

PHASE I Environmental Site Assessments

What You Need to Know to Close Your Deal

By Andrew Brought

As someone who frequently helps businesses buy and sell commercial and industrial properties, I frequently encounter misunderstandings about Phase I Environmental Site Assessments (ESAs) and their role in a property transaction. Although not an exhaustive list, these 10 items are among the most important you should know about for your next property transaction.

1. THEY DON'T DO WHAT YOU THINK THEY DO

The purpose of conducting a Phase I ESA is to avoid legal liability for pre-existing contamination. Contrary to popular belief, they are not a comprehensive environmental due diligence review. Rather, Phase I ESAs are standardized assessments using a practice issued by ASTM (E1527-13) intended to identify conditions indicating the presence of

surface or subsurface contamination, such as a release from underground storage tanks or chemical solvents like perchloroethylene from a legacy dry-cleaning establishment.

If done properly, a buyer can satisfy one of three legal defenses under the federal Superfund law (CERCLA); a law that otherwise makes landowners strictly liable for pre-existing contamination, even if they were not the cause. Consequently, a property buyer can avoid this federal liability by undertaking “all appropriate inquiries” into the uses and conditions of the property, and hence the need for a Phase I ESA before property acquisition that complies with the ASTM standard and EPA’s All Appropriate Inquiries Rule at 40 CFR Part 312.

To be clear, however, a Phase I ESA is not a guarantee that there is no subsurface contamination, nor does it automatically protect against third-party toxic tort claims or liability asserted by state or local entities.

2. A PHASE I ESA ALONE IS NOT ENOUGH

To qualify for the legal defenses, a prospective buyer must also conduct a title search for any recorded environmental cleanup liens and also search for activity use limitations on the property. Such activity use limitations can include, for example, deed restrictions limiting the use of the property to only industrial or commercial uses, or prohibiting the use or installation of groundwater



wells. These searches rest with the prospective buyer and not the Phase I environmental consultant, as most Phase I ESA contracts will exclude such a review.

3. IF CONTAMINATION EXISTS, YOU CAN STILL CLOSE THE DEAL AND AVOID FEDERAL CLEANUP LIABILITY

Yes, that's right. Even if a "recognized environmental condition" (REC) is identified by the Phase I ESA, there is a legal defense known as the "bona fide prospective purchaser" defense that allows a prospective buyer to buy contaminated property and still avoid federal cleanup liability. But the acquiring property owner still has to perform all appropriate inquiries and make sure any continuing care obligations are satisfied. Working with professionals who understand these nuances is advisable in these situations.

4. MANY ENVIRONMENTAL RISKS ARE EXCLUDED

Asbestos, PCBs, lead-based paint, mold, regulatory compliance, wetlands, and many other risks are not part of a Phase I ESA. Additional surveys are needed to assess these risks. Vapor intrusion risk, however, is now a consideration with the 2013 version of the ASTM standard.

5. THEY HAVE A SHORT SHELF-LIFE

A Phase I ESA that pre-dates the closing by more than 180 days will have to be updated to qualify for protection. And if the analysis and report are more than one year old, you will need to commission a new review.

6. SPECIFIC LANGUAGE IS REQUIRED

Yes, really. The Phase I ESA standard and the federal law specifically identify language that "shall" or "must" be included. For example, you must use a qualified "Environmental Professional" to perform the review. When contracting for a Phase I ESA, be sure to work with a firm or individual with vast experience in environmental law – one who knows the exact language required by CERCLA and the Phase I ESA standard.

7. RELIANCE IS LIMITED

Buyer beware if all you do is review the Phase I ESA that was prepared for the current owner of the property when he or she previously bought it. Aside from the fact that the report will likely have exceeded its shelf-life (see above) and new risks may be present, the Phase I ESA was prepared for a different user and you will not be able to qualify for the defenses to liability. Simply put, if the report is prepared for another user, certain updates and actions need to be taken if you want to rely on the report, and the report should specifically identify the landowner seeking protections. This is particularly important

if you plan to have a separate LLC or similar entity own the property, as commonly occurs.

8. ALWAYS REQUEST A DRAFT REPORT

Requesting a draft report will allow you and the environmental professional to identify and isolate any particular issues that require attention before the report becomes finalized. Equally important, because timing of the transaction is often critical, it is also helpful to have a verbal report immediately after the on-site reconnaissance to identify if the consultant believes any RECs are present. This also allows you to begin parallel work on subsurface investigation activities – Phase II ESA – on a faster timeframe if necessary.

9. LENDERS TYPICALLY REQUIRE THEM

Even though financial institutions have their own separate legal defense under CERCLA, if you need a loan from a bank or the SBA, chances are good a Phase I ESA will be required to protect credit risk and the loan value.

10. RECOMMENDATIONS ARE NOT REQUIRED

Although an environmental professional should provide an "opinion" regarding whether additional appropriate investigation is necessary to confirm the presence of a REC if it is not obvious, "recommendations" are not required for an ASTM-compliant Phase I ESA. And if recommendations are desired, consider having them addressed in an accompanying side letter and not the report itself.

Beyond these issues, there are also a variety of considerations for both buyers and sellers in the process, including the hiring and contracting with an environmental professional, adequacy of insurance, limitations on liability, indemnity obligations, and the like. In this regard, it is advisable to integrate your legal counsel and real estate professionals into the Phase I ESA early on in the process rather than waiting until the time of closing to work through these issues.

In summary, while contracting for and conducting a Phase I ESA has a number of subtle nuances with substantial ramifications, working with seasoned advisors through the process will allow your business to achieve its goals for the property transaction. ■