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Environmental Due Diligence: New Era, New Rules

When the infamous Love Canal hazardous waste site was discovered, Congress responded by enacting the federal Superfund environmental law in 1980 to clean up contaminated properties nationwide. Since that time, "environmental due diligence" has been an important part of most business transactions, particularly those involving the transfer of industrial or commercial real estate as part of the deal. Using environmental consultants to conduct "Phase I and Phase II" environmental site assessments has become commonplace in business transactions. However, the rules regarding the environmental due diligence process are now changing, as a result of new regulations issued by the United States Environmental Protection Agency (USEPA) that become effective November 1, 2006.

Why Conduct Environmental Due Diligence?

There are two fundamental reasons why environmental due diligence is performed as part of a business transaction. First, the parties want to discover and quantify potential environmental issues early in the proposed transaction, so that they can either address them as part of the final negotiated business deal (such as by price adjustments, escrows, either party's pre-closing or post-closing cleanup requirements, the contractual allocation of specified environmental risks, etc.), or even abort the deal before closing, if necessary.

Second, conducting proper environmental due diligence prior to closing on the deal is a necessary element of creating certain potential environmental liability defenses, if an environmental agency asserts a claim against the property owner at a later date. In particular, the federal Superfund law provides certain statutory defenses "for innocent landowners," "bona fide prospective purchasers," and "contiguous property owners." In order to assert these defenses (in addition to various other requirements), the statute requires that the purchaser/property owner must have conducted "all appropriate inquiries" regarding the environmental condition of the property before acquiring it – which translates into a very specific type of "environmental due diligence."

USEPA's new regulations include a number of new or changed requirements necessary to meet the "all appropriate inquiries" test. Some of the more important ones are listed below.

USEPA's New Regulations

1. Environmental Consultant Qualifications. Perhaps the most

important change is that USEPA has now established specific qualifications that an environmental consultant (called an "Environmental Professional") must have in order to conduct an environmental site assessment that will meet the "all appropriate inquiries" test. USEPA requires that such an "environmental professional" must have:

- (a) a current professional engineer's or professional geologist's license or other state environmental professional license of certification, and three years of relevant experience; or
- (b) a bachelor's degree or higher in engineering or science, and five years of relevant experience; or
- (c) 10 years of relevant experience.

2. Increased Interviewing Requirements. The new regulations increase the site interviewing requirements over prior practice, make it mandatory for the environmental professional to interview the current owners and occupants of the subject property, and include increased requirements for interviewing (in some circumstances) current and past facility managers, past owners and occupants, and current and past employees. For abandoned properties, neighboring owners and occupants must be interviewed in many cases.

3. Data Gaps Must Be Addressed. Under the new regulations, if the environmental professional determines that there are "data gaps" (missing information) that affect his or her ability to identify relevant environmental conditions at the property, then such data gaps must be identified and commented upon by the environmental consultant. The environmental professional must include a specific written certification in his or her environmental report that "all appropriate inquiries" have been performed and that these new USEPA regulations have been met. This written certification will cause the environmental professional to take the "data gap" reporting requirements very seriously.

The American Society of Testing and Materials has issued an updated industry standard, ASTM E1527-05 ("Standard Practice for Environmental Site Assessments: Phase I Process"), which complies with the new USEPA regulations. Parties involved in future commercial transactions are urged to utilize the new USEPA regulations and ASTM E1527-05 to reduce their environmental risks in the deal. ★

For more information about environmental due diligence, contact Russell S. Warner at MacDonald, Illig, Jones & Britton, LLP at 814/870-7759 or rwarner@mijb.com