

Environmental Law

Maintaining 'Innocence' Gets Complicated

USEPA revises the 'all appropriate inquiries' rule

By Daniel J. Sheridan

The USEPA recently amended its "all appropriate inquiries" (AAI) rule to approve the use of ASTM's recently updated Standard Practice for Environmental Site Assessments (ASTM E1527-13). The updated ASTM Standard makes several significant changes to the required elements of a basic "Phase I" environmental due diligence report. More importantly, it once again brings into stark relief the fact that, to qualify as an "innocent landowner" under the applicable environmental liability schemes, it is necessary to carefully comply not only with the applicable *federal* due diligence standard, but with the corresponding New Jersey requirements.

On the positive side, as a result of the recent structural changes to the site remediation program in New Jersey, which "privatized" the process into the hands of licensed site remediation professionals, or LSRPs, a properly conducted and documented environmental due diligence exercise may now serve as the basis for greatly enhanced legal protection.

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By way of background, the federal superfund law, commonly referred to as "CERCLA," imposes strict liability upon owners and operators of real property, without regard to fault, for the cost of remediating environmental contamination. There is a corresponding statute in New Jersey, commonly referred to as the "Spill Act," which imposes a similar, though not identical liability standard. Both CERCLA and the Spill Act afford a limited defense to liability to a potentially responsible party who is able to demonstrate that a reasonably thorough environmental due diligence process was conducted prior to its acquisition of the property.

The CERCLA terminology for this investigation, taken directly from the statute, is "all appropriate inquiries." Compliance with the AAI rule is the primary (but not only) required element for establishing the "innocent landowner," "innocent purchaser" or "contiguous property owner" defenses to liability under CERCLA.

The Spill Act innocent landowner defense, codified at N.J.S.A. 58:10-23.11g(d)(2), also requires the party claiming the defense to establish that it undertook, at the time of acquisition, "all appropriate inquiry" into the previous ownership and uses of the property. In order to establish its compliance with

this requirement, a party must perform a "preliminary assessment," and if that assessment indicates that further inquiry is needed, a "site investigation." While these terms are defined broadly by statute, the NJDEP's Technical Requirements for Site Remediation (N.J.A.C. 7:26E-1.1 et seq.) include detailed specifications for each of these investigations.

This dual federal-state compliance burden is not new. However, there have been several very important developments in recent years. First was the 2006 adoption of the AAI rule by EPA. That rule identified ASTM E1527-05 as the standard against which the performance of satisfactory due diligence would be measured. The ASTM standard was recognized by Congress in the Small Business Liability Relief and Brownfields Revitalization Act, which became law in 2002.

In November 2013, ASTM published a significant update to the 2005 version of E1527. This updated version has been endorsed by EPA, which has indicated that it plans further revisions to the AAI rule to eliminate references to the prior (2005) version of the standard. While much of the 2005 standard remains intact in the updated version, there are several significant changes, including:

- *RECs, HRECs and CRECs*: The definition of "recognized environmental conditions" (RECs) has been simplified. It now encompasses only those conditions that indicate:

[T]he presence or likely presence of any hazardous substances or petroleum products in or at a property: (1) due to release to the environment; (2) under conditions indicative of a release to the environment; or (3) under conditions that pose a material threat of a future release to the environment. De minimis conditions are not recognized environmental conditions.

The distinction between RECs and historical RECs (HRECs) has also been clarified. HRECs are now limited to those conditions that have been previously remediated to the *current applicable* unrestricted use standards without imposition of special control mechanisms, such as limitations on permitted land use, engineering controls and institutional controls. If the unrestricted use standard that was in effect at the time of the remediation has become more stringent, it is very possible that an HREC must now be classified as a REC.

The new standard also introduces the term controlled RECs (CRECs), applicable to previously completed risk-based remediation that has been “addressed to the satisfaction of the applicable regulatory authority...with hazardous substances...allowed to remain in place subject to the implementation of required controls...” Many remedial actions in New Jersey are not conducted to residential or “unrestricted” use standards. These remedial actions result in the imposition of various controls at the affected site which often are memorialized in a “deed notice” recorded with the applicable real estate records. These conditions are identified as CRECs under the revised ASTM standard.

- *Vapor Intrusion*: The definition of “migrate” now includes exposure pathways in any form, including “vapor in the subsurface.” Under the new standard, it will be necessary to assess potential indoor air quality impacts from subsurface soil or groundwater contamination.

- *File Reviews and User Responsibilities*: There are enhanced file review responsibilities to which environmental professionals must adhere. If a property or adjoining property appears on a federal, state or tribal database, the environmental professional must exercise its discretion as to the necessity of reviewing “pertinent

regulatory files and/or records associated with the listing,” or alternatively, must document its rationale to forego such a review. The ultimate recipient of the Phase I report (referred to in the ASTM standard as “Users”) are responsible for review of real property records, land use limitations and environmental liens, unless the environmental professional is contracted to do this work. User responsibilities are mandatory, and must account for a user’s specialized knowledge of the property, commonly known or reasonably ascertainable information, and the degree of obviousness of the presence or likely presence of a release or threatened release of hazardous substances.

Perhaps the other most significant development is the passage in 2009 of New Jersey’s Site Remediation Reform Act, or SRRA. SRRA established the new LSRP program under which qualified individuals now have authority to issue a “response action outcome,” or RAO, the functional equivalent of a “no further action” determination formerly within the sole province of the NJDEP. When an LSRP issues an RAO upon completion of a preliminary assessment (and, if required, site investigation), a “covenant not to sue” is granted to “the person who undertook the remediation” which grants protection “from all civil liability to the State to perform any additional remediation, to pay compensation for damage to, or loss of, natural resources, for the restoration of natural resources in connection with the discharge on the property...”

Importantly, the covenant not to sue applies by operation of law to all “successors in ownership of the property and to all persons who lease the property or who engage in operations on the property,” but does not apply to a person who “does not have a defense to liability” under N.J.S.A. 58:10-23.11g(d) (the so-called “innocent landowner” defense). While somewhat circular, the combined effect of these provisions provides not just a “defense to liability,” but rather an enforceable statutory covenant against the assertion of liability in the first instance.

There is, however, a significant potential pitfall with this approach. Very often, a real estate seller does not want to acquire knowledge of an adverse environmental condition of which it is not aware (and therefore not under a present legal obligation to remediate). An LSRP, on

the other hand, may have an independent legal obligation to report the evidence of a “discharge” to the appropriate regulatory authorities. Any party for whom this is a concern should carefully evaluate the contract due diligence procedures and potential termination rights in order to work around possible unintended consequences.

When contracting for due diligence investigation services in New Jersey, it is possible to maximize the return on investment under both federal and state law. Pay close attention to the following elements of the engagement:

- *Scope of Investigation*: The investigation should require that the final report of investigation be issued in two different formats, one of which conforms to the requirements of a Phase I Environmental Site Assessment under ASTM Standard E1527-13, and one of which satisfies the requirements for a Preliminary Assessment/Site Investigation under the Technical Requirements for Site Remediation.

- *Qualifications of Investigator*: The person conducting the investigation should satisfy the qualifications for an “environmental professional” under the ASTM Standard, and also be an NJDEP Licensed Site Remediation Professional.

- *NJDEP Procedural Requirements*: In order to be eligible for the “covenant not to sue,” certain NJDEP filings (and fees) will be required. Compliance with both the substantive and procedural elements of the SRRA will undoubtedly add expense to this process. This must be balanced against the potential benefits of the liability protection afforded by a covenant not to sue as opposed to the liability defense available upon satisfaction of the “all appropriate inquiries” standard.

- *Carefully Identify the Contracting Party*: Under the ASTM Standard, the user or users should be explicitly identified (e.g., the property owner, prospective purchaser and lender could all potentially be “users,” but, as such, each has independent responsibilities in the process), and under SRRA, the “person conducting the remediation” also should be identified. While the covenant not to sue expressly extends to successors in interest, the relative roles, responsibilities and benefited parties should all be identified in both the applicable contract documents and regulatory filings.

Environmental due diligence continues to be an evolving discipline. Much progress has been made since the ASTM standard first appeared on the scene in the early 1990s. There is room for more progress, especially toward greater harmonization between federal and state standards, as well as state-to-state requirements. The process for identification and containment of environmental risk will continue to be refined. Improvements in the process, such as those implemented in the revised ASTM Standard, are a welcome development that keeps all of us moving in the right direction. ■