Code §93.4a.

[50] 25 Pa. Code Chapter 94.

[51] *Id.*

[52] 25 Pa. Code §94.20.

[53] *See* 25 Pa. Code §§94.55-94.57.

[54] 25 Pa. Code §94.42.

[55] 25 Pa. Code §94.22.

permit regulations[56] (and the conditions included in such permits) contain provisions regarding the transfer of either a Pennsylvania NPDES permit (Pennsylvania has been delegated NPDES authority by EPA) or a Pennsylvania water quality permit (Part II permit).[57] These provisions require written notice to PaDEP thirty days in advance of the proposed transfer and a written agreement between the existing permittee and the new permittee containing a specific date for transfer of permit responsibilities, coverage, and liability between the parties.[58] The Pennsylvania Air Pollution Control Regulations[59] provide another example of a codified permit transfer process. With regard to Plan Approvals, PaDEP must approve the transfer in writing, following a compliance review.[60] Simply stated, each regulatory program must be carefully reviewed to discern applicable obligations since failure to do so could result in potentially significant violations.

Another concern regarding the transfer of ongoing industrial operations involves the transferability of a hazardous waste generator identification number to a new owner of a facility. While it may be legally feasible to transfer an existing hazardous waste generator identification number by completing and submitting an EPA hazardous waste registration form to both EPA and PaDEP, there are numerous reasons why a new owner should consider obtaining a new identification number. By obtaining a new identification number for the facility, the new owner would reduce potential issues with the prior owner and others as to the responsibility for hazardous wastes generated prior to the transfer.

In addition to assessing permit transfer requirements and the current regulatory compliance of the existing facility, there are many other issues that can complicate the transaction. These include but are not limited to interim status/corrective action obligations pursuant to the federal Resource Conservation and Recovery Act[61] and any obligations to maintain institutional or engineering controls in place pursuant to the Pennsylvania Land Recycling and Environmental Remediation Standards Act, commonly known as Act 2.[62]

An often overlooked environmental requirement that is particularly relevant to the transfer of current or former industrial facilities involves deed acknowledgments under the Pennsylvania Solid Waste Management Act ("SWMA")[63] and the Pennsylvania Hazardous Sites Cleanup Act ("HSCA").[64] Under the SWMA and HSCA, a deed acknowledgement is required for transactions involving parcels on which hazardous waste/substances are currently being or have ever been (to the grantor's actual knowledge) disposed.[65] To constitute disposal, the hazardous substance/waste must have come in contact with the environment, as required in the definition of the term "disposal" in each statute.[66] Moreover, the SWMA contains a rebuttable presumption that storage of substances for a period exceeding one year constitutes disposal.[67] Thus, it can be argued that a deed notice will be required under the SWMA where hazardous waste has been stored on a property for a period longer than one year, unless this presumption is rebutted with "clear and convincing evidence." Evidence that the property was cleaned up prior to transfer may provide a basis to avoid a deed acknowledgement depending on the Act 2 cleanup standard achieved.[68] Failure to comply with the relevant statutory deed acknowledgment provisions could constitute a violation of either or both statutes.

MISCELLANEOUS DUE DILIGENCE PROCEDURAL ISSUES

Another delicate situation involving the transfer of operating facilities involves the negotiation of site access agreements for environmental due diligence to enable the prospective purchaser to investigate the condition of the property and assess regulatory compliance while not interfering with the current owner's operations. Such agreements typically contemplate that the prospective purchaser will obtain the owner's approval of the proposed

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[56] 25 Pa. Code §92.1 *et seq.*
[57] 25 Pa. Code §92.71(a).
[58] 25 Pa. Code §92.71a(2).
[59] *See* 25 Pa. Code §121.1 *et seq.*
[60] 25 Pa Code §127.12 and §127.32(a).
[61] 42 U.S.C. §6901 *et seq.*
[62] 35 P.S. §6026.101 *et seq.*
[63] 35 P.S. §6018.101 *et seq.*
[64] 35 P.S. §6020.101 *et seq.*
[65] 35 P.S. §6018.405, 35 P.S. §6020.512.
[66] 35 P.S. §§6018.103 and 6020.103.
[67] 35 P.S. §6018.103. The legislative intent behind this presumption is to avoid the situation in which "storage becomes merely a sham to avoid the more extensive—and expensive—requirements pertaining to disposal." *Starr* v. *DER*, 147 Pa. Cmwlth. 196, 205, 607 A.2d 321 (1992) (internal citations omitted).
[68] Cleanup to the Background Standard or Residential Statewide Health Standard under Act 2 avoids the otherwise applicable deed acknowledgment requirements.

due diligence work plan. Timing of due diligence activities is also usually a consideration so as to ensure non-interference with ongoing business operations. The existing owner may also require that all due diligence activities should be conducted in compliance with environmental laws and that the property will be restored to its original condition after any subsurface sampling. The owner may impose specific insurance requirements on the due diligence proponent (e.g. worker's compensation, employer's liability, CGL, business/automobile and professional liability with pollution coverage) and may require an indemnification of the owner for liability that flows from site investigation work.

In some scenarios, it may be desirable for the prospective purchaser to provide the owner with split samples, analytical results and reports relating to the environmental investigations. Conversely, the owner may explicitly request that such information not be shared and kept solely within the purchaser's possession. In any event, confidentiality of information obtained during the environmental investigation is of obvious concern to both parties. Access agreements may require the purchaser to keep analytical results and reports confidential, unless otherwise required by law and after consulting with the owner. However, the purchaser should not readily consent to such provisions if it needs to share information with other parties (e.g. lenders, project engineers, land planner, etc.). The parties should also consider the disposition of documents regarding the facility shared with the prospective purchaser if the transaction fails to close.

There is also a common misconception that if counsel (rather than the client) hires an environmental consultant to perform environmental due diligence investigations, that the results of such investigation are automatically cloaked by the attorney-client privilege. It is critical to bear in mind that such information may not constitute a privileged communication unless the consultant was directly assisting the lawyer in providing legal advice and that certain underlying facts (e.g., analytical results) may never be subject to the privilege. Nevertheless, there are often useful reasons for counsel to retain the consultant. First, it increases chance that consultant's work will be deemed privileged (especially if the contract is drafted with this objective). Second, the consulting contract may also require the consultant to report information to counsel first and prohibit unauthorized disclosures. Third, routing report drafts through counsel helps to catch inaccuracies and misinterpretation of regulations by non-lawyer consultants. With respect to potentially maintaining a privilege, it is important to note that the exchange of environmental information between the parties to a transaction undercuts the argument in favor of privilege.

CONCLUSION

Due diligence in the environmental arena touches on considerations of timing and financing, allocating environmental liability associated with the transaction, consideration of available government liability protections, assessing which party will be performing any required cleanup, identifying potential issues affecting future development and compliance, and complying with any property transfer requirements including deed disclosures. With approximately 240,000 Phase I Environmental Site Assessments conducted nationally on an annual basis at a total cost of approximately $500 million, performing environmental due diligence is a burgeoning business.[69] The advent of the AAI Rule will only serve to heighten the importance of environmental due diligence in many real estate transactions. Parties to such transactions need to look beyond potential contamination and understand all constraints that could impact potential development plans. Facilities that will continue to operate under new ownership present unique due diligence challenges. By proactively implementing a thorough plan for environmental due diligence and allocating the necessary time and resources for such investigations, prospective purchasers can avail themselves of significant assurances and minimize the potential for future environmental liability.

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[69] Sven-Erik Kaiser, Due Diligence Update: The Inside Scoop on the All Appropriate Inquiry Rule. www.brownfieldnews.com, December 2004.