

# Environmental Due Diligence in Real Property Transactions\*

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## I. Introduction

When acquiring any interest in real property, whether through a simple real estate purchase or a larger corporate transaction, the importance of undertaking a thorough environmental

due diligence investigation cannot be overstated. This is particularly true with respect to the discovery of any actual or potential environmental contamination, the historical use of hazardous substances at or near the project site, or the existence of any hazardous building materials in improvements located on the property. Both federal and state laws impose potentially significant liabilities on owners and operators of properties with environmental contamination. See, e.g., Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C.A. §§ 9601 *et seq.* (“CERCLA”).<sup>1</sup> However,

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Dear Subscribers:

In this issue of *The Environmental Counselor*, we are please to provide two excellent and informative articles. The first, written by Robert L. Falk, William F. Tarantino, and Miles H. Imwalle, of Morrison & Foerster LLP, discusses the environmental due diligence inquiries needed in real property transactions, including the lawyer’s role in this process. Our second article, written by Heather Corken of Fulbright & Jaworski LLP, provides an overview of the Chemical Facility Anti-Terrorism Standards now that the final Appendix A to the Standards has been published in the Federal Register. We would like to thank these authors and their firms for allowing us to share these articles with our subscribers.

Very truly yours,  
Jeanne D. Wertz  
Senior Attorney Editor

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“cleanup” liability is only one part of the equation. Acquiring an interest in an environmentally impacted property may present risks of future tort liability and other third-party claims that should be taken into account when determining the property’s current and future uses, as well as its value to your organization.

Conducting adequate environmental due diligence serves two business functions. *First*, it is designed to uncover potential liabilities the prospective purchaser may assume by purchasing the property. Depending on the terms of the relevant contract, if environmental contamination is discovered through the diligence process, the buyer often has several options to address these risks: it may decide not to purchase the property, it may attempt to negotiate an indemnity to shift financial responsibility for an environmental risk, or it may attempt to adjust the purchase price. In some instances, the buyer may choose to obtain environmental insurance to protect itself. Often, when environmental risks are significant, sophisticated buyers will use a combination of these strategies. *Second*, properly conducted environmental due diligence can help a buyer qualify for an important defense to CERCLA liability, known as the “bona fide prospective purchaser” (“BFPP”) defense. If the new owner has taken the required steps prior to and upon assuming ownership, it may be able to establish the BFPP affirmative defense. In essence, if the new owner can establish that all releases of hazardous substances occurred prior to the commencement of its ownership or operation of the property, it will not be held liable for remediation costs under CERCLA.

This article gives an overview of the environmental due diligence process and provides guidance on how to best conduct such due diligence, focusing on the role

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of the lawyer. Section II examines the reasons to conduct environmental due diligence, including determining the likelihood or scope of potential liability arising under CERCLA and other laws, as well as to establish the “bona fide prospective purchaser” defense to CERCLA liability. Section III examines provisions in a purchase contract that may guide the due diligence process. Section IV provides an overview of the due diligence process with a focus on the role of the attorney.

## II. Why Conduct Environmental Due Diligence?

The primary reason to conduct environmental due diligence prior to acquiring any real property interest is to determine whether the property presents a liability risk. New landowners may be held liable under a variety of environmental laws—either statutory or common law—for liability relating to the property, in some cases regardless of whether they, as the “innocent” new owner, played any role in causing contamination or other environmental damage. Traditionally, the most powerful of these laws is remediation liability under CERCLA.<sup>2</sup> Liability under CERCLA is normally joint and several; it can be imposed on a current owner or operator of a facility, regardless of whether the party played any role in causing the contamination, and remediation liability and associated defense and administrative costs can be enormously expensive. In addition, liability may also arise under tort theories, as a result of natural resources damages, from liens or “superliens” (environmental liens that assume higher priority than other security interests, similar to property tax liens), and under various state transfer acts, which impose specific conditions on the transfer of former industrial properties. Land use restrictions or other deed restrictions may also affect a property, potentially prohibiting the new owner from using the property as desired. By conducting thorough environmental due diligence prior to acquisition, the new owner may be able to avoid exposure to liability in the first place and/or may be in a stronger position to negotiate an indemnification or purchase price adjustment.

A second reason to conduct environmental due diligence is to qualify for the BFPP defense under CERCLA and the equivalent defense(s) under state environmental statutes, if applicable. The BFPP defense (discussed at more length below) allows a new owner that has conducted “all appropriate inquiries” prior to acquiring a property, and that has taken certain other steps to prevent further contamination, to avoid liability for contamination existing on the property prior to acquisition. However, to qualify for this potential defense, the prospective purchaser must properly investigate the property (*i.e.*, conduct adequate environmental due diligence) *prior* to closing.

### A. Liability Arising under CERCLA<sup>3</sup>

CERCLA has been described as a “virtual leviathan” and “a black hole that indiscriminately devours all who come

near it.” *United States v. Alcan Aluminum Corp.*, 1996 WL 637559, at \*2 (N.D.N.Y. 1996). Needless to say, CERCLA liability can be particularly draconian. Liability is imposed retroactively, meaning that it applies to contamination that predates CERCLA and was legal at the time caused. *United States v. Northeast Pharmaceutical & Chem. Co.*, 810 F.2d 726, 732-37 (8th Cir. 1986). Liability under CERCLA is “absolute,” meaning that it may be imposed regardless of causation or fault. *Atlantic Richfield Co. v. Blenski*, 847 F. Supp. 1261, 1286 (E.D. Pa. 1994). Finally, as to claims initiated by federal or state government or by an “innocent” party (*i.e.*, an entity whose status would not give rise to CERCLA liability), CERCLA liability is joint and several. Any liable party may be required to cleanup *all* contamination at a site, even if that party only caused a small amount of the total contamination. *United States v. Monsanto Co.*, 858 F.2d 160, 172-73 (4th Cir. 1988). Although a party that cleans up a site may seek contribution from other potentially responsible parties for their share of the cleanup, *United States v. Atlantic Research Co.*, 551 U.S. \_\_\_ (2007), that process can be expensive and fraught with litigation risk, and a party that caused the condition or owned the property at the time of contamination arose may also no longer exist, leaving the current owner or operator as the only liable party to pay for a cleanup.

Liability for CERCLA response (investigative and remediation) costs may be imposed on persons that qualify under the following categories: (1) the current owner or operator of the property; (2) the owner or operator of the property at the time hazardous materials were disposed of; (3) any person who arranged for the disposal of hazardous materials at the property; and (4) any person who transported the hazardous waste to any disposal or treatment facility. 42 U.S.C.A. § 9607(a).

It is the “current owner or operator” provision that strikes the most fear in new property owners because it imposes liability for past contamination simply by virtue of now owning the property or operating any type of business on the property, regardless of the fact that all contamination predated that party’s ownership or operation of the site. In addition, courts have interpreted CERCLA liability to be joint and several, meaning that any liable party may be held responsible by the government or an innocent party for cleaning up the entire site. The harshness of these liability provisions is frequently compounded by the fact that investigations of the extent of environmental contamination and associated remediation can be extremely expensive.<sup>4</sup> New owners of real property thus have a strong incentive to properly investigate environmental risks potentially associated with a property prior to taking ownership. A thorough environmental investigation is particularly necessary if there is any evidence that the property has ever been used for an industrial purpose or if there is any reason to think that contamination exists.

## 1. The “Bona Fide Prospective Purchaser” Defense to CERCLA Liability

A properly conducted pre-purchase inquiry may also enable the new owner to avail itself of a defense to liability under CERCLA. Defenses to CERCLA liability traditionally have been extremely limited. However, due to the perceived unfairness associated with holding a new, “innocent” owner liable for pre-existing contamination and to create an incentive for the cleanup and redevelopment of formerly contaminated properties, CERCLA was amended in 2002 to create the BFPP defense. *See* 42 U.S.C.A. §§ 9601(35)(B), (40)(B). Under the defense, an owner that qualifies as a “bona fide prospective purchaser” cannot be held liable for pre-existing releases of hazardous substances on a property, provided certain conditions are met.

In order to be deemed a bona fide prospective purchaser pursuant to CERCLA, a property owner must be able to demonstrate that release of hazardous substances on the acquired property occurred before the new owner acquired it. The new owner also must have conducted “all appropriate inquiries” into previous ownership and uses of the site *prior to acquisition*. The U.S. Environmental Protection Agency (“EPA”) recently defined “all appropriate inquiries” to mean a Phase I Environmental Site Assessment prepared in compliance with ASTM Standard E1527-05. 40 C.F.R. Part 312. The “all appropriate inquiries” (“AAI”) standard is examined in more detail in Section IV.C, but, in general, the AAI investigation must seek to identify factors such as current and past property uses, hazardous substances used, waste disposal activities, cleanup activities, engineering or institutional controls, and releases from nearby properties. Because the cost of a Phase I assessment that meets the all appropriate inquiry standard is usually marginal in comparison to the potential costs associated with CERCLA liability, the potential benefits of conducting an AAI compliant Phase I usually outweigh the associated costs.

If contamination is discovered during the AAI investigation, a new owner must take further steps to qualify for the BFPP defense. For example, the statute *requires* that all legally required notices of a discovered release be given. This might include, for example, notifying the relevant state environmental protection agency (or other appropriate local agency) that a chemical release has been discovered. The prospective purchaser also must exercise appropriate care with respect to the hazardous substances discovered by taking “reasonable steps” to stop any continuing release, prevent future releases, and prevent or limit exposure to existing releases. A company seeking BFPP protection also must fully cooperate with anyone conducting remedial actions and must not interfere with any institutional controls (*e.g.*, deed restrictions) in connection with such an action. Finally, the bona fide prospective purchaser must not be potentially liable, or affiliated with any person

potentially liable, for remedial costs at the property. *See* 42 U.S.C.A. § 9601(40).

As a relatively new provision of CERCLA, the BFPP defense and its requirements have not yet been the subject of any published judicial decision. Due to this uncertainty, it is advisable to interpret these provisions conservatively. In addition, a new owner may want to create a “paper trail” demonstrating that all elements of the defense have been met, such as by maintaining documentation of notices sent to agencies advising of a discovered release. Such documentation should be retained for many years since the government may not require a cleanup of environmental contamination for some time and the burden is on a potentially responsible party to demonstrate that the defense applies.

## 2. Additional CERCLA Considerations with Regard to the Acquisition of Real Property in Corporate Transactions

If a party is acquiring real property in the context of a corporate transaction, additional consideration should be given to structuring of the corporate entities so as to maximize the potential to avoid spreading of CERCLA liability. The U.S. Supreme Court in *United States v. Bestfoods et al.*, 524 U.S. 51 (1998), set forth rules establishing when a parent corporation may be held liable for contamination caused by a subsidiary (including an acquisition target). The Court held that a parent corporation is *not* liable for the acts of a subsidiary, unless the corporate veil may be pierced under traditional veil piercing theories *or* the parent exhibited certain traits such that it effectively controlled the day-to-day operations of the subsidiary’s facility. A party acquiring ownership in a company that holds real property assets via the purchase of stock may therefore be able to protect itself from CERCLA liability by ensuring the integrity of a parent-subsidiary relationship. (In contrast, if a corporate transaction involves a merger, due diligence should include facilities belonging to the acquisition’s target company.)

### B. Tort Liability Arising from Environmental Contamination

Though CERCLA liability is by far the most well-known and common form of environmental liability, risks of traditional tort liability may also accompany the acquisition of some contaminated sites. While CERCLA provides a relatively straightforward method of obtaining a defense to liability through the BFPP/AAI process, there is no equivalent protection from claims that may be brought by individuals or classes of individuals against an owner of a property for contaminating drinking water, lowering their property values, or impacting their health. Although the risk of tort actions may be relatively remote in most situations, thorough environmental due diligence may

assist a prospective purchaser in evaluating these potential liabilities as well.

There are three basic types of torts that an owner of an environmentally impacted property may see: (1) property damage; (2) toxic tort/personal injury; and (3) trespass/nuisance. In essence, each of these tort claims requires a potential plaintiff to prove that the owner of the contaminated property acted inappropriately (or failed to act appropriately) with respect to the hazardous substances on the property, and as a result, the plaintiff's property or health was or may be impacted. While a purchaser who has not contributed to the presence of hazardous substances may not be the prime target of a wronged plaintiff, toxic tort litigation can ensnare parties who are tangentially associated with contamination at the subject property, particularly if they fail to take precautions to prevent the migration of hazardous substances on site or do not disclose the conditions to future occupants. In many instances, these claims may not be covered by general commercial liability insurance, as many insurers have adopted pollution exclusions that can reach to exclude these types of tort claims.

### Emerging Issue: Vapor Intrusion

The term "vapor intrusion" refers to the process by which volatile chemicals move from an underground source—usually contaminated groundwater—up through the soil and into the indoor air of a building. When certain hazardous substances vaporize, if a pathway exists, they may be able to enter work or living spaces in concentrations that, under conservative assumptions, could present an increased health risk.

Vapor intrusion presents a particularly challenging risk to evaluate since the science behind vapor intrusion pathway modeling and the toxicity of chemicals most likely to present vapor intrusion problems is rapidly evolving.<sup>5</sup> Even with robust soil and groundwater data, it is very difficult to predict whether vapor intrusion presents any real risk of future tort liability or potential limitations on land use. Some commentators predict that the first "wave" of vapor intrusion litigation will take the form of diminution in value and property damage claims, as landowners discover that groundwater plumes are vaporizing into their buildings. In light of the developing science, any diligence assessment involving a property contaminated with volatile chemicals should include consideration of vapor intrusion potential by an environmental consultant who is well-versed in the most recent regulatory guidance and exposure models.

### C. Other Environmentally-Related Considerations

Liability under CERCLA and tort law are not the only cause for concern with regard to environmental issues that may affect a real property transaction. Land use restrictions may apply to contaminated sites, prohibiting the property from being used for purposes that may pose a greater risk of exposing people to the contamination. This may be a problem

if, for example, a party is purchasing the property for residential development, but a land use restriction imposed due to an environmental issue only allows for limited industrial or commercial use. Environmental liens may have been placed on property where the government funds an environmental investigation or cleanup, which may be problematic to securing financing. In some circumstances, the government may even place a "Superlien" on the property, under which the lien to repay the government for remediation will be given seniority over other liens. In addition, some states have mandatory "transfer acts," which require generally that parties seeking to buy or sell certain industrial facilities first conduct and report on environmental investigations and potential remediation. This can require additional time and/or consultation with government agencies and, in some cases, even require them to issue an approval before a transaction can be completed. *See e.g.*, Connecticut Transfer Act, Conn. Gen. Stat. §§ 22a-134 *et seq.*; New Jersey Industrial Site Recovery Act, N.J. Stat. Ann. § 13:1K and N.J. Admin. Code § 7:26B. The scope of the environmental due diligence should therefore be broad enough to assess whether any of these issues may affect the property and/or the timing of a planned closing.

### III. Due Diligence Provisions in the Purchase Agreement

The purchase agreement (or whatever other agreement confers the property interest) should include a due diligence period with sufficient time to inspect the property and, if appropriate, to test for hazardous substances. The necessary period for investigation naturally depends on whether contamination is known or suspected and whether environmental liabilities associated with the property are uncertain.

During the due diligence period, the seller should be required to provide all potentially relevant documentation concerning environmental conditions at and around the property that is in their possession, and the purchaser/lender should be allowed reasonable entry upon the property to conduct a visual inspection.<sup>6</sup> The agreement should also provide the purchaser/lender with a right to perform soil and other physical tests where the documentation or visual inspection suggests that contamination may be present. While the precise access terms will depend on and may reasonably be constrained by a variety of circumstances (*e.g.*, location of buildings, operating hours, tenant considerations), it is generally better for these terms to be included in the initial purchase agreement or memorandum of intent rather than to try and negotiate them in the midst of the due diligence process.

Some principal drafting concerns to address in an environmental due diligence investigation include the following:

- adequate time to complete investigation;

- cooperation of owner and access to owner's records;
- right to make inquiries of governmental authorities;
- scope of entry and testing rights; and
- determination of the positions and rights of the parties if a problem is discovered, including the right to terminate the purchase agreement, the right to extend the closing date or diligence period, the obligation/option of seller to correct the problem, the right or duty of buyer to report the problem to authorities, and the respective roles of buyer and seller in any cleanup efforts (pre-closing and post-closing).

In most instances, the seller will also want the data and results of any investigations to be kept confidential and to be turned over to the seller if the transaction fails to close. Execution of a confidentiality agreement may be appropriate in such circumstances; however, the parties must be careful to avoid placing themselves in a position where compliance with governmental reporting requirements may be hampered.

In drafting due diligence provisions into an agreement, it is important to consider the following practical issues (among others) as well:

- **Physical constraints:** For example, the size of the site, enclosed parts of structures, locations of underground storage tanks, structures (such as concrete pads) on top of former manufacturing locations, and contamination problems that may not be visible to the naked eye.
- **Timing constraints:** Often, the client will tell the lawyer that there is an "urgent need" to close the deal; however, the purchase contract or loan commitment should, at a minimum, allow enough time to complete an adequate environmental due diligence review, particularly if the prior use of the property suggests the potential for contamination (generally at least thirty days should be provided to allow for a normal level of environmental due diligence review without extensive testing; provisions should extend the time period by at least another thirty to sixty days if testing will be needed).
- **Cost constraints:** Comprehensive environmental reviews can be expensive, particularly if extensive physical and laboratory tests are done on a "rush" basis. A typical method of controlling investigation costs is to conduct a phased investigation, moving on to a later phase (*i.e.*, from document review to testing) only when the results of an earlier phase suggest a need for further investigation.
- **Concerns of the current owner:** Contractual provisions concerning environmental due diligence should

contemplate avoiding potential disruptions to the existing operations at a property and/or what will happen where a potential buyer or lender discovers a problem and reports it to the government (which may be required by law) and/or aggravates conditions at the site in the course of their testing activities.

## IV. The Due Diligence Process

### A. Role of Lawyer and Consultant

The role of the lawyer in a due diligence investigation includes conducting or overseeing the following activities:

- permit compliance review;
- review of files and records of owner, governmental agencies, and occupants;
- inquiry of governmental agencies and officials;
- analysis of results of investigation; and
- legal evaluation of risks.

Below are the major components of environmental due diligence investigations (note that not all of these steps may be necessary in every transaction; indeed, one normally proceeds in a step-by-step fashion to gradually widen the effort as and when the facts justify additional investigation).

- Engage a competent and experienced environmental consultant. This should be done at the very outset of the acquisition, if possible. If feasible, obtain at least three proposals from qualified environmental consultants to compare qualifications and costs.
- Make sure that an experienced and responsible individual at the consulting firm is overseeing the "field" consultant's work. That individual's participation in the project should be a material term written into the consulting services agreement. Assess the consultant's experience with the relevant local agencies and staff who may be involved with the site. Consider requesting references and exemplars of previous work product if you have not worked with the consultant before.
- Make sure that the consultant has adequate errors-and-omissions (E&O) insurance coverage. For example, if the consultant fails to identify an environmental condition at the property, and the purchaser is prohibited from invoking CERCLA's BFPP defense, will the consultant be financially capable of indemnifying the purchaser for liability that results from the consultant's negligence?
- Consider issues of confidentiality relating to performance of the due diligence work. Query whether it makes sense for the consultant to be hired directly by the lawyer rather than by the client for purposes of potential future privilege claims;

- For purposes of potential future privilege claims, while the ability to establish and preserve a privilege or protection is not at all clear, at least in the absence of a clear litigation threat; it may nevertheless be beneficial to lay the groundwork for future assertions of privilege claims (including by instructing the consultant to label all field notes, lab notes, and drafts as “Privileged and Confidential – Developed at the Direction of Legal Counsel”). The use and disclosure by the consultant of any information, data, and investigation results should also be contractually restricted.
- Work with the consultant to develop an appropriate scope of a phased investigation, including satisfaction of all requirements under the “all appropriate inquiries” standard; set forth proposed timelines for completion of field work, for production of a draft report, and for reporting results to client. If the consultant will be contacting government authorities, collaborate on appropriate questions and answers for government staff.
- Review consultant work product to determine compliance with AAI standard; assist the consultant in developing a final report and set of recommendations for the client through review and comment on drafts.

## B. Becoming a *Bona Fide Prospective Purchaser*

As discussed above, in order to be deemed a “bona fide prospective purchaser” pursuant to CERCLA, a property owner must be able to demonstrate that all disposals of hazardous substances on the acquired property occurred before the new owner acquired it. To make this showing, the new owner must have conducted “all appropriate inquiries” into previous ownership and uses of the site. Effective November 1, 2006, a Phase I environmental site assessment prepared in compliance with ASTM Standard E1527-05 constitutes “all appropriate inquiries” for properties acquired after this date. *See* 42 U.S.C.A. § 9601(35)(B); 40 C.F.R. Part 312. A party wishing to assert the BFPP defense must also take certain additional steps discussed above in Section II.A.1.

## C. The “All Appropriate Inquiries” Standard

A Phase I environmental site assessment addressing the AAI standard must seek to identify factors such as current and past property uses, hazardous substance uses, waste disposal activities, cleanup activities, engineering or institutional controls, and releases from nearby properties. 40 C.F.R. § 312.20(e). Specifically, investigation meeting the AAI standard must be conducted by an “environmental professional” (“EP”), as defined in § 312.10(b), and must include the following elements:

- interviews with past and present owners, operators, and occupants (§ 312.23);

- reviews of historical sources of information (§ 312.24);
- searches for recorded environmental cleanup liens (§ 312.25);
- reviews of federal, state, tribal, and local government records (§ 312.26); and
- visual inspection of the property and adjoining properties (§ 312.27).

The EP must document the results of this inquiry in a written report, taking into account the “degree of obviousness” of the presence of contamination. §§ 312.21(b); 312.31. Finally, the EP must include an opinion as to whether the inquiry indicates releases or threatened releases; identify data gaps; state the EP’s qualifications; and include a declaration that the inquiry was conducted in compliance with regulatory standards. § 312.21(c)–(d).

In addition to the EP’s inquiry, to meet the AAI standard, the BFPP itself must take into account the following, and provide the results to the EP (*see* §§ 312.22; 312.28 to .30):

- information about environmental cleanup liens, not otherwise obtained by the EP;
- any specialized knowledge or experience the BFPP possesses, to help identify conditions indicating releases or threatened releases;
- the relationship between the property’s purchase price and its fair market value, if the inquiry did not reveal contamination; and
- other commonly known or reasonably attainable information about the property, from sources such as Web sites and neighboring property owners.

A BFPP may use a Phase I prepared by or for another party to demonstrate AAI, but only under certain circumstances. First, the report in question must meet the performance objectives specified in U.S. EPA’s regulations setting out the AAI standard. Second, the person seeking to establish the BFPP defense (or, more likely, its consultant) must review the existing report, conduct any inquiries the AAI standard requires, and update the results as necessary. § 312.20(d)(1)–(2).

An environmental site assessment (Phase I) report meeting the AAI standard has a “shelf life” of one year. § 312.20(a). There are two caveats to this general rule. First, certain components of the due diligence investigation must be conducted or updated *within 180 days* prior to acquisition, rather than one year. These include: (1) interviewing former and current owners, operators, and occupants; (2) searching for records of environmental cleanup liens; (3) reviewing federal, state, local, and tribal government records; (4) visually inspecting the facility and adjacent properties; and (5) a declaration by the environmental professional in charge. § 312.20(b).

Second, a Phase I report may use information and results from an earlier inquiry, subject to the following restrictions: (1) the information was collected in compliance with CERCLA under previous AAI standards; (2) the information was collected or updated within one year prior to the date of acquisition; (3) the same components that need to be updated in general must also be updated (see list above); and (4) the information is supplemented to include relevant changes in the property, as well as any specialized knowledge of the person acquiring the property and the responsible EP. § 312.20(c).

The following summarizes the key elements of the AAI standard:

- Environmental Professional. The Phase I activities must be supervised by, but do not need to be conducted by, an EP who meets specific certification (or license), education, and experience requirements.
- Interviews with Current Owner and Occupants. Under ASTM E1527-05, interviews with the current owner and occupants now are mandatory.
- Interviews with Past Owners and Occupants. Interviews with past owners and occupants also must be conducted when necessary to obtain information regarding past releases. Conducting such interviews is left up to the discretion of the environmental professional.
- Review of Historical Sources. The Phase I assessment must include a review of historical sources back to when the property either first contained structures or was first used for residential, agricultural, commercial, industrial or governmental purposes.
- Records of Activity and Use Limitations. In order to provide a continuous record of land uses, the new standard also requires a search of environmental cleanup liens, including those recorded under tribal and local laws. The search need only go back to 1960 and may be conducted by either the property owner or the EP.
- Government Records Review. The new standard now requires a review of tribal and local government records in addition to state and federal government records.
- Site Inspection. The Phase I assessment must include a visual inspection of the property and adjoining properties. The inspection of adjoining properties must be from the property line, public right-of-way, or other vantage point. There is a limited exemption if a site cannot be visually inspected, and the Phase I assessment must document efforts taken to gain access. It also must include the opinion of the environmental professional regarding the significance of not doing a visual inspection if such an inspection was not possible.

- Contaminants of Concern. The AAI standard itself does not technically require releases or threatened releases of petroleum products to be reported in the Phase I assessment.<sup>7</sup> However, if the prospective owner is seeking to protect itself from any non-CERCLA liability, petroleum releases must be discussed. If the prospective owner is receiving an EPA Brownfields grant, the Phase I also must look for evidence of releases of CERCLA hazardous substances, petroleum, and other controlled substances.
- Data Gaps. The Phase I assessment must name the sources used to identify data gaps, and requires comment in the Phase I assessment on the significance of the data gap as it affects the ability of the environmental professional to identify releases and threatened releases.
- Shelf Life. Under the new standard, a Phase I is valid only for one year, and certain parts of the report must be updated if the report is more than 180 days old. Elements that must be updated within 180 days include interviews, visual inspection, historical records review and the environmental lien search.

#### ENDNOTES

1. Many states have enacted liability schemes similar to CERCLA's. *See e.g.*, California Hazardous Substance Account Act, Cal. Health & Safety Code §§ 25300 *et seq.*
2. CERCLA contains a "petroleum exclusion" and therefore does not apply to certain common forms of environmental contamination, such as fuel leaks. However, the exclusion does not apply to waste or used oil and many states' CERCLA-like statutes do not contain petroleum exclusions as extensive as those in CERCLA, or often contain separate provisions that address petroleum-related contamination.
3. While many state statutes mirror CERCLA, there are also some important differences in these regimes, and practitioners, therefore, need to be familiar with specific state law requirements in their jurisdictions.
4. Although not as common, the government can also use CERCLA to recover damage caused to natural resources. 42 U.S.C.A. §§ 9607(a)(4)(C), and 9607(f). Damage to natural resources is typically measured as the difference between the value after site cleanup, plus the lost use value of the resource and the costs of damage assessment. *See, e.g., In re Acushnet River & New Bedford Harbor*, 712 F. Supp. 1019, 1035 (1989). Claims for damages to natural resources can exceed even the dollar amount associated with the cleanup costs.
5. As of this writing, vapor intrusion models, particularly with respect to chlorinated solvents, are being reevaluated by the U.S. EPA and are likely to become more conservative.
6. The purchaser or lender should also be allowed to make pre-purchase inquiries of governmental agencies without liability to the seller or borrower for the outcome of such discussions.
7. Even though not required as part of the AAI standard for purposes of CERCLA's BFPP defense, an environmental site assessment/Phase I assessment should nevertheless discuss releases and threatened releases of petroleum products in order to understand any associated risks and liabilities under other statutes and common law.



# Clock Started For Compliance with the New Chemical Facility Anti-Terrorism Standards\*

By Heather Corken\*\*

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On November 20, 2007, the final Appendix A to the new Chemical Facility Anti-Terrorism Standards (CFATS) was published in the Federal Register, triggering the 60-day deadline for regulated chemical facilities to submit the required "Top-Screen" questionnaire to the Department of Homeland Security (DHS). Because the applicability of the standards to a facility is triggered primarily by the possession of Appendix A chemicals at or above the listed threshold quantities, it is critical that companies review Appendix A carefully.

On October 4, 2006, President Bush signed the Department of Homeland Security Appropriations Act of 2007 (the Act). Section 550 of the Act provided DHS with the authority to regulate the security of "high-risk" chemical facilities and required DHS to issue an interim final rule on chemical facility security within six months. Congress intended that the Act would fill a significant gap in the United States' anti-terrorism efforts. The legislation arose out of concern that the aggregation of potentially dangerous chemicals in one place creates an attractive target for terrorists. Prior to the Act, the federal government did not have authority to regulate the security of most chemical facilities in the United States.

The Act required DHS to promulgate interim final regulations that: (1) established risk-based performance standards; (2) required Security Vulnerability Assessments and Site Security Plans; (3) allowed Alternative Security Programs; (4) mandated audits and inspections to determine compliance with regulations; (5) provided for civil penalties for violation of an order issued under the Act; (6) authorized the Secretary of Homeland Security to order a facility to cease operations if the facility is not in compliance with the requirements; and (7) give DHS the authority to protect from inappropriate public disclosure any information developed by industry pursuant to the Act's requirements (referred to as "Chemical-terrorism Vulnerability Information"). The Act does *not* apply to: (1) facilities regulated under the Maritime Transportation Security Act of 2002; (2) Public Water System as defined in Section 1401 of the Safe Drinking Water Act; (3) Treatment Works as defined in Section 212 of the Federal Water Pollution Control Act; (4) any facility owned or operated by the Department of Defense or the Department of Energy; or (5) any facility subject to regulation by the Nuclear Regulatory Commission.

DHS issued the interim final rule on April 9, 2007, and the rule became effective on June 8, 2008. The interim final rule imposes the first comprehensive federal security regulations for high-risk chemical facilities in the United States. The rule focuses on the types of chemicals stored, the quantity of chemicals stores, and the location of each chemical facility in order to determine whether such facilities present a high risk of significant adverse consequences for human life or health, national security and/or critical economic assets if subjected to terrorist attack, compromise, infiltration, or exploitation. The rule will be published at 6 C.F.R. Part 27.

The interim final rule applies as an initial matter to all "chemical facilities." The term "chemical facility" is defined broadly as "any establishment that possesses or plans to possess, at any relevant point in time, a quantity of a chemical substance determined by the Secretary of DHS to be potentially dangerous or that meets other risk-related criteria identified by the DHS." The definition does not require ownership or title to the chemicals; only possession or plans to possess the chemicals above the threshold quantities. In addition, the definition does not limit the types of facilities that may be covered to those that traditionally would be considered to be in the chemical sector. Rather, the interim rule casts a broad net, potentially including petroleum refineries, natural gas peak shaving facilities, tank farms, and warehouses.

The chemical substances determined by DHS to be potentially dangerous or to meet other risk-related criteria are listed in Appendix A to the interim final rule. Appendix A provides a list of chemicals of interest, along with Screening Threshold Quantities (STQ) for each chemical. The final Appendix A contains approximately 300 chemicals of interest, including both common industrial chemicals (e.g., chlorine and propane) and specialty chemicals (e.g., arsine and phosphorous trichloride).

The STQs assigned to each chemical of interest vary based on the security issues associated with each chemical: (1) Release (i.e., quantity of toxic, flammable, or explosive chemicals that have the potential to create significant adverse consequences for human life or health if intentionally released or detonated); (2) Theft or Diversion (i.e., chemicals that have the potential, if stolen or diverted, to be used as weapons or easily converted into weapons, in order to create significant adverse consequences for human life or health); and (3) Sabotage or Contamination (i.e., chemicals that, if mixed with other readily available materials, have the potential to create significant adverse consequences for human health or life).

In some cases, Appendix A establishes different STQs for chemicals of interest based upon the security issue presented. For example, the STQ for sulfur dioxide varies based upon whether the chemical poses a threat of release in vessels and underground storage facilities (5,000 pounds) or a threat of theft or diversion in transportation packaging (500 pounds). Where there are multiple security issues associated with a chemical of interest, a facility must complete and submit a Top-Screen if it meets or exceeds the STQs for any of the applicable security issues.

Any facility that possesses a chemical of interest in quantities that meet or exceed the STQs must complete and submit a Top-Screen within 60 calendar days of the publication of the final Appendix A (November 20, 2007) or within 60 calendar days of coming into possession of the listed chemicals at or above the listed STQs. The required “Top-Screen” must be submitted using the Chemical Security Assessment Tool (CSAT). CSAT is a suite of four applications, including User Registration, Top-Screen, Security Vulnerability Assessment, and Site Security Plan, through which DHS will collect and analyze key data from chemical facilities. CSAT is available on-line through the DHS Web site.

The Top-Screen solicits answers to a series of questions that are intended to assess the level of damage that could result from a terrorist incident at the facility. The Top-Screen is designed to gather information both to evaluate the consequences of a catastrophic explosion or release and to assess the possible danger if dangerous chemicals are stolen. The process is relatively self-explanatory, but will require facilities to gather information prior to or during the process on completing the Top-Screen. Once the Top-Screen is completed, DHS will review it and make a determination whether the chemical facility presents a high level of security risk. DHS anticipates that the large majority of chemical facilities that are required to complete the Top-Screen will exit the process at this point.

A chemical facility determined by DHS to present a high level of security risk or which is presumptively high risk will be classified as a “covered facility” for purposes of the interim final rule. The interim final rule adopts a risk-based tiering structure. Covered facilities are placed in one of four risk-based tiers, ranging from highest risk facilities in Tier 1 to lowest risk facilities in Tier 4. As the level of risk increases, DHS scrutiny of chemical facilities will increase. Upon determining that a chemical facility presents a high level of security risk, DHS will notify the facility in writing of such initial determination and the facility’s placement in a risk-based tier.

All covered facilities must complete a Security Vulnerability Assessment (SVA). The SVA is due within 90 calendar days of written notification from DHS or within the time frame specified in any subsequent Federal Register notice. The interim final rule requires each SVA to include the

following elements: (1) asset characterization (i.e., identification and characterization of potential critical assets, identification of hazards and consequences of concern for the facility, its surroundings, and its supporting infrastructures, and identification of existing layers of protection, (2) threat assessment, including a description of possible internal threats, external threats, and internally-assisted threats; (3) a security vulnerability analysis (i.e., identification of potential security vulnerabilities and identification of existing countermeasures and their level of effectiveness in both reducing identified vulnerabilities and in meeting the acceptable Risk-Based Performance Standards, and (4) a countermeasures analysis, including strategies that reduce the probability of a successful attack or reduce the probable degree of success and strategies that enhance the degree of risk reduction, the reliability and maintainability of the options, the capabilities and effectiveness of mitigation options, and the feasibility of the options.

DHS will review and approve in writing all SVAs that satisfy the regulatory requirements. DHS will also provide written notice if an SVA does not satisfy the requirements, including a clear explanation of the SVA’s deficiencies. The facility must then revise the SVA and resubmit the materials to meet the DHS performance standards. DHS will provide technical assistance to facilities, if needed.

In addition to a Top-Screen and an SVA, a covered facility must complete and submit a Site Security Plan (SSP). The SSP is due within 120 calendar days of written notification from DHS or within the time frame specified in any subsequent Federal Register notice. The SSP must address each vulnerability identified in the facility’s SVA and identify and describe the security measures to address each vulnerability. The SSP must identify and describe how the security measures selected by the facility will address the applicable risk-based performance standards and potential modes of terrorist attack. In addition, the SSP must identify and describe how security measures selected and utilized by the facility will meet or exceed each applicable performance standard for the appropriate risk-based tier for the facility. The SSP must also specify other information DHS deems necessary regarding chemical facility security.

DHS will review and approve or disapprove all SSPs that satisfy the regulatory requirements in a two-step process. First, upon receipt of an SSP, DHS will review the documentation and make a preliminary determination as to whether it satisfies the requirements of 6 C.F.R. § 27.225. If DHS finds that the requirements are satisfied, DHS will issue a Letter of Authorization to the covered facility. Next, DHS will inspect the covered facility for purposes of determining compliance with the regulatory requirements. If DHS approves the SSP, the Department will issue a Letter of Approval to the facility. The facility must then implement the approved SSP. If DHS disapproves the SSP, the Department will provide the facility with a written notification, including a clear explanation of deficiencies in

the SSP. The facility must then revise the SSP and resubmit the materials to meet DHS' performance standards. DHS will provide technical assistance to facilities, if needed.

The interim final rule allows covered facilities to submit an Alternative Security Program (ASP) under certain circumstances. The ASP must meet the requirements of 6 C.F.R. Part 27 and provide for an equivalent level of security to that established by Part 27. Responsible Care® and other like programs could potentially provide a basis for an ASP. For example, Coatings Care® has been approved in New Jersey for such use under the state program.

The interim final rule provides that a Tier 4 facility (lowest risk) may submit an ASP in lieu of an SVA, SSP, or both. Tier 1, Tier 2, or Tier 3 facilities may submit an ASP in lieu of an SSP, but these facilities may not submit an ASP in lieu of an SVA. DHS will provide notice to the covered facility of its approval or disapproval, in whole or in part, of the AASP.

Under the interim final rule, all covered facilities must satisfy the risk-based performance standards identified in 6 C.F.R. § 27.230. DHS has stated that it will issue guidance on the application of the performance standards to risk-based tiers of covered facilities, but no guidance has yet been issued. According to the DHS, the acceptable layering of measures used to meet the performance standards will vary by risk-based tier.

Each covered facility must select, develop in its SSP, and implement appropriate risk-based measures designed to satisfy the performance standards set forth in the interim final rule. These risk-based performance standards are designed to allow flexibility in implementation. DHS is not seeking to mandate, for example, how high a facility's perimeter fence must be or the number of security personnel needed to patrol the perimeter, only that the perimeter of the facility must be secure.

The interim final rule sets forth the following risk-based performance standards: (1) secure and monitor the perimeter of the facility; (2) secure and monitor restricted areas or potentially critical targets within the facility; (3) control access to the facility and to restrict areas within the facility by screening and/or inspecting individuals and vehicles as they enter; (4) deter, detect, and delay an attack, creating sufficient time between detection of an attack and a point at which the attack becomes successful; (5) secure and monitor the shipping, receipt, and storage of hazardous materials for the facility; (6) deter theft or diversion of potentially dangerous chemicals; (7) deter insider sabotage; (8) deter cyber sabotage, including by preventing unauthorized onsite or remote access to critical process controls, critical business systems, and other sensitive computerized systems; (9) develop and exercise an emergency plan to respond to security incidents internally and with assistance of local law enforcement and first responders; (10) maintain effective monitoring, communications and warning systems; (11)

ensure proper security training, exercises, and drills of facility personnel; (12) perform adequate background checks on and ensure appropriate credentials for facility personnel, and as appropriate for unescorted visitors with access to restricted areas or critical assets; (13) escalate the level of protective measures for periods of elevated threat; (14) address specific threats, vulnerabilities or risks identified by DHS for the particular facility at issue; (15) report significant security incidents to DHS and to local law enforcement officials; (16) identify, investigate, report, and maintain records of significant security incidents and suspicious activities in or near the site; (17) establish officials and an organization responsible for security and for compliance with the performance standards; and (18) maintain appropriate records.

In order to assess compliance with the interim final rule, DHS may enter, inspect, and audit the property, equipment, operations, and records of covered facilities. Audits and inspections will be conducted at reasonable times and in a reasonable manner. DHS intends to inspect high risk chemical facilities at regular intervals, with higher tier facilities being inspected first and more frequently. DHS will generally provide 24-hour advance notice before inspections unless: (1) the Under Secretary or Assistant Secretary of DHS determines that an inspection without such notice is warranted by exigent circumstances and approves such inspections; or (2) any delay in conducting an inspection might be seriously detrimental to security, and the Director of the Chemical Security Division determines that an inspection without notice is warranted and approves the inspection. All information received in an audit or inspection, including the identity of the persons involved in the inspection or who provided information during the inspection, shall remain confidential and shall not be subject to a Freedom of Information Act request.

Information protected by the Department of Homeland Security Appropriations Act of 2007 is classified by DHS as Chemical Vulnerability Information (CVI). Protected information includes: (1) Security Vulnerability Assessments; (2) Site Security Plans; and (3) other security-related information, records, and documents. Each person who as a need to know CVI or gains access to what they know or reasonably should know constitutes CVI must take reasonable steps to safeguard CVI from unauthorized disclosure, store CVI in a secure place (such as a safe) when not in physical possession of the CVI, and disclose or otherwise provide access to CVI only to persons who have a need to know. Requests for CVI by persons without a need to know must be referred to DHS. All persons who will have access to CVI must register with DHS, complete a short on-line training course, and consent to a background check.

The interim rule also contains record-keeping requirements for covered facilities. A covered facility must keep specified records for at least three years and make them available to DHS upon request. Categories of records

required to be kept include: (1) training; (2) drills and exercises; (3) incidents and breaches of security; (4) maintenance, calibration, and testing of security equipment; (5) security threats; (6) audits; and (7) Letters of Authorization and Approval. In addition, a covered facility must retain records of submitted Top-Screens, SVAs, SSPs, and all related correspondence with DHS for at least six years. Records may be kept in electronic format, but all electronic records must be protected against unauthorized access, deletion, destruction, amendment, and disclosure.

Finally, the interim rule provides DHS with significant enforcement authority. The Assistant Secretary of DHS can issue an order assessing civil penalties for violations of the interim rule. The rule allows the assessment of a maximum penalty of \$25,000 per day per violation. As a result, penalties for multiple violations of extended duration

can quickly lead to penalties in excess of \$1 million. DHS may assess penalties throughout the process, including for failure to submit a Top-Screen. In addition, the Assistant Secretary of DHS can order a facility to cease operations if the facility is not in compliance with the requirements of the rule. The cessation order may remain in effect until the facility comes into compliance, which could take weeks or months depending upon the violation.

The new CFATS cast a broad net in the fight against terrorism. Although most establishments in the United States probably will not be designated as “high risk” chemical facilities, many will be required to register with DHS and complete a Top-Screen questionnaire. Companies should review the final Appendix A carefully and determine whether any of their facilities likely will be covered by the interim final rule.

## Environmental Case Law Update

By Jeanne D. Wertz, J.D.

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### Whether Material Containing Lead Sold to Lead Processor for Reclamation Fell Within the “Useful Products Doctrine” Was a Question of Fact

In *California Department of Toxic Substances Control v. Alco Pacific, Inc.*, 2007 WL 4180593 (November 28, 2007), the appeals court reversed the district court's grant of summary judgment in favor of the defendants. The district court had found that, as a matter of law, the defendants' sale of materials containing lead to a lead processor, who refined and reclaimed the lead, was within the “useful products doctrine” and so the defendant sellers were not liable under CERCLA as arrangers for the disposal or treatment of hazardous materials. The appeals court held that summary judgment was not appropriate because it was a question of fact as to whether the lead containing materials sold to the lead processor were valuable enough to fall under the “useful products doctrine.” The state had brought an action for the recovery of costs associated with the cleanup of the former lead processing facility. The state asserted that various defendants who had sold materials containing lead to the lead processor, which then refined and reclaimed lead from these materials, were liable under CERCLA as “arrangers.”

An “arranger” for CERCLA liability is defined as follows:

[A]ny person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any

facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances ....

42 U.S.C.A. § 9607(a)(3).

The appeals court stated that

arranger liability encompasses not only transactions in which the central purpose is the disposal of hazardous waste but also “transactions that contemplate disposal as a *part* of, but not the focus of, the transaction.” *United States v. Burlington N. & Santa Fe Ry. Co.*, 479 F.3d 1113, 1139 (9th Cir. 2007).

CERCLA itself does not define the terms “disposal” and “treatment,” but instead incorporates the definitions of those terms as set forth in the Solid Waste Disposal Act (“SWDA”). See 42 U.S.C. § 9601(29). The SWDA defines “disposal” as:

the discharge, deposit, injection, dumping, spilling, leaking, or placing of any solid waste or hazardous waste into or on any land or water so that such solid waste or hazardous waste or any constituent thereof may enter the environment or be emitted into the air or discharged into any waters, including ground waters.

42 U.S.C. § 6903(3). “Treatment” is defined as:

any method, technique, or process, including neutralization, designed to change the physical, chemical, or biological character or composition of any hazardous waste so as to neutralize such waste or so as to render such waste nonhazardous, safer for transport, amenable

for recovery, amenable for storage, or reduced in volume.

42 U.S.C. § 6903(34).

We have held that these definitions necessarily implicate the concept of “waste,” and have developed a body of case law distinguishing between the disposal or treatment of “waste” and the sale of a “useful product.” See, e.g., *Burlington*, 479 F.3d at 1140-41; *A & W Smelter & Refiners, Inc. v. Clinton*, 146 F.3d 1107, 1112 (9th Cir. 1998); *Catellus Dev. Corp. v. United States*, 34 F.3d 748, 750 (9th Cir. 1994). A person may be held liable as an “arranger” under § 9607(a)(3) only if the material in question constitutes “waste” rather than a “useful product.” ... Application of this distinction has been referred to as the “useful product doctrine.”

Because the doctrine has developed piecemeal through caselaw, its contours are not entirely clear.

*Alco Pacific, Inc.*, 2007 WL 4180593 at \*3, \*4.

The appellate court discussed a number of cases in which the “useful product doctrine” was examined. The appeals court then looked at the three factor test set out by the district court in the instant case for determining if material is a “waste” or a “useful product.”

While at this juncture we refrain from expressly adopting or crafting a concrete test for this fact-intensive inquiry, we agree that the factors upon which the district court relied, including (1) “the ‘commercial reality’ and value of the product in question”; (2) “a

factual inquiry into the actions of the seller in order to determine the intent underlying the transaction”; and (3) “whether the material in question was a principal product or by-product of the seller,” are among the factors appropriate to consider in determining “whether in light of all the circumstances the transaction involved an arrangement for disposal or treatment of a hazardous waste.” *Cadillac Fairview*, 41 F.3d at 566. However, because a reasonable finder of fact could infer from the evidence in the record that this question could be answered in the affirmative, we conclude that the district court misapplied the factors in granting summary judgment for Defendants.

*Alco Pacific, Inc.*, 2007 WL 4180593 at \*7.

The appeals court stated that the “commercial reality” factor supported the district court’s grant of summary judgment, but that price is just one indication of whether transaction should be characterized as the sale of a useful product or the disposal of waste. The appeals court stated that “[o]n the present record, a reasonable finder of fact could conclude—after a full factual inquiry into the actions of the parties—that almost all of the transactions were intended as arrangements for the disposal or treatment of a hazardous substance.” *Alco Pacific, Inc.*, 2007 WL 4180593 at \*8. However, the appeals court also found that “the current record is insufficient to establish as a matter of law that the useful product doctrine does not apply ....” *Alco Pacific, Inc.*, 2007 WL 4180593 at \*9. Therefore, the appeals court reversed the summary judgment in favor of the defendants and remanded the cause to the district court for further proceedings.





