

Why New Phase I Site Standard Matters For Real Estate

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The preeminent standard for Phase I environmental site assessments — an essential part of transactional due diligence — is changing. Last month, ASTM International, the leading technical standards organization, published the highly anticipated update to the Phase I environmental site assessment, or ESA, process.

The new standard should be followed by interested parties in transactions involving real estate if they wish to claim certain liability protections under the Comprehensive Environmental Response, Compensation, and Liability Act, or CERCLA, also known as the Superfund law, as well as other benefits offered by many states.

The new standard, known as E1527-21, is an update to E1527-13, and is based on lessons learned, as shared by practicing environmental professionals and users of the standard, as well as a review of recent litigation and claims arising from Phase I ESA disputes.

An Essential Part of Transaction Due Diligence

The U.S. Environmental Protection Agency's all appropriate inquiries, or AAI, rule represents the minimum level of environmental due diligence required to afford certain liability protections under CERCLA. ASTM's E1527 is used by the vast majority of environmental professionals when completing AAI as part of real estate transaction due diligence.

Interested parties in real estate transactions and mergers and acquisitions — including owners, operators, developers, lenders, insurance providers, and bond issuers and underwriters — will be affected by the newly updated standard.

A Phase I investigation is essential to environmental due diligence for any transaction involving real estate. Interested parties often rely solely on the Phase I ESA findings to evaluate the environmental risks and liabilities associated with the property.

Phase I ESAs are also used by the EPA, and state environmental agencies, to determine whether



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sufficient environmental due diligence has been conducted to afford certain liability protections under CERCLA and state counterparts.

The Changes

While the update includes many small improvements, some of the key changes include:

- Definitional clarifications to improve consistent identification by environmental professionals of recognized environmental conditions, or RECs;
- Significantly expanded procedures for researching historical uses of the subject property and adjoining properties;
- Identification of emerging contaminants as a nonscope consideration;
- Clarification of the obligations of the user of the Phase I report to search for environmental liens;
- Changes to information that must be included in a Phase I report, including expanded findings and opinions sections, and required photographs and figures;
- A new definition for a "significant data gap" that affects the environmental professional's ability to identify RECs, and guidance on how to address a gap;
- Addition of examples and a decision flow chart as a guide for practitioners to help ensure consistency; and
- Clarification that various components of the Phase I ESA must be completed within 180 days prior to the transaction date, not the report date.

Changes That May Have the Most Effect on Phase I ESAs

RECs

The updated standard clarifies key terms, including REC; controlled recognized environmental condition, or CREC; and historical recognized environmental condition, or HREC. The standard also adds new definitions for the terms "likely" — in the context of whether there is the likely presence or likely release of a hazardous substance — and "property use limitation" as it pertains to CRECs.

To help environmental professionals perform consistent assessments, the standard adds an appendix with examples of conditions that represent RECs, CRECs and HRECs, and a flow chart to aid in identifying the type of REC at issue.

The clarifications may lead to identification of RECs or ASTM-designated business environmental risks that would not have been identified previously — and in some instances, may lead to elimination of RECs previously identified out of an abundance of caution or a misapplication of the standard.

The standard also calls for more detailed discussion of the logic for each REC, CREC and HREC determination and conclusions. Though the standard does not compel Phase II sampling, the

identification of more RECs, or of a more focused list of RECs, may lead to additional inquiry if elected by the interested party based on the Phase I findings.

Historical Use Research

The standard expands the scope of diligence for historical research and interviews concerning prior use of the subject property, adjoining properties and the surrounding area. The expanded procedures may lead to identification of RECs or business environmental risks that would otherwise not have been identified.

Upon identification of an off-site release of a hazardous substance that has migrated to the subject property, consideration should be given to the potential impacts to occupants and future uses of the subject property, as well for business interruptions caused by the possibility of continuing investigation and remediation of the off-site property that requires access to the subject property.

Additionally, if investigation of the off-site release identifies the subject property as a contributing source in a state where liability is joint and several, there are significant cost considerations beyond those that would be incurred simply from an on-site investigation and/or cleanup.

How the New Standard Addresses Emerging Contaminants

Per- and polyfluoroalkyl substances, or PFAS, and other emerging contaminants are not yet designated by the EPA as hazardous substances under CERCLA.[1] As such, they do not meet the definition of RECs, and therefore fall outside the scope of Phase I ESAs.

However, the updated standard includes additional guidance suggesting that emerging contaminants be included in a Phase I ESA to satisfy any applicable state or local requirement for claiming liability defenses if the state defines the contaminant as hazardous.

Additionally, as we expected, the new standard includes the option that any party seeking a Phase I ESA can request the inclusion of emerging contaminants as a nonscope consideration, even if the state where the property is located does not regulate the contaminant.

Nonscope considerations are those that may present environmental risks associated with a property, but which are not required to be assessed under the AAI rule for claiming applicable CERCLA defenses, because they are not regulated as hazardous substances under the Superfund law. Nonscope considerations have included such items as asbestos, PCBs, lead-based paint, mold and radon.

Many states are now regulating PFAS in drinking water, including Massachusetts, Maine, New Hampshire, New Jersey, New York and Vermont, while others either have guidance or notification levels, including Alaska, California, Colorado, Connecticut, Delaware, Illinois, Minnesota, North Carolina, New Mexico and Ohio.

The necessity to evaluate the potential for PFAS at the subject property as a nonscope consideration will increase as local regulatory agencies continue to adopt standards and protocols for addressing emerging contaminants.

For example, in New Jersey, certain transactions are considered a triggering event, subjecting the property to the state's regulatory program requiring an environmental assessment that should consider

the potential presence of emerging contaminants based on historical operations or historical releases — regardless of the closure status of any prior environmental issues.

In states with similar programs, it would be prudent to identify any potential use or release of an emerging contaminant like PFAS as part of due diligence. If PFAS or other emerging contaminants are identified as potentially present at the subject property, further inquiry may be appropriate to consider more fully the risk associated with a property transaction.

All Appropriate Inquiry Status

While ASTM International has approved and published E1527-21 as the current standard, and demoted E1527-13 to historical standard status, it may take the EPA up to a year to update the AAI rule^[2] to reference E1527-21 as compliant with AAI.

However, given that the updated standard clarifies and expands the E1527-13 standard, Phase I ESAs completed using the E1527-21 clarifications — new or revised definitions and expanded procedure — should also be compliant with the AAI rule.

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[1] According to the EPA's PFAS strategic road map for 2021-2024, released on Oct. 18, 2021, EPA intends to designate certain PFAS compounds as CERCLA hazardous substances in a proposed rule expected in spring 2022, with a final rule expected in summer 2023. If and when any emerging contaminants are designated as hazardous substances under CERCLA, they would be evaluated under the Standard and would not be considered "non-scope."

[2] 40 C.F.R. Part 312.