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All Appropriate Inquiries in Commercial Real Estate Due Diligence: What Inquiring Minds Need To Know

On November 1, 2006, the U.S. Environmental Protection Agency (EPA) adopted an "All Appropriate Inquiries" (AAI) rule. The AAI rule, found at 40 C.F.R. Part 312, 70 Fed. Reg. at 66,070 (November 1, 2005), codifies new requirements for conducting environmental due diligence inquiries in all transactions involving commercial real estate. The AAI rule establishes good commercial and customary practices for environmental site assessments of commercial real estate within the scope of the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. §§9601 *et seq.* (CERCLA). Sellers or buyers of commercial property must comply with these new requirements or risk losing innocent purchaser and other defenses. This article will explain the purpose and history of AAI, the legal liability context for buyers and sellers of commercial real estate, and the key provisions of AAI.

Purpose of AAI

Liability and cost are the two mainstays of conducting environmental due diligence under CERCLA and Florida law. This process was introduced at the federal level with the enactment of CERCLA in December 1980, where the threat of liability and costs of cleanup brought new concerns for real estate transactions. The effect of CERCLA imposed liability on those properties which had suffered a release or threatened release of hazardous substances. In October 1986, the Superfund Amendments and Reauthorization Act

(SARA), Pub. L. No. 99-499 (1986), amended CERCLA by establishing an innocent landowner defense to liability. However, SARA did not establish eligibility requirements for the defense. As a result, in January 2002, the Small Business Liability Relief & Revitalization Act, Pub. L. No. 107-118 (2002) (known as the Brownfields Amendments), clarified requirements of the innocent landowner defense and added two more defenses, discussed below. In order to be eligible for these defenses, a buyer or seller must have performed "all appropriate inquiries" into previous ownership, uses, and environmental conditions.¹ The phrase "all appropriate inquiries" has become the EPA's version of conducting environmental due diligence, the process of assessing conditions within a property for the presence or threatened presence of contamination.

History of AAI

The high costs associated with cleaning up contaminated properties motivated Congress to establish a superfund that would attempt to deal with some of the costs incurred by prospective purchasers. The enactment of CERCLA set up this superfund to allay the costs, but also imposed liability on owners and operators of the contaminated properties. Owners and operators are held strictly liable for the incurrence costs regardless of who caused the actual contamination. The enactment of SARA established the innocent landowner defense to avoid liability for acquiring contaminated property. Yet again, in January 2002, the Brown-

fields Amendments added two additional defenses to CERCLA liability: bona fide prospective purchaser and contiguous property owner. All three defenses required those seeking protection from liability to conduct "all appropriate inquiries." The effect of these new defenses begged the question: what exactly were "all appropriate inquiries"? The SARA amendments touched upon this concept in their innocent landowner defense, but it remained a mystery to many. In response, Congress directed the EPA to promulgate a set of standards delineating what is necessary to perform all appropriate inquiries, and in the meantime set up interim standards to assist parties involved in real estate transactions. In November 2005, the EPA published the "Standards and Practices for All Appropriate Inquiries" which became effective on November 1, 2006. Additionally, the American Society for Testing and Materials (ASTM), a private standard-setting organization, established standards that comply with these federal requirements and assist buyers and sellers in conducting successful all appropriate inquiries. The ASTM also created a new standard, E1527-2005, to comply with the new EPA AAI rule.

Defenses to CERCLA Liability

To claim a defense to CERCLA liability, a buyer or seller must demonstrate they had no reason to know that a hazardous substance was present on the property by conducting all appropriate inquiries into the previous ownership and uses on

or before the date of acquiring the property. It is important to note that the EPA's new AAI rule is just one of the many steps required for protection from liability. Additionally, to be afforded liability protection, one must perform other continuing obligations, such as providing access and information to the contaminated property. Moreover, the new EPA AAI rule relates to the federal standard only, and does not apply expressly to state and local standards, which are discussed below.

To claim an innocent landowner defense, the buyer or seller must establish by a preponderance of evidence that the release or threatened release was caused by an independent third party and that they did not know or have reason to know of the contamination or threatened contamination. Also, they must show they exercised due care with respect to identifying any conditions related to hazardous substances and with respect to foreseeable acts or omissions of the third party.²

To claim a bona fide purchaser defense, purchasers must have purchased the property after January 11, 2002 (the date of the Brownfields Amendments), and show they are not liable or associated with any party potentially liable. A bona fide prospective purchaser may have knowledge of the contamination and continue to purchase the property, but only after conducting all appropriate inquiries and performing the other continuing obligations.³

A contiguous property is a property situated near the contaminated property that may be contaminated as a result of the activities on the contaminated property. To claim this defense, the owner or buyer must show they did not cause, contribute, or consent to any release and also that they did not know or did not have reason to know of contamination at the time they acquired the property after conducting all appropriate inquiries.⁴

In addition to conducting all appropriate inquiries into previous ownership and uses, a party seeking a defense to liability must also perform other continuing obliga-

tions. This includes complying with any land use restrictions, taking reasonable steps with regard to hazardous substances, not impeding institutional controls, and providing assistance, cooperation, and access to the EPA.⁵

Defenses to Florida Law Liability

In Florida, discharges or releases of pollutants from facilities are heavily regulated. Liability is imposed generally under the Pollutant Discharge Prevention and Control Act and the Florida Air and Water Pollution Control Act, F.S. Chs. 376 and 403. Specifically, F.S. §376.302 provides that "it shall be prohibited for any reason: to discharge pollutants or hazardous substances into or upon the surface or ground waters of the state or lands..." In addition, F.S. §403.161(1) provides that "it shall be prohibited for any person: to cause pollution ... so as to harm or injure human health or welfare, animal, plant, or aquatic life or property."⁷

The Florida Department of Environmental Protection is authorized to file a civil suit against any person who caused a discharge of pollutants or hazardous substances, or who owned or operated a facility at which the discharge occurred.⁶ Individuals who have suffered damages resulting from a discharge or condition of pollution are also covered by these statutes.⁷ In *Aramark Uniform and Career Apparel v. Easton*, 894 So. 2d 20 (Fla. 2004), the Florida Supreme Court held that F.S. §376.313(3) creates a private cause of action imposing strict liability for damages against an adjoining landowner without proof that the defendant actually caused the pollution. In addition, the court held the defendant is limited to the statutory defenses found in F.S. §376.308(1)(c).⁸

It should be noted that the environmental due diligence requirements discussed in this article under federal and Florida law apply to purchase and sale of commercial property only and not to residential property. It also should be noted that in Florida, caveat emptor applies in the sale of commercial property only.⁹

The statutory defenses available under F.S. §376.308(2) include an act of war, an act of government, an act of God, or an act or omission of a third party. To claim a defense based on an act or omission of a third party, the statute requires that defendant exercised due care with respect to the contamination and took the appropriate precautions against the third party's acts or omissions. Additionally, Florida Statutes provide a functional equivalent to the EPA's all appropriate inquiries. In cases of petroleum products or dry cleaning solvents, the defendant must establish that the prior owner or other third party caused the contamination. Furthermore, under F.S. §376.308(1)(c), if the owner acquired the property after July 1, 1992, the defendant must have conducted "all appropriate inquiry into the previous ownership and use of the property." Florida's all appropriate inquiry standards in F.S. §376.308(1)(c) include visual inspections, defendant's specialized knowledge, relationship of purchase price to value, commonly known information, and the degree of obviousness of contamination. In light of Florida's all appropriate inquiry scheme, taking into account its acceptance of the ASTM standards, it seems likely that compliance with EPA's AAI would also extend to compliance with Florida's AAI requirements.¹⁰

Key Provisions of the AAI Rule

The purpose of the AAI rule is expressed in its "objectives and factors." Environmental professionals, sellers, and buyers should always keep an eye on these in conducting all appropriate inquiries under the rule.

Prior to the new AAI rule, it was not clear who qualified as an "environmental professional." Now, there are specific standards to be met in order to qualify, with an emphasis on experience. One with 10 or more years of full-time relevant experience may qualify as an environmental professional without having a college degree. Those who have a science or engineering degree coupled with five or more years of full-time

relevant experience also qualify as an environmental professional. The requirement of experience lessens to three or more years with a professional engineering or professional geologist license. A qualifying environmental professional may also be licensed or certified by the federal or state government and have three or more years of relevant full-time work experience. All types of qualifying professionals must remain current in their field, and their experience should consist of participation in environmental site assessments.

Regarding documentation of results, while there are no requirements as to length or format or even submission to the EPA, the new rule requires a written report documenting the results of all appropriate inquiries. The party seeking liability protection should use this opportunity to document the required evidence to qualify for the protection. Additionally, the new rule requires two signed declarations by the environmental professional. The first declaration should attest that the environmental professional meets the qualifications, but there is no explicit requirement of proof. The second declaration states that the standards and requirements of all appropriate inquiries have been carried out successfully.

The new rule requires the environmental professional or someone under his or her supervision to conduct "interviews" of past and present owners, occupants, operators, facility managers, and even nearby owners and operators in cases of abandonment. Whether all of these interviews are necessary is left to the environmental professional's discretion. However, interviews must be conducted in full accordance with the objectives and factors of all appropriate inquiries. It should always be kept in mind that the fundamental purpose of conducting all appropriate inquiries is to identify conditions that would lead one to believe a release has or will occur. The new rule does not specify which questions should be asked during the interview, but the environmental professional should have those goals

in mind.¹¹

The new rule requires "on-site visual inspections" of the subject property, including the facilities and places where hazardous substances may have been used, stored, or handled. There are certain foreseeable instances where an on-site visual inspection may be impractical, such as where the current owner will not allow the inspection or it is physically

impossible to inspect certain areas. However, in these limited cases, the environmental professional must document these situations. Also, it is important to note that mere refusal to allow access by the current owner should not be accepted until a good faith effort has been made to inspect the property. One could imagine inquiring repeated times or possibly taking aerial photos and

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even standing at the property line to inspect. Additionally, the new rule recognizes that most of these limited situations involve a local government attempting to cleanup an abandoned property and gives certain flexibility to those situations for the benefit of the community.

The inclusion of “specialized knowledge” on behalf of the defendant originates from the 1986 SARA amendments. Since CERCLA imposes liability, the party claiming a defense to liability is known as the “defendant.” In the course of conducting all appropriate inquiries, which in essence is to identify any conditions that may evidence a release or threatened release of a hazardous substance, the defendant is required to include any specialized knowledge he or she may possess. In determining whether all appropriate inquiries have been successfully completed, courts use their discretion to take into account any specialized knowledge the defendant had. For instance, a bona fide prospective purchaser would be unable to claim he or she had no reason to know the property was contaminated if he or she possessed knowledge of the prior owners’ business activities. While the defendant is not required to share his or her knowledge with the environmental professional, the written report prepared by the professional must treat that as a data gap and inquire whether the choice not to share is indicative of an environmental condition leading to contamination.

When the property is not contaminated, the new rule still requires that a “comparison between the purchase price of the property and the fair market value” of the property be made. This requirement was first introduced in the 1986 SARA amendments, and the new rule is merely a continuation of the old rule. This relationship may be ascertained by the defendant (prospective landowner) or the environmental professional, despite public concern that environmental professionals lack adequate knowledge to make a judgment of value. However, if this concern exists, the prospective landowner may hire a third party to evaluate the relationship between

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price and value, although an appraisal is not required. In evaluating this relationship, one should take into account any discrepancies between the price and value and ask whether this may be evidence of a potential environmental condition of contamination.¹²

The requirement to include any “commonly known information” is another holdover from the 1986 SARA amendments. In establishing defense to liability, the prospective landowner should take into account any information that is commonly known. This includes a variety of sources such as newspapers, community organizations, Web sites, and local government officials. As one can imagine, much of this information may have already been collected at some point during the all appropriate inquiries process. Again, the prospective landowner and the environmental professional must always consider the objectives of conducting all appropriate inquiries: to identify conditions indicative of a release or threatened release of hazardous substances. Neighboring owners may have information that cannot be found on public record and those conducting all appropriate inquiries must take these possibilities into account.

A review of “historical sources” is necessary to identify past uses and occupancy that may give rise to potential contamination. The new rule requires the search to be conducted

far enough into the past to reasonably evaluate the possibility of contamination, and may need to go back to the first use of the property or when the first structures were placed there. It is the environmental professional’s discretion as to how far back the review should be. While there is no set number of documents required, again, the idea is to meet the objectives and factors required in conducting all appropriate inquiries. A search of historical sources may include chain of title documents, aerial photographs, building department records, land use records, or fire insurance maps.

A search of any “environmental cleanup liens” is important in identifying possible releases of hazardous substances for obvious reasons. A lien for an environmental cleanup is placed when incurrence costs have resulted from an environmental condition. These conditions are likely to identify past and future contamination. The search may be conducted by either the prospective landowner or the environmental professional, although the landowner may prefer to conduct the search in efforts to reduce costs. Liens can typically be found on chain of title documents and are rather easy to identify. Be aware though, the EPA may issue a lien on the property after all appropriate inquiries have been completed if they are in the process of cleaning up a property.¹³

A review of “federal, state, local and tribal records” with emphasis on “engineering and institutional controls” is also required. The scope of this inquiry is limited only to the subject property and not to nearby properties, although reviewing those in addition may be helpful. Institutional controls may include any legal limitations or land use restrictions imposed upon the property that attempt to protect the public. Engineering controls work to eliminate possible exposure to hazards that may include a physical barrier. Identifying any engineering or institutional controls is valuable for the prospective landowner, as they will be required to cooperate with those controls after acquiring the subject property. This requirement is part of the continuing obligations

imposed upon those who claim a defense to liability, and is separate from conducting all appropriate inquiries. In addition to identifying controls on the property, there are other sources which should be reviewed including records of landfill locations, disposal units, storage tanks, hazardous waste handlers, other cleanup sites, and spills.

Once all the information has been gathered, the prospective landowner and environmental professional should look at the totality of circumstances to identify whether "any obvious" contamination has occurred or will occur. Additionally, the environmental professional should determine whether the data and information collected renders necessary additional inquiry into the possibilities of contamination. Although taking samples of the land is not required at this stage, it may be helpful in completing this step successfully. Any efforts to identify harmful conditions should be taken.

The new rule requires extensive documentation of "data gaps," especially since the prospective landowner is not required to share information they ascertain with the environmental professional. In those cases, the environmental professional should treat the lack of information as a data gap and consider whether additional investigation is appropriate. Additionally, the sources used in gathering information should be documented.¹⁴

While the statutory language of CERCLA does not provide hard criteria as to "when" one should conduct all appropriate inquiries, the new rule says it should be within one year prior to acquiring title to the property. The new rule permits use of prior "all appropriate inquiries"; however, if they were performed more than a year prior, the study must be completely updated. Also, the rule allows prior studies that were conducted in compliance with past standards, including the standards from the ASTM.¹⁵ For instance, studies on property purchased on or after May 31, 1997, may have been conducted in compliance with the ASTM E1527-97 standard or the ASTM E1527-2000 standard. For studies on property purchased before May 31, 1997, compliance with

CERCLA will be accepted. However, the prior studies must be updated using the standards and practices set forth in the new rule. Furthermore, the following parts of all appropriate inquiries must be conducted within 180 days of acquiring title to the property: interviews, environmental cleanup lien searches, reviews of federal, tribal, state and local government records, visual inspections, and the environmental professional's declaration.¹⁶

Finally, it should be noted that the ASTM is a not-for-profit organization that publishes the standards required to be in compliance with CERCLA and the other statutory provisions amending CERCLA. ASTM is made up of committees, such as Committee E-50 on Environmental Assessment, which in turn is composed of environmental engineers, real estate and insurance professionals, and government representatives. ASTM has updated its standards for a Phase I environmental site assessment. The new standard, ASTM E1527-2005 has been updated to reflect EPA's new all appropriate inquiries rule.¹⁷

Conclusion

The new EPA AAI rule and the new ASTM standard for conducting environmental site assessments of commercial real estate are important new tools in the process of evaluating impacts to commercial real property associated with environmental conditions and the allocation of responsibility and liability related thereto. It is important for buyers and sellers of such properties, as well as attorneys and environmental professionals, to be familiar with these new rules. Should such persons fail to comport with these requirements, the protections of federal and state law otherwise available to them will be lost. In addition, as a practical matter, a purchaser of contaminated property in particular will not know what he or she is buying, and this lack of knowledge could diminish significantly the value of such property and frustrate his or her plans. In this regard, inquiring minds need to know the new all appropriate inquiry standards or beware of the consequences. In this case, what you do not know *can* hurt you! □

¹ See 42 U.S.C. §9601(35)(B)(i).

² AAI, 70 Fed. Reg. at 66,074.

³ AAI, 70 Fed. Reg. at 66,073.

⁴ AAI, 70 Fed. Reg. at 66,073.

⁵ Parties looking to receive a Brownfields grant (under the 2002 Brownfields Amendments) are also required to conduct all appropriate inquiries. See 42 U.S.C. §9604(k)(2)(B).

⁶ FLA.STAT. §376.308(1).

⁷ FLA.STAT. §376.313(3).

⁸ For a discussion of this case, see Ralph A. DeMeo, Carl Eldred, Lisa J. Feuerstein, *Florida Supreme Court Takes Property Owners to the Cleaners: The Impact of Aramark v. Easton*, 79 FLA. B.J. 66 (June 2005).

⁹ See *RNK Family Limited Partnership v. Alexander-Mitchell Associates*, 788 So. 2d 1035 (Fla. 2d D.C.A. 2001); *Moustoufi v. Presto Food Stores, Inc.*, 618 So. 2d 1372 (Fla. 2d D.C.A. 1993).

¹⁰ For a comparison of the new AAI and state standards, see EPA, All Appropriate Inquiry Criteria Analysis/Comparison to State, Federal, and Commercial Assessment Approaches, EPA 500-F-03-229 (June 2003).

¹¹ AAI, 70 Fed. Reg. at 66,077-89.

¹² AAI, 70 Fed. Reg. at 66,095-99.

¹³ AAI, 70 Fed. Reg. at 66,092-100.

¹⁴ AAI, 70 Fed. Reg. at 66,088-101.

¹⁵ For a comparison of the new AAI and previous standards see EPA, Comparison of the Final All Appropriate Inquiries Standard and the ASTM E-1527-00 Env'tl. Site Assessment Standard, EPA 560-F-05-242 (Oct. 2005); see also New Env'tl. Due Diligence Standards (ABA Section of Environment, Energy, and Resources and the ABA Center for Continuing Legal Education, Oct. 31, 2006); New EPA "All Appropriate Inquiry" Regulations: EPA Clarifies the Standard for Env'tl. Site Assessments (ABA Section of Environment, Energy, and Resources and the ABA Center for Continuing Legal Education CD-ROM, Sept. 27, 2004).

¹⁶ AAI, 70 Fed. Reg. at 66,084.

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