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Environmental Due Diligence in the Wake of *Atlantic Richfield*

By Maria de la Motte and Dianne R. Phillips*

The U.S. Supreme Court's decision in Atlantic Richfield Co. v. Christian *confirmed the broad statutory definition of "Potentially Responsible Party" under the Comprehensive Environmental Response, Compensation, and Liability Act. The decision underscores the importance of environmen-tal due diligence prior to purchasing, leasing or financing a property, including conducting "All Appropriate Inquiries," not only to establish a landowner liability defense, but also to understand continuing obligations with respect to a contaminated property. This article provides a refresher on the key components of All Appropriate Inquiries.*

The U.S. Supreme Court's decision in *Atlantic Richfield Co. v. Christian*[1] confirmed the broad statutory definition of "Potentially Responsible Party" ("PRP") under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"),[2] also known as the Superfund statute. The decision highlights that environmental due diligence, including conducting "All Appropriate Inquiries" in accordance with 40 C.F.R. § 312, remains as important as ever in real estate transactions.

BACKGROUND

The Anaconda Copper Smelter in Butte, Montana, had contaminated an area of over 300 square miles with arsenic and lead.[3] The U.S. Environmental Protection Agency ("EPA") and the current owner of the since-closed smelter, Atlantic Richfield Company, had worked together for 35 years to implement a remediation plan slated to continue through 2025.[4] A group of 98 neighboring landowners, who had proposed an alternative cleanup plan that exceeded the measures EPA had deemed necessary to protect the environment and human health, sued Atlantic Richfield in Montana state court for common law nuisance, trespass and strict liability, seeking restoration damages and other

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1 Slip Op. No. 17-1498 (April 20, 2020).

2 42 U.S.C. § 9601 *et seq.*

3 Opinion at 1.

4 *Id.* at 1, 4.

remedies.[5] The U.S. Supreme Court held that the neighboring landowners were PRPs and, therefore, could not initiate their desired remedial actions on their properties without approval from EPA as required by Section 122(e)(6) of CERCLA.[6]

Atlantic Richfield Co. is a timely reminder of the importance of environmental due diligence in real estate transactions, including conducting All Appropriate Inquiries, not only to qualify for a landowner liability defense, but also to understand continuing obligations and potential constraints on remediation and development plans prior to closing a deal. CERCLA imposes strict, joint and several liability on property owners and operators for releases of hazardous substances. Liability for remediation costs can be substantial, even for parties who did not cause the contamination, as recent case law reinforces.[7]

LANDOWNER LIABILITY DEFENSES

The 2002 Small Business Liability Relief and Brownfields Revitalization Act, the "Brownfields Amendments" to CERCLA, included three landowner liability defenses:

(1) For "innocent landowners"[8] ("ILOs");

(2) For "contiguous property owners"[9] ("CPOs") who can demonstrate that they did not know and had no reason to know of the contamination prior to acquiring the property; and

(3) For "bona fide prospective purchasers"[10] ("BFPPs") who may purchase or lease property with knowledge of contamination provided they meet the regulatory requirements.

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[5] *Id.* at 1.

[6] *Id.* at 13.

[7] *See, e.g.*, *Von Duprin LLC v. Moran Electric Service Inc.*, No. 1:16-cv-01942-TWP-DML (S.D. Ind. Mar. 3, 2020), appeal docketed, No. 0:20-cv-01793 (7th Cir. May 12, 2020) (current owners held liable for 100 percent of the harm on two parcels even though they had not "used, generated, transported, treated, stored, or disposed of any of the hazardous substances at issue . . . on any of the properties at issue, at any time"); *Valbruna Slater Steel Corp. v. Joslyn Manufacturing Co.*, 934 F.3d 553 (7th Cir. 2019) (no-fault owner held liable for 25 percent of past and future cleanup costs). Recoverable remediation costs include those incurred before the current owner acquired the property. *See generally Pennsylvania Dep't of Envtl. Protection v. Trainer Custom Chemical LLC,* No. 17-2607 (3rd Cir. Oct. 5, 2018).

[8] CERCLA §§ 101(35)(A-B) and 107(b)(3).

[9] CERCLA § 107(q)(1)(A).

[10] CERCLA §§ 101(40)(B)(i)-(viii) and 107(r).

The BFPP defense was interpreted by EPA to allow tenants to establish the defense.[11]

The ILO and CPO defenses are difficult to establish due to the requirement that the party did not know or have reason to know of the contamination, which is highlighted in *Atlantic Richfield Co.*, where the neighboring landowners had argued in the alternative that they qualified as CPOs.[12] The Court quickly dismissed this argument, citing public knowledge of the contamination and the fact that in the early 1900s, the Anaconda Company had obtained smoke and tailing easements authorizing the disposition of waste onto many of the landowners' properties.[13] Additionally, CPOs must cooperate with EPA to maintain their status, which these landowners, in seeking to implement a conflicting plan, had not done.[14]

The BFPP defense, however, has become the bedrock of environmental due diligence in anticipation of a real estate acquisition or lease. Even though few properties make it on to the Superfund National Priorities List, sophisticated real estate developers, lenders, investors, and ordinary businesspeople now routinely undertake environmental due diligence prior to acquiring or leasing real estate.

ALL APPROPRIATE INQUIRIES MUST BE CONDUCTED

While the three landowner liability protections involve some different elements, common to all three is that as a threshold matter, a party must demonstrate that it made All Appropriate Inquiries ("AAI"),[15] including seeking a Phase I Environmental Site Assessment ("ESA") from a qualified environmental professional. EPA recognizes two ASTM International Standards as compliant with AAI requirements: (1) ASTM E1527-13 "Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process," and (2) for rural areas, E2247-16 "Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process for Forestland or Rural Property."[16]

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[11] For information about establishing and maintaining the BFPP defense as a tenant, refer to the EPA guidance at https://www.epa.gov/sites/production/files/2015-08/documents/tenants-bfpp-2012-mem-note.pdf.

[12] Opinion at 20.

[13] *Id.* at 21.

[14] *Id.*

[15] CERCLA §§ 101(40)(B)(ii), 107(q)(1)(A)(viii), and 101(35)(A)(i),(B)(i).

[16] 40 C.F.R. § 312.11.

AAI must be conducted or updated within one year prior to closing, with certain elements required to be completed within 180 days prior to closing.[17] Proper timing is critical. In a recent case where a party leased a property relying on a stale Phase I ESA, then later purchased the same property relying on a new, properly timed Phase I ESA, the tenant-turned-purchaser did not qualify for the BFPP defense, because the initial stale report could not be cured by obtaining a new report, even in an entirely new transaction.[18]

Equally important is ensuring that the Phase I ESA report is addressed to the correct entity or that a proper reliance letter is obtained. For example, in another recent case where a borrower brought a breach of contract claim against an environmental consultant for a false and misleading report, a federal district court found a disclaimer in the report dispositive, which stated that the report had been prepared for the sole use of the consultant's client, the lender, and that no other party may use the report without written permission.[19] It did not matter that the consultant had a general awareness that multiple parties rely on environmental assessments, that a service agreement had contained language that the report should have been addressed to both lender and borrower, that the reason to perform the assessment was because the borrower sought a refinancing or that the borrower would pay the costs of the report at closing.[20] The BFPP protection can even be lost if a Phase I ESA report is addressed to an incorrect entity within the same corporate group as the owner or tenant.[21]

While case law focusing specifically on AAI is limited, it is clear is that an owner or tenant must scrupulously follow all of the regulatory requirements set forth in 40 C.F.R. § 312.[22] For example, a submission not discussing the "numerous regulatory requirements for making appropriate inquiries" was "woefully insufficient" to establish the BFPP defense.[23] A discussion of the requirements under 40 C.F.R. Part 312 for AAI follows.

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[17] 40 C.F.R. § 312.20.

[18] *Von Duprin LLC v. Moran Electric Service Inc.*, No. 1:16-cv-01942-TWP-DML (S.D. Ind. Mar. 3, 2020), appeal docketed, No. 0:20-cv-01793 (7th Cir. May 12, 2020).

[19] 105 *Mt. Kisco Associates LLC v. Carozza*, No. 7:2015cv05346 (S.D.N.Y. Dec. 20, 2019).

[20] *Id.*

[21] *See Von Duprin LLC v. Moran Electric Service Inc.*, No. 1:16-cv-01942 (S.D. Ind. Feb. 11, 2019) (entry on the parties' cross-motions for summary judgment) (Phase I ESA report was prepared for Major Tool and Machine, but Major Holdings was the nominal owner of the parcel).

[22] *See Von Duprin LLC v. Moran Electric Service Inc.*, No. 1:16-cv-01942-TWP-DML (S.D. Ind. Mar. 3, 2020), appeal docketed, No. 0:20-cv-01793 (7th Cir. May 12, 2020).

[23] *Voggenthaler v. Maryland Square LLC*, 724 F.3d 1050, 1063 (9th Cir. 2013).

Within 180 Days Prior to Closing

- Interviews with current and past owners, operators and occupants (in the case of abandoned properties, interviews with one or more neighboring property owners);[24]
- Searches for recorded environmental cleanup liens filed against the property;[25]
- Review of federal, state, tribal and local government records, including records indicating land use restrictions and institutional controls;[26]
- Visual inspection of the facility and adjoining properties;[27] and
- A signed declaration of the environmental professional.[28]

Within One Year Prior to Closing

- Review of historical sources of information;[29]
- Review of commonly known or reasonably ascertainable information about the property;[30]
- Assessment of any specialized knowledge or experience of the prospective landowner;[31]
- Assessment of the relationship of the purchase price to the fair market value of the property if the property was not contaminated;[32] and
- Assessment of the degree of obviousness of the presence or likely

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[24] 40 C.F.R. § 312.23. *See BankUnited, N.A. v. Merritt Envtl. Consulting Group*, 360 F. Supp. 3d 172, 180 (S.D.N.Y. 2018) (failure to conduct such interviews produced a "defective and misleading Phase I Report").

[25] 40 C.F.R. § 312.25. ASTM intends to clarify in the next update to Standard Practice E1527 that parties ordering what are commonly referred to as activity and use limitation (AUL) and environmental lien search reports should be sure that the title information vendors are searching in the land title records at least as far back as 1980.

[26] 40 C.F.R. § 312.26.

[27] 40 C.F.R. § 312.27.

[28] 40 C.F.R. § 312.21. *See Von Duprin LLC v. Moran Electric Service Inc.*, No. 1:16-cv-01942 (S.D. Ind. Feb. 11, 2019) (entry on the parties' cross-motions for summary judgment) (court specifically mentioned the absence of this certification, among other deficiencies, in finding that AAI had not been met).

[29] 40 C.F.R. § 312.24.

[30] 40 C.F.R. § 312.30.

[31] 40 C.F.R. § 312.28.

[32] 40 C.F.R. § 312.29.

presence of contamination at the property and the ability to detect the contamination.[33]

Conducting AAI is only a threshold requirement, and there are several additional and continuing requirements to obtain and maintain the landowner liability protections. For example, to secure and maintain BFPP status, a party is required to demonstrate that it has no affiliation with any potentially liable parties,[34] demonstrate that there has been no disposal after acquisition,[35] exercise appropriate care by taking steps to stop any release and prevent any future release,[36] comply with any land use restrictions and not impede the effectiveness or integrity of any institutional controls,[37] fully cooperate with and allow access to the site for ongoing response actions,[38] provide all legally required notices[39] and comply with all requests for information.[40]

CONCLUSION

Properly completed AAI, in addition to being necessary to establish a landowner liability defense, can help parties understand the continuing obligations and limitations that may exist with respect to a contaminated property prior to closing, rather than later like the neighboring landowners in *Atlantic Richfield Co.*

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[33] 40 C.F.R. § 312.31.

[34] CERCLA § 101(40)(B)(viii). For information on the non-affiliation requirement, refer to the EPA guidance at https://www.epa.gov/sites/production/files/2013-11/documents/affiliation-bfpp-cpo.pdf.

[35] CERCLA § 101(40)(B)(i).

[36] CERCLA § 101(40)(B)(iv). *See PCS Nitrogen Inc. v. Ashley II of Charleston LLC*, 714 F.3d 161, 180 (4th Cir. 2013) (owner did not exercise the appropriate care required to establish the BFPP defense where it "failed to clean out and fill in sumps that should have been capped, filled, or removed when related aboveground structures were demolished" and "did not adequately monitor and address conditions relating to a debris pile"); *Voggenthaler v. Maryland Square LLC*, 724 F.3d 1050, 1063 (9th Cir. 2013) (requirement to prevent further harm not met where owner hired a contractor to demolish a building, but did not describe any remedial steps in affidavit, including removing the soil after demolishing the building).

[37] CERCLA § 101(40)(B)(vi).

[38] CERCLA § 101(40)(B)(v).

[39] CERCLA § 101(40)(B)(iii).

[40] CERCLA § 101(40)(B)(vii).