

New Rules Provide for More Detail in Phase I Environmental Site Assessments



Doing environmental due diligence in order to come within the “all appropriate inquiry” safe harbor under federal and many state environmental statutes has become a necessary component of the underwriting process for commercial and industrial property transactions. For a lender needing to know what surprises might be lurking at a property, a Phase I environmental site assessment produced under this “all appropriate inquiry” rule is an imperfect vehicle. That’s because a Phase I is primarily a records search, coupled with a visual inspection and interviews with knowledgeable owners and users, and it only identifies potential red flags that often raises more questions than it answers. As of December 30, 2013, the U.S. Environmental Protection Agency (“EPA”) has endorsed a new set of standards for Phase I reports that, potentially, could make them more useful in evaluating the risks at a property, although it is likely to cost more and take more time to prepare.

The “all appropriate inquiry” rule comes into play if a party can show that it did everything commercially reasonable before closing a property transaction to inquire about previous

ownership and uses of the property that would identify whether there were releases or threatened releases of hazardous substances at the site. A Phase I that meets standards adopted by the EPA qualifies a party for the innocent landowner defense under the federal Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”), which states such as Washington use as the guidance for statutes such as the Model Toxics Control Act. All appropriate inquiry also applies to brownfields funding, as well as prospective purchasers of contaminated property.

The new standard is referred to as ASTM E1527-13 and it attempts to fill in gaps and clarify the prior standard, E1527-05 (“2005 Standard”). Among the highlights of the new standard:

- Definitions of Recognized Environmental Condition (“REC”) and Historical REC (“HREC”) have been clarified and a new category of Controlled REC (“CREC”) has been added;
- The definition of “de minimus” has been removed from the REC definition and made a standalone;

- Vapor migration has been added as a migration pathway to be evaluated;
- Agency, judicial and title records review verification has been standardized; and
- There is no requirement to make recommendations for additional services in the Phase I.

A REC is the presence or likely presence of hazardous substances due to a release, or conditions that indicate a release, or that pose a material threat of future release, into the environment. In the 2005 standard, this definition excluded “de minimus” conditions, which are conditions that do not present a threat to human health or the environment and generally would not be the subject of an enforcement action if brought to the attention of a government agency. The new standard simply takes that “de minimus” language out of the REC definition and creates a new definition by itself.

More significantly, the new standard now distinguishes between an HREC and a CREC. In the 2005 standard, the HREC category applied to past releases of hazardous substances that had been remediated, but it was unclear whether that applied to sites where some contamination remained but was

not considered a problem due to restrictions on the uses of the property or controlled by engineering or operational methods. The new standard makes an HREC applicable only to sites where a no further action determination has been issued without any restrictions. It also requires that the environmental professional take into account whether changes to the cleanup standards since issuance of a no further action with restrictions would require reconsideration as a REC.

The new CREC category applies to sites where there has been some cleanup but the regulator allows the remainder to be left in place with one or more restrictions on activities, or by using engineering or operational controls. For example, restrictions against use of groundwater as drinking water are common and it's this type of situation where the CREC designation would apply.

Vapor intrusion into structures has become an important environmental issue. Because the vapor pathway now is called out specifically in the definition of "migration,"

this will be an area where closer attention is necessary in the Phase I. While there is no requirement to conduct monitoring in the Phase I, the fact that the vapor pathway is now a part of the Phase I identification of RECs means that evaluating the potential for vapor intrusion could very well lead to follow-up monitoring and sampling.

The records search component of the Phase I is one of the most critical, and the new standard provides clarity that more is required than simply doing a chain of title report. A Phase I must also consider whether use restrictions are filed in judicial records or with an agency.

Frequently Phase I reports have closed with recommendations on further investigation and assessment that could or should be done. In some cases this has created problems for the parties because it has had the tendency to look and sound like an obligation. The new standard does not require the Phase I report to make any recommendations, but that does not mean

that an underwriter should ignore potential follow-up investigations when the Phase I indicates one or more RECs.

EPA muddied the waters a bit when it adopted ASTM E1527-13 as the all appropriate inquiry standard because the agency did not remove references to the 2005 standard. Technically, compliance with the 2005 Standard would still comply with the all appropriate inquiry rule. In the new rule adoption notice, however, EPA indicated that it would be publishing a proposed rulemaking to remove references to the 2005 standard. As a practical matter, even before that happens, it's likely that many environmental professionals and lenders will adopt the new standard as the default. 



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