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Environmental Due Diligence: A Guide to Liability Risk Management in Commercial Real Estate Transactions

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ARTICLES

ENVIRONMENTAL DUE DILIGENCE: A GUIDE TO LIABILITY RISK MANAGEMENT IN COMMERCIAL REAL ESTATE TRANSACTIONS

JOSEPH PHILIP FORTE*

INTRODUCTION

ENVIRONMENTAL due diligence is just one aspect of the developing area of environmental liability risk management which includes, among other things, environmental impairment insurance, legal compliance audits, contractual risk allocation and pollution prevention. No longer the exclusive preserve of the environmental activist or the conservationist, environmental concerns are now a paramount issue for the American business community. Congress and the state legislatures have enacted and continue to enact various types of environmental legislation¹ in response to a perceived need to eliminate, limit or at least control the deleterious effect of the products and by-products of our industrial society on all aspects of our environment. Real estate professionals — developers, owners, operators, tenants, lenders and other investors (individually “investor” and collectively “investors”) — as well as their respective legal counsel — are now actively attempting to limit or otherwise allocate their environmental liability by means of transaction structures, documentary provisions, ownership vehicles, third party credit support, indemnification, insurance and other prophylactic measures.

Environmental risk to the investor is significantly more serious than the mere loss of investment equity or impairment of real estate value occasioned by the noncompliance with ordinary land-use statutes. The consequence of an investment in real property by an investor could be an environmental clean-up directive or judgment far in excess of the investment made or even the value of the real estate or

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1. In this article, “environmental laws” will refer only to those statutes and regulations governing hazardous substances and hazardous waste. “Environmental laws” will not include those statutes addressing underground storage tanks, asbestos, radon, pesticides, lead-based paint, PCBs, endangered species, wetlands and other environmental issues.

interest acquired.² The potential environmental liability that could result from mere ownership or operation of real estate may be joint and several, perpetual, unlimited and regardless of fault.

I. FEDERAL/STATE LEGISLATION

Federal, state and local environmental laws and regulations are constantly growing in number and complexity. The laws often impose complex requirements and severe civil and criminal penalties for failure to comply. Unfortunately, there has been a lack of coordination and cooperation among the federal, state and local authorities which has fostered confusion, duplication and conflict among the applicable statutory and regulatory schemes. Although the state and local statutes are voluminous and growing, they can reasonably be identified as falling within four separate categories of legislation:

- State "Superfund" laws allowing governmental authorities to order and/or perform preventive measures or clean-up and impose a lien for costs incurred if performed.
- Similar state "Superfund" laws permitting imposition of a superlien for clean-up costs prior to existing liens on the real property and/or spreading liens for clean-up costs which attach to other non-affected property of the same owner.
- Transfer pre-clearance statutes requiring performance of a clean-up before the property may be sold or transferred.
- Notice laws requiring notice of problems to be given to potential purchasers, specific governmental agencies and others.

In this ever-growing maze of environmental laws, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, commonly known as "Superfund" or "CERCLA,"³ has had the greatest effect on business and industry in general, and more particularly on real estate investment. Liability under CERCLA has been

2. Superfund enforcement is not limited to the Environmental Protection Agency (EPA) or other federal agencies. State governments and private parties who expend funds for clean-up can likewise recover their costs through citizens' suits. 42 U.S.C. § 9607(a)(4) (1988 & Supp. 1990). This provision has been interpreted to allow potentially responsible parties who undertake a clean-up to sue other potentially responsible parties. *City of Philadelphia v. Stepan Chem. Co.*, 544 F. Supp. 1135 (E.D. Pa. 1982). Thus, there is some hope that investors held responsible for clean-up costs can recover against other parties. In the case of a trustee holding title to real property in trust for a third party beneficiary ("Trustee"), the question is whether the liability of the Trustee is limited to the trust assets. *City of Phoenix v. Garbage Servs. Co.*, 816 F. Supp. 564 (D. Ariz. 1993). Here a distinction is made between the liability of current owners and operators and the owners and operators at the time of disposal. Liability of a Trustee who is a current owner is limited to the extent that trust assets are sufficient to indemnify the Trustee, but liability of a Trustee who is an owner at the time of disposal of hazardous substances will depend on the Trustee's power to control the use of the property. If the Trustee has power of control of the property, and knowingly allowed the use, the Trustee is personally liable regardless of the trust's ability to indemnify the Trustee. *Id.* at 568.

3. 42 U.S.C. §§ 9601-9675 (1988).

characterized as imposing strict liability retroactively on innocent landowners or operators for the acts of property owners, operators or tenants which were neither illegal nor negligent at the time of their occurrence.⁴ This liability is perpetual and unlimited. Upon acquisition of an interest in real property, an investor has at risk more than a mere investment equity and more than the fair market value of the real property. There are significant business costs and liabilities attendant to "*recognized environmental conditions*"⁵ at a particular property, including:

- the cost of compliance with law;
- the cost of remediation;
- business interruption costs;
- loss of value of asset as a direct result of environmental condition;
- loss of value of asset resulting from market reaction to publicity about a possible or actual environmental condition;
- liability to third parties, e.g., toxic tort, adjacent property damage, etc., and
- legal costs of environmental claims or litigation without regard to liability.

Clearly the economic consequences of a *recognized environmental condition* could be catastrophic for an unwitting party.

There are three statutory defenses to liability under CERCLA⁶ – acts of God, acts of war, and acts or omissions of "non-contractual" third parties. In practice, however, the defenses generally provide little comfort to investors.⁷ Although the act or omission of a third

4. Joseph Philip Forte, 2 ENVIRONMENTAL LIABILITY RISK MANAGEMENT, PROBATE AND PROPERTY, No. 7, 57-61 (Jan./Feb. 1989).

5. "*Recognized environmental conditions*" means the presence or likely presence of any hazardous substances or petroleum products on a property under conditions that indicate an existing release, a past release, or a material threat of a release of any hazardous substances or petroleum products into structures on the property or into the ground, groundwater, or surface water of the property. The term includes hazardous substances or petroleum products even under conditions in compliance with laws. The term is not intended to include de minimis conditions that generally do not present a material risk of harm to public health or the environment and that generally would not be the subject of an enforcement action if brought to the attention of appropriate governmental agencies. STANDARD PRACTICE FOR ENVIRONMENTAL SITE ASSESSMENTS: PHASE I ENVIRONMENTAL SITE ASSESSMENT PROCESS E 1527-93 § 1.1.1 (Am. Soc'y for Testing and Materials 1993) (emphasis omitted) [hereinafter E 1527-93]; STANDARD PRACTICE FOR ENVIRONMENTAL SITE ASSESSMENTS: TRANSACTION SCREEN PROCESS E 1528-93 § 1.1.1 (Am. Soc'y for Testing and Materials 1993) (emphasis omitted) [hereinafter E 1528-93]. As the two practices have the same introduction, definitions and principles in this article, reference will be made to only the Standard Practice E 1527-93.

6. 42 U.S.C. § 9607(b) (1988 & Supp. 1990). These enumerated defenses are exclusive of any others. *United States v. Aceto Agr. Chem. Corp.*, 872 F.2d 1373 (8th Cir. 1989).

7. *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985); *City of Phoenix v. Garbage Servs. Co.*, 816 F. Supp. 564 (D. Ariz. 1993), and 827 F. Supp. 600 (D. Ariz. 1993).

party would seem to be a readily available defense to liability in many instances, unfortunately the defense is eliminated if the party asserting the defense has a contractual relationship with the third party (e.g., land contract, deed, lease, option, mortgage, easement, etc.), or if the third party is an employee or agent of the party claiming the defense.⁸ The original CERCLA legislation also contained a "Secured Creditor Exemption"⁹ which many lenders were relying on as their insulation from liability until the federal courts began to limit the usefulness of the defense.¹⁰ In fact, EPA had promulgated a final rule on the secured creditor exemption¹¹ which has recently been challenged in, and vacated by, the Court of Appeals for the District of Columbia.¹²

In October 1986, Congress recognized the unfairness of the statutory scheme, and CERCLA was amended by the Superfund Amendments and Reauthorization Act of 1986 (SARA).¹³ SARA provided, among other things,¹⁴ a clarification of the third-party defense to allow an investor to defend on the act or omission of a third-party even if a contractual relationship did exist, provided the owner or operator claiming the so-called innocent landowner defense demonstrated that:

8. As with the innocent landowner defense, the person asserting the non-contractual third-party defense must exercise due care and take precautions against foreseeable acts or omissions of any such third party. As with the other defenses, there is no guide to what is necessary to qualify for this defense. Acquisition by inheritance or bequest is also a defense to liability in certain circumstances.

9. 42 U.S.C. § 9601 (20)(A) (1988 & Supp. 1990).

10. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986); *United States v. Fleet Factors Corp.*, 724 F. Supp. 955 (S.D. Ga. 1988) *aff'd and remanded*, 901 F.2d 1550 (11th Cir. 1990), *cert. denied*, 498 U.S. 1046 (1991). Following a non-jury trial on remand in *Fleet Factors*, the district court ruled that the lender was liable as an owner/operator and not entitled to the secured creditor exemption but was not liable as an arranger. *United States v. Fleet Factors Corp.*, 821 F. Supp. 707 (S.D. Ga. 1993). *See also Kelley v. Tiscornia*, 810 F. Supp. 901 (W.D. Mich. 1993); *Waterville Indus., Inc. v. Finance Auth. of Me.*, 984 F.2d 549 (1st Cir. 1993); *Ashland Oil, Inc. v. Sonford Prods. Corp.*, 810 F. Supp. 1057 (D. Minn. 1993); *Grantors to the Silresim Site Trust v. State Street Bank & Trust Co.*, 23 *Envtl. L. Rep. (Envtl. L. Inst.)* 20,428 (D. Mass. 1992).

11. EPA Rule on Lender Liability under CERCLA, 57 *Fed. Reg.* 18,344 (Apr. 29, 1992). A lender is not required to perform any environmental due diligence to qualify for the secured creditor exemption under CERCLA. EPA also stated in the preamble to the Rule that it did not believe that trustees should be held liable solely by virtue of owning trust property. 57 *Fed. Reg.* 18,344, 18,349. *But see O'Neil v. Q.L.C.R.I. Inc.*, 750 F. Supp. 551 (D.R.I. 1990) (lender is liable for common law "aiding and abetting" a borrower in violating environmental law).

12. *Kelley v. E.P.A.*, Nos. 92-1312, 92-1314, 1994 U.S. App. LEXIS 1715 (D.C. Cir. Feb. 4, 1994).

13. Pub. L. No. 99-499, 100 Stat. 1613 (1986).

14. Potentially responsible parties (PRPs) may find some relief in two provisions of SARA. SARA authorizes the government to enter into de minimis settlements with PRPs if the "settlement involves only a minor portion of the response costs" and meets other criteria. 42 U.S.C. § 9622(g) (1988 & Supp. II 1990). In addition, SARA authorizes the government to enter into covenants not to sue PRPs in some limited circumstances. 42 U.S.C. § 9622(f) (1988).

- it acquired the property after disposal or placement of the hazardous substance;
- it had no part in causing the problem;
- at the time of acquisition, it did not know and had no reason to know of the problem; and
- it exercised due care with respect to hazardous substances, and took precautions against foreseeable acts or omissions of third parties and the consequences of such acts and omissions.¹⁵

For an investor “[t]o establish that [it] had no reason to know” about the hazardous substance, the investor “must have undertaken, at the time of acquisition, *all appropriate inquiry* into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability.”¹⁶

SARA expressly offers five factors for the courts to consider in interpreting this duty to inquire into previous ownership and uses of the property:

- any specialized knowledge or experience on the part of the defendant,
- the relationship of the purchase price to the value of the property if uncontaminated,
- commonly known or reasonably ascertainable information about the property,
- the obviousness of the presence or likely presence of the contamination at the property,¹⁷ and
- the ability to detect such contamination by appropriate inspection.¹⁸

Obviously, investors cannot simply cease investing in real estate altogether to avoid liability for the risks of potentially contaminated property. Owners, developers, sellers, buyers, operators, tenants, lenders and other investors must accept existing environmental issues as another risk of doing business, and attempt to deal with their potential liability as with any other market risk. The overreaction to environmental issues as reported by the media will probably disappear as the risks are better understood and the potential liability quantified. The best protection for investors is to train their real estate professionals to be sensitive to environmental risks in their underwriting and value analyses. The investor could then assess the risk and the probability of liability. It could best manage the risk by conducting “appropriate inquiry” into the status of any real estate that it contem-

15. 42 U.S.C. § 9601(35)(A) (1988).

16. 42 U.S.C. § 9601(35)(B) (1988 & Supp. 1990) (emphasis added).

17. The ASTM Standard defines “*obvious*” as “that which is plain or evident; a condition or fact that could not be ignored or overlooked by a reasonable observer while *visually or physically observing the property*.” E 1527-93, *supra* note 5, § 3.3.21.

18. 42 U.S.C. § 9601 (35)(B) (1988 & Supp. 1990).

plates offering for sale, developing, leasing or financing.¹⁹ Thus, the threshold question for the real estate investment community becomes whether or not its members have made appropriate inquiry to protect themselves.

II. EMERGING INDUSTRY PRACTICES

Notwithstanding extended legislative commentary on the "innocent landowner defense,"²⁰ Congress did not provide a practical or useful guide for the real estate industry and its constituents for their investment strategies. Appropriate inquiry is the proffered path to the statutory safe harbor, but there are no charts to guide investors. Neither judicial decisions nor government agency rulings or positions offer any comfort or consistent approach.²¹ Several courts have exonerated investors from CERCLA liability when the investors failed to perform any inquiry whatsoever,²² yet another had found liability in the case of an investor who actually performed a site assessment, but who had had continuing suspicions about the property being "a dusty old warehouse."²³ Although EPA publicly recognizes and encourages the use of site assessments, its published guidance offers the investor few useful specific details or practical suggestions.²⁴ Thus, the real estate industry has been frustrated in its attempts to take advantage of the defense with any degree of confidence in its success. What is "appropriate inquiry?" Unfortunately, in the absence of a standard approach in the real estate industry, the scientific and "quasi-scientific" commu-

19. The legislative history of SARA indicates that those involved in commercial transactions are to be held to a higher standard of diligence than parties involved in residential transactions. H.R. CONF. REP. No. 962, 99th Cong., 2d Sess. 187 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3276, 3280. EPA has adopted a formal policy that it will not ordinarily pursue single family owners under CERCLA. EPA Policy Towards Owners of Residential Property at Superfund Sites, OSWER Directive No. 9834.6 (July 3, 1991). See *infra* note 33 (noting ASTM standard definitions of "commercial real estate," and "commercial real estate transaction").

20. H.R. CONF. REP. No. 962, 99th Cong., 2d Sess. 186-188 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3276, 3279-81.

21. There is no consistent case law to guide investors as to the minimum level of due diligence necessary or appropriate to avail themselves of the innocent landowner defense. See, e.g., *United States v. Monsanto Co.*, 858 F.2d 160, 168-69 (4th Cir. 1988), *cert. denied*, 490 U.S. 1106 (1989); *Shapiro v. Alexanderson*, 741 F. Supp. 472, 478 (S.D.N.Y. 1990); *United States v. Pacific Hide & Fur Depot*, 716 F. Supp. 1341, 1346-49 (D. Idaho 1989); *United States v. Serafini*, 706 F. Supp. 346, 351-53 (M.D. Pa. 1988), *and* 791 F. Supp. 107 (M.D. Pa. 1990); *In re Sterling Steel Treating*, 94 B.R. 924, 929-30 (Bankr. E.D. Mich. 1989).

22. *United States v. Pacific Hide & Fur Depot*, 716 F. Supp. at 1348-49; *United States v. Serafini*, 706 F. Supp. at 353.

23. *BCW Assocs. v. Occidental Chem. Corp.*, No. CIV.A.86-5947, 1988 U.S. Dist. LEXIS 11275, at *28 (E.D. Pa. Sept. 29, 1988).

24. Guidance on Landowner Liability Under Section 107(a)(1) of CERCLA, 54 Fed. Reg. 34,235 (1989).

nities²⁵ have offered a variety of due diligence approaches for the lending community in response to lenders' concerns that were heightened by judicial decisions limiting the "secured creditor exemption."²⁶

All of these approaches, variously known as "site assessments," "environmental audits," or "Phase I investigations," usually required a site inspection, a record review, and an adjacent area reconnaissance to be conducted by an "environmental consultant."²⁷ Environmental consulting became a growth business with a vast array of so-called "experts" offering a variety of approaches to the appropriate inquiry dilemma. Concerned lenders fueled this growth, but did not simultaneously exercise any control in establishing qualifications or uniformity. At best, individual financial institutions established their own guidelines and approved lists of experts. Eventually there could have been as many different approaches as there were different lenders.

Then, in 1989 the Federal Home Loan Bank Board (FHLBB), the predecessor of the Office of Thrift Supervision, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) each promulgated its own version of due diligence.²⁸ The real estate industry was faced with a maze of requirements, thus preventing an investor from approaching any lender or group of lenders with a uniform due diligence of its prop-

25. Today, environmental due diligence is generally performed in three separate, but integrated phases: Phase I is a limited non-intrusive inquiry which attempts to identify "recognized environmental conditions." E 1527-93, *supra* note 5, § 6.1. Phase II is an intrusive investigation of the identified recognized environmental conditions involving sampling and laboratory analysis. *Id.* § X1.3.3.2. Phase III involves the development of a remediation plan and the implementation of the actual cleanup of contamination confirmed by the Phase II investigation.

26. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 579-80 (D. Md. 1986); *United States v. Fleet Factors Corp.*, 724 F. Supp. 955, 960-61 (S.D. Ga. 1988), *aff'd and remanded*, 901 F.2d 1550, 1556-59 (11th Cir. 1990), *cert. denied*, 498 U.S. 1046 (1991).

27. No national or state licensing or registration scheme, or professional organization certification program exists for the individuals who hold themselves out as "environmental consultants," although federal and state licensing and registration, as well as national certification societies, exist for certain professionals, e.g., engineers, geologists and hygienists, who act in the capacity of environmental consultants. Sophisticated investors will usually seek out licensed or registered professionals or those with recognized national certification to act as their environmental consultants. *See also* E 1527-93, *supra* note 5, § 3.3.11 (defining "environmental professional").

28. FHLBB, THRIFT BULLETIN 16 (Feb. 6, 1989) requires thrift (not commercial) banks to obtain a Phase I environmental risk report for commercial real estate lending; FANNIE MAE, CONVENTIONAL SELLING GUIDE 61, (Sept. 1991) (Environmental Hazards Management Procedures/Multifamily Programs); Freddie Mac circulated unpublished proposed Environmental Guides in August, 1989 which were less comprehensive, but broader than the procedures put out by Fannie Mae. In addition, FEDERAL DEPOSIT INSURANCE CORPORATION, GUIDELINES FOR AN ENVIRONMENTAL RISK PROGRAM (Feb. 25, 1993) now require FDIC insured banks to adopt and implement an environmental risk management program. Fannie Mae, Freddie Mac and FDIC have been active participants in the ASTM process to develop an industry-wide approach.

erty. It was difficult enough to impose the new cost of environmental due diligence without the potential that it would be unacceptable because of the consultant's qualifications, the scope of the work or the nature of the inquiry undertaken. Finally, there was the possibility that a judge would use a "Chinese restaurant menu" approach to interpret whether there had been "appropriate inquiry" by picking and choosing various pieces of the standards published by FHLBB, Fannie Mae, Freddie Mac and other lenders. This would create a methodology which no one in the market place would meet. Consequently, no one would be able to assert the defense successfully.

III. ASTM STANDARDS

In late 1989 and early 1990, a substantial number of the national real estate industry and real estate finance industry trade groups²⁹ gathered to organize and develop an acceptable real estate industry approach to due diligence to qualify for the innocent landowner defense. This informal, ad hoc effort was a direct response to a serious concern over the lack of certainty and uniformity in dealing with the environmental consulting industry. After considering a proper forum for its discussions and the dissemination of their ultimate product, the informal realty group decided to work under the auspices of ASTM (formerly the American Society for Testing and Materials).³⁰ ASTM provides a system for the development of voluntary standards designed to ensure that all standards developed have undergone a thorough review process. The ASTM staff neither develops nor reviews the technical content of the standards, but the volunteer members, participating on the ASTM Subcommittee that is formed for a particular project, perform the actual work. However, ASTM does lend credibility to the standards by ensuring that they will be viewed as the product of a broad cross-section of affected interests, including participants from industry and government, consultants and consumer advocates. ASTM tries to discourage the federal government from prescribing a standard where an ASTM standard already exists, and also informs regulators when a standard will meet the needs of a particular issue for which the regulator has responsibility. In fact, the United States Office of Management and Budget Circular A-119 re-

29. Active participants included: Mortgage Bankers Association of America, the American Bankers Association, BOMA, the National Realty Council, the Multi-Family Housing Council, International Council of Shopping Centers, the American Council of Life Insurance Companies, the Independent Bankers Association, as well as the American College of Real Estate Lawyers and the Real Property, Probate and Trust Section of the American Bar Association.

30. Founded in 1898, ASTM is the largest voluntary standard development system in the world with 33,000 members in 89 countries and a staff of 200. It has 135 technical committees and has published over 8500 standards. Its offices are located in Philadelphia, Pennsylvania.

quires that the federal government rely on voluntary standards where possible.³¹

In March 1990, the informal realty group established the Subcommittee on Environmental Assessment for Commercial Real Estate Transactions (Subcommittee)³² to develop a due diligence standard for commercial real estate transactions³³ under ASTM. At its initial meeting, the ASTM Subcommittee adopted the following statement:

The Subcommittee will attempt to prepare a standard or standards for commercial real estate transactions (1) to define the practices necessary to qualify for the innocent landowner defense to Federal Superfund liability and (2) to outline prudent business practices for the environmental assessment of properties that are the subject of commercial real estate transactions.

A commercial real estate transaction is defined as a transfer of title to or possession of real property or receipt of a security interest in real property when the real property is intended to be used for revenue generating purposes.

It is intended that multifamily properties will be specifically addressed, and it is likely that some provisions may apply only to certain property types. It is recognized that ASTM has no authority to make any standards mandatory, either by legislation or regulation,

31. OMB, Circular No. A-119, Federal Participation in the Development and Use of Voluntary Standards, 47 Fed. Reg. 49, 496 (1982).

32. The Subcommittee was later placed under the jurisdiction of a newly formed ASTM Committee on Environmental Assessment. The proposed scope of the Subcommittee was the promotion of knowledge, stimulation of research, and the development of standard guides, specifications, practices, test methods, classifications, and definitions relating to environmental assessment. It includes, but is not limited to, commercial real estate transactions, storage tanks, and pollution prevention. One objective of the Subcommittee is to establish good commercial practices that satisfy the due diligence responsibilities of landowners.

33. The ASTM Standard defines "commercial real estate" as "any real property except a dwelling or property with no more than four dwelling units exclusively for residential use (except that a dwelling property with no more than four dwelling units exclusively for residential use is included in this term [commercial real estate] when it has a commercial function, as in the building of such dwellings for profit). This term includes but is not limited to undeveloped real property and real property used for industrial, retail, office, agricultural, other commercial, medical or educational purposes; property used for residential purposes that has more than four residential dwelling units; and property with no more than four dwelling units for residential use when it has a commercial function, as in the building of such dwellings for profit." E 1527-93, *supra* note 5, § 3.3.7. The Standard defines "*commercial real estate transaction*" as

[a] transfer of title to or possession of real property or receipt of a security interest in real property, except that it does not include transfer of title to or possession of real property or the receipt of a security interest in real property with respect to an individual dwelling or building containing fewer than five dwelling units, nor does it include the purchase of a lot or lots to construct a dwelling for occupancy by a purchaser, but a commercial real estate transaction does include real property purchased or leased by persons or entities in the business of building or developing dwelling units.

Id. § 3.3.8. The Standard clarifies that there is no implication of a requirement for a site assessment for a residential home purchaser or a residential tenant. *Id.* § 4.2.2.

and thus it is intended that the standard or standards to be developed will be voluntary. In addition, the Subcommittee may prepare procedures, guidance and criteria to certify the environmental condition of real property that is the subject of commercial real estate transactions for purposes of the federal Superfund law and other laws, including state and common law requirements. It is hoped that the Subcommittee will recommend means by which subsequent holders of title, possessory or security interest may rely on previous environmental assessments or certifications in order to avoid duplicative due diligence practices.

Objectives that will guide the development of these standards are (1) to ensure the efficiency and integrity of commercial real estate transactions, (2) to facilitate compliance with applicable governmental requirements for environmental protection, (3) to improve the quality of environmental assessments, (4) to clarify the legal responsibilities associated with commercial real estate transactions, and (5) to ensure that the standard of inquiry is practical and reasonable.³⁴

At the outset it was determined that the project be limited to commercial (including multifamily) transactions, CERCLA contaminants (as well as petroleum because it is now customarily included in due diligence), and the memorializing of "good current commercial or customary practice." The project was not intended to alter current industry practices.

The Subcommittee, with more than 400 members, represents a balance of users (owners, lenders, etc.) and producers (the environmental industry). It is comprised of national, regional and local environmental companies, real estate owners, chemical, oil and other major industrial concerns, large and small lenders, national and regional real estate industry trade associations, national professional associations,³⁵ government organizations (including Resolution Trust Corporation, Federal Deposit Insurance Corporation, Department of Defense and EPA) and quasi-government organizations (Fannie Mae and Freddie Mac). The Subcommittee is governed by the ASTM rules. The Subcommittee is fully democratic, balloting through a hierarchical committee system through the entire ASTM.³⁶ To assure that the Standard is representative of current practices, the ASTM rules require that after

34. *Statement of ASTM Subcommittee* (on file with author).

35. The Subcommittee and its sections have been led primarily by representatives of the lending and real estate finance investment community and the liaisons from the American College of Real Estate Lawyers and the Real Property, Probate and Trust section of the American Bar Association.

36. For example, all votes require super majorities and all negative ballots must be considered before balloting continues.

adoption of a standard, it must be reviewed periodically to incorporate developing industry practices and other changes.³⁷

The final Standard for Environmental Assessments for Commercial Real Estate (Standard) adopted by ASTM in March 1993 was the result of a lengthy process of negotiation and compromise among the members of the Subcommittee to arrive at a consensus acceptable to the ASTM membership. The Standard consists of two separate but interrelated Practices – the “Environmental Site Assessment: Phase I Environmental Site Assessment Process”³⁸ and the “Environmental Site Assessment: Transaction Screen Process”³⁹ (each individually a “Practice”). The Standard recognizes several significant principles about “good commercial or customary practice” of the real estate industry as a “[u]ser”⁴⁰ (as opposed to “scientific” certainty of the environmental industry). As “appropriate inquiry,” due diligence:

- can only reduce risk (but cannot eliminate it with certainty);
- must be practical and within the time and cost constraints of actual transactions;
- cannot be an exhaustive analysis of a clean property;
- must allow for a range of approaches to different properties;
- is the result of the application of professional judgments and is not simply a mechanical process; and
- is subject to practical cost-benefit questions balancing the value of results against increases in cost.

The Standard is designed for voluntary use as “appropriate inquiry” under CERCLA⁴¹ and to “reflect a commercially prudent and reasonable inquiry.”⁴² It acknowledges that different degrees of inquiry (including, in some cases, no site assessment whatsoever) may be appropriate in particular circumstances and that “no implication is intended that a person must use [the Standard] in order to be deemed to have conducted inquiry in a commercially prudent or reasonable manner in any particular transaction.”⁴³ Thus, the Standard confirms due diligence as a process of incremental inquiry — from the basic to the comprehensive — as deemed appropriate. As it is designed, the Standard permits an investor to commence its due diligence by conducting a transaction screen level of inquiry or to proceed directly to the

37. It is intended that after the Standard is final, the Subcommittee will consider adopting other standards for an asbestos assessment, intrusive testing practices (Phase II), as well as several other projects.

38. E 1527-93, *supra* note 5.

39. E 1528-93, *supra* note 5.

40. “User” is defined in the Standard as the party seeking to use the Transaction Screen to perform an environmental assessment of property, i.e., an investor or property manager. E 1527-93, *supra* note 5, § 3.3.39. A “preparer” is defined as the party preparing the Transaction Screen Questionnaire who may be either the user or a party to whom the user delegated the inquiry. *Id.* § 3.3.25.

41. E 1527-93, *supra* note 5, § 1.1.

42. *Id.* § 4.1.

43. *Id.*

Phase I Site Assessment level. The legal basis for the Standard is set forth in the Legal Background Report of the legal section of the Subcommittee (included as an appendix to the Standard).

An environmental site assessment or a transaction screen performed in conformance with this Standard will be presumed valid for 180 days after its completion and in certain limited cases, in whole or in part, thereafter.⁴⁴ In addition, the Standard provides certain procedures and express principles with respect to use of prior assessment information.⁴⁵

A. *Transaction Screen*

The transaction screen has been designed to be completed by an investor as user without the assistance of an environmental consultant. It consists basically of a question-answer approach which consists of three stages of inquiry:⁴⁶

- questioning owners and/or operators;
- visiting the site; and
- checking government records, and historical sources.⁴⁷

The questions the user is to ask of owner/operators require corresponding observations by the investor on a site visit. An investor is to exercise business judgment to determine whether an affirmative or unknown answer should require additional inquiry, and if so, whether a full Phase I, or a limited inquiry of the specific issues raised, is appropriate. Although affirmative or "unknown" answers create a presumption in favor of further inquiry, this presumption may be rebutted by the investor in consideration of the variables and circumstances of the particular transaction. Of course, the investor's rebuttal analysis should be properly documented and retained for future evidentiary use. To assist the investor in the performance of the transaction screen, the Standard provides a detailed questionnaire to be completed by the user for the interview, site visit and the government records/historical sources review.

In an attempt to assure that the process is not merely a rote checklist, the transaction screen also incorporates a detailed guide to completing each question in the questionnaire, using prior environmental site assessments, conducting site visits and periphery observation, obtaining governmental records and using historical sources.

The transaction screen requires a very limited record search of specified governmental records within the specified areas:

44. *Id.* § 4.6.

45. *Id.* § 4.7

46. E 1528-93, *supra* note 5, § 5.1.

47. *Id.* § 5.1.

- Federal CERCLA List 0.5mi/0.8km
- Federal NPL Site List 1.0mi/1.6km
- Federal RCRA TSD Facilities List 1.0mi/1.6km
- State Superfund List 1.0mi/1.6km
- State CERCLA List 0.5mi/0.8km
- LUST Lists 0.5mi/0.8km
- Solid Waste Landfill Lists 0.5mi/0.8km.⁴⁸

Also included are very limited historical sources – review of fire insurance maps and an interview with a local fire marshal. Unlike the personal questions and site visit, the Standard expressly permits the user to contract with an available third-party data service to obtain a record search. This provision takes advantage of the growing environmental data search, retrieval and reporting businesses which have developed simultaneously (and sometimes in competition) with the environmental consulting industry.⁴⁹ Even the title insurance industry under the auspices of the American Land Title Association (ALTA) has decided to offer its customers a limited land record review of the chain of ownership as an environmental due diligence tool.⁵⁰ The data service provider industry offers investors a valuable service for environmental risk management. For the most part, the providers are honest and competent. Yet as with *any* industry enjoying unregulated growth in a seller's market, there are always those who will play on the ignorance of the public. Some unscrupulous parties have claimed that the use of their data service will constitute a sufficient basis to claim the innocent landowner defense. Others have used words like "guarantee" or "warrant" in their materials to instill an investor with a false sense of security.

If an investor determines additional inquiry is warranted by the results of the transaction screen (or simply desires a higher inquiry level at the outset), a Phase I Environmental Site Assessment can be conducted by or under the supervision of a "qualified" environmental consultant.⁵¹

B. *Environmental Site Assessment*

The second practice adopted by ASTM as part of the Standard is the Phase I Environmental Site Assessment (Phase I) which offers an

48. *Id.* §§ 10.1-10.2.

49. Without endorsement, some of the private data service providers are: EN-SITE Corp., 11632 East Lake Ave., Englewood, CO 80111, (303) 740-7483; Environmental Audit Inc., Box 322, Lionville, PA 19353, (215) 524-7002; Environmental Information Systems Inc., 700 North Central Ave., Suite 250, Glendale, CA 91203, (818) 241-4100; and Toxichack/Environmental Information Servs., 1400 N. Woodward Ave., Suite 10, Bloomfield Hills, MI 48304, (313) 647-5408.

50. See ALTA Form RECORDED DOCUMENT CERTIFICATE (Oct. 3, 1990); ALTA Form RECORDED DOCUMENT GUARANTY (Oct. 3, 1990). As the Standard obligates the user to identify environmental liens, engaging a title company to conduct a record search is recommended.

51. E 1528-93, *supra* note 5, § 5.8.

investor a more exhaustive and comprehensive level of due diligence than the transaction screen.⁵² The Standard provides that there are four components of any Phase I:

- a review of records;
- a site reconnaissance;
- interviews with current owners and operators; and
- report preparation and evaluation.⁵³

Unlike the transaction screen process, the Phase I was intended by the Practice to be conducted by or under supervision of an environmental consultant and not by the investor.⁵⁴ Since SARA makes it clear that anyone who knowingly transfers contaminated property without disclosing a hazardous substance problem forfeits his defenses to CERCLA liability,⁵⁵ an investor has the obligation to cooperate with the environmental consultant and provide him with all data and personal knowledge in the investor's possession.⁵⁶ The environmental consultant is required under the Standard to note separately whether the user has reported any environmental liens or has any material, specialized knowledge or experience of prior ownership or risks. The user has the responsibility under the Practice to perform the following tasks for the consultant: check land title records for environmental liens, communicate any specialized knowledge or expertise of user before site reconnaissance is scheduled, and determine and document a below market purchase price in purchase transactions.⁵⁷ Like the transaction screen, the records review portion of Phase I may be contracted out to independent third-party service providers. Moreover, a Phase I can be performed by more than one environmental consultant and may be performed by an "in-house" employee or staff professional of the investor.⁵⁸

In deference to a practical approach, the Practice requires that the consultant review and consider the results of the interviews, record review and site reconnaissance cumulatively and in concert.⁵⁹ The results of each component may be used to compensate for inadequacies in the results of the other two components but only when "reasonably ascertainable" and "practically reviewable."⁶⁰ "Reasonably ascertainable" information must be "publicly available"⁶¹ and "obtainable from

52. E 1527-93, *supra* note 5, § 6.1.

53. *Id.* §§ 6.2-6.2.4.

54. *Id.* §§ 6.5-6.5.2.

55. 42 U.S.C. § 9607 (6)(3) (1988 & Supp. 1990).

56. E 1527-93, *supra* note 5, § 6.3.2.

57. *Id.* §§ 5.1-5.4. *See also* §§ 6.3.2, 9.7.1.

58. *Id.* §§ 6.5-6.5.2.

59. *Id.* § 6.3.1.

60. *Id.* *See also* §§ 3.3.24, 3.3.27.

61. To be "publicly available" information, the source must "allow access to the information by anyone upon request." *Id.* § 3.3.26.

its source within reasonable time and cost constraints”⁶² For information to be “*practically reviewable*”, it must be provided “in a manner and in a form that, upon examination, yields information relevant to the property without the need of extraordinary analysis of irrelevant data.”⁶³

1. Record Review

Pursuant to the record review component of a Phase I, the environmental consultant is required to review the enumerated standard federal and state environmental record sources.⁶⁴ This record review extends beyond the property to an identified “approximate minimum search distance” to cover contamination migration.⁶⁵ Except for the Federal NPL Site List and Federal RCRA TSD List,⁶⁶ these distances may be reduced by the environmental consultant. Under the Practice, the standard federal and state environmental record sources are:

	Approximate Minimum Search Distance
• Federal NPL Site List ⁶⁷	1.0mi/1.6km
• Federal CERCLA List ⁶⁸	0.5mi/0.8km
• Federal RCRA TSD Facilities List ⁶⁹	1.0mi/1.6km
• Federal RCRA Generators List ⁷⁰	Property & Adjoining Properties
• Federal ERNS List ⁷¹	Property Only
• State Lists of Hazardous Waste Sites Identified for Investigation or Remediation (NPL and CERCLA Equivalents)	1.0mi/1.6km
• State Landfill and/or Solid Waste Disposal Site Lists	0.5mi/0.8km
• State Leaking Underground Storage Tank (LUST) Lists ⁷²	0.5mi/0.8km
• State Registered UST Lists.	Property & Adjoining Properties ⁷³

62. *Id.* § 3.3.27. Such information must be available within 20 days of contact for a nominal cost. *Id.* § 7.1.4.2.

63. *Id.* § 3.3.24. Records must be retrievable by property locations or geographic area. Records available only chronologically are not Practically Reviewable. *Id.* § 7.1.4.3.

64. *Id.* § 7.2.1.

65. *Id.* § 7.2.1.1.

66. *Id.* §§ 3.2.20, 3.2.32.

67. *Id.* § 3.2.20.

68. *Id.* § 3.2.3.

69. *Id.* § 3.2.32.

70. *Id.* § 3.2.30.

71. *Id.* § 3.2.11.

72. *Id.* § 3.2.41.

73. *Id.* § 7.2.1.1.

Additional state and local sources may be reviewed in the environmental consultant's discretion to supplement and enhance the standard sources in the appropriate circumstances. The Practice specifies the following types of local records:

- Lists of Landfill/Solid Waste Disposal Sites
- Lists of Hazardous Waste/Contaminated Sites
- Lists of Registered Underground Storage Tanks
- Records of Emergency Release Reports (SARA section 304)
- Records of Contaminated Public Wells and Local Sources
- Department of Health/Environmental Division
- Fire Department
- Planning Department
- Building Permit/Inspection Department
- Local/Regional Pollution Control Agency
- Local/Regional Water Quality Agency
- Local Electric Utility Companies (for records relating to polychlorinated biphenyls).⁷⁴

In addition, the governmental records review must be supplemented by a review of "standard physical setting source[s]."⁷⁵ At present, the *only* standard physical setting source set forth in, and the *only* one required to be reviewed under the Practice if "*reasonably ascertainable*", is the United States Geological Survey (USGS). The current USGS 7.5 Minute Topographic Map⁷⁶ indicates where the property is located, and may provide additional geologic, hydrogeologic, hydrologic or topographic characteristics.⁷⁷ If more information is locally customary for environmental consultants or migration to soil or groundwater is possible, the following additional discretionary and non-standard physical setting sources must be checked:

- USGS and/or State Geological Survey – Groundwater Maps
- USGS and/or State Geological Survey – Bedrock Geology Maps
- USGS and/or State Geological Survey – Surficial Geology Maps
- Soil Conservation Service – Soil Maps
- Other Physical Setting Sources that are Reasonably Credible (as well as reasonably ascertainable).⁷⁸

Historical inquiry to develop previous uses and occupancies is substantially more extensive under the Phase I Practice than is required for the Transaction Screen. Inquiry into historical sources is done in two phases. The first phase is a minimum inquiry from the present back to 1940.⁷⁹ However, if the property was developed before 1940, inquiry using at least one standard historical inquiry must be done at least back to a date before the property was developed (including

74. *Id.* § 7.2.2.

75. *Id.* § 7.2.3.

76. *Id.* § 3.2.42.

77. *Id.* § 7.2.3.

78. *Id.*

79. *Id.* § 7.3.2.

placement of fill) as determined by the environmental consultant. Such earlier date chosen by the consultant, as well as the search intervals set by the consultant, must be memorialized in the written report. Any historical analysis should include areas surrounding the site as well. Several historical sources are enumerated in the Standard:

- Aerial Photographs
- Fire Insurance Maps
- Property Tax Files
- Recorded Land Title Records
- USGS 7.5 Minute Topographic Maps
- Local Street Directories
- Building Department Records
- Zoning/Land Use Records
- Other Historical Sources (owner/occupant files and personal knowledge).⁸⁰

Although only one standard historical source must be chosen and consulted under the Practice, other historical sources must be consulted if the standard chosen is not useful for the consultant. Additionally, other historical sources may also be reviewed to supplement and verify the primary historical source.⁸¹ Recorded land title records, however, *cannot* be used as the sole historical source.⁸² The historical inquiry of prior Phase I reports in conformance with this Practice need not be searched again or reviewed, but the uses must be updated since such prior report was made.⁸³

2. Site Reconnaissance

The second component of the Practice for a Phase I is a site reconnaissance.⁸⁴ The environmental consultant is required to physically visit the property and to “visually” observe the physical site and structures, to the extent not obstructed. This physical observation should include the exterior and interior of all structures on the property and, to the extent possible, the uses of adjoining properties should be determined. Of course, the environmental consultant’s report will detail the methodology of the physical investigation⁸⁵ and the circumstantial limitations on the ability to view the site, *e.g.*, no access to areas or structures. It need not, however, visit the site more than once. Prior Phase I report site reconnaissance may be used as a guide but may not be relied upon without a new site visit.⁸⁶ Uses and conditions noted in

80. *Id.* §§ 7.3.4-7.3.4.9.

81. *Id.* § 7.3.4.

82. *Id.* § 7.3.4.4.

83. *Id.* § 7.4.

84. *Id.* § 3.3.30.

85. A prior draft of the Standard contained a “Site Survey Summary” which was deleted from the current Practice in response to comments concerned with confusion about its use.

86. E 1527-93, *supra* note 5, § 8.3.

the site visit should also be the subject of the owner/occupant interviews. The consultant should:

- Identify the general site setting including:
 - Current Use(s) of the Property,
 - Past Use(s) of the Property,
 - Current Uses of Adjoining Properties,
 - Past Uses of Adjoining Properties,
 - Current or Past Uses in the Surrounding Area,
 - Geologic, Hydrogeologic, Hydrologic and Topographic Conditions,
 - General Descriptions of Structures,
 - Roads,
 - Potable Water Supply, and
 - Sewage Disposal System;
- Observe the interior and exterior of the property including:
 - Current Use(s) of the Property,
 - Past Use(s) of the Property,
 - Hazardous Substances and Petroleum Products in Connection with Identified Uses,
 - Storage Tanks,
 - Odors,
 - Pools of Liquid,
 - Drums,
 - Hazardous Substance and Petroleum Products Containers (Not Necessarily in connection with Identified Uses),
 - Unidentified Substance Containers, and
 - Polychlorinated Biphenyls;⁸⁷
- Observe the interior of the property for:
 - Heating/Cooling,
 - Stains or Corrosion, and
 - Drains and Sumps;
- Observe the exterior of the property for:
 - Pits, Ponds or Lagoons,
 - Stained Soil or Pavement,
 - Stressed Vegetation,
 - Solid Waste,
 - Waste Water,
 - Wells, and
 - Septic Systems.⁸⁸

3. Owner/Occupant Interviews

The third component of the Phase I involves an environmental consultant's undertaking to interview the owner(s) and occupant(s) of a property about their knowledge of its uses and physical condition. Except as noted below, the timing, manner and method of this process is left to the discretion of the environmental consultant who can ac-

87. *Id.* § 8.4.2.10.

88. *Id.* §§ 8.4.1-8.4.4.7.

comply with the interview in face-to-face meetings, by telephone, or through correspondence at any time before, during and/or after a site visit. The Practice does, however, specifically identify the parties to be identified and interviewed in the conduct of a Phase I. Before arranging to visit the property, the environmental consultant should request that the owner⁸⁹ identify someone as the key site manager. The key site manager can be an individual, an employee, a supervisor, a manager, or a third-party independent contractor who has "good knowledge" of the uses and physical condition of the site.⁹⁰ Once this person has been identified, the environmental consultant should attempt to interview the key site manager at the property during the site visit.⁹¹ If such a meeting cannot be arranged, the environmental consultant can attempt to identify and interview another person having appropriate knowledge.

While occupants of the property must also be interviewed, such meetings need not be in conjunction with the site visit. Although it is not necessary for residential occupants on multifamily properties to be contacted, the non-residential occupants of such properties should be interviewed about the site.⁹² For properties with less than five occupants, an attempt should be made to contact all the occupants; but if there are more occupants, only "major occupants"⁹³ and occupants with operations likely to create "recognized environmental conditions"⁹⁴ should be questioned by the environmental consultant.⁹⁵ While the Practice requires that interviewees be asked to answer in good faith and within their knowledge specifically, it also recognizes that no party (other than a user wishing to rely on the process) has any obligation to cooperate or answer any questions addressed to them in the process.

In preparation for the environmental consultant's site visit, the Practice requires the environmental consultant to ask the owner, key site manager and user about:

- the existence of certain "helpful" documents and whether copies are readily available,⁹⁶ and

89. In the event the user is the current property owner, the user is required to identify a key site manager. *Id.* § 9.5.1.

90. The Practice also permits the user to be the key site manager. *Id.*

91. In all cases, the Practice merely requires the Environmental Professional to make reasonable attempts to arrange interviews with the major occupants. *Id.* § 9.5.2. Reasonable attempt would include contacting such occupants by telephone. *Id.* § 9.5.2.3.

92. *Id.* § 9.5.2.1.

93. Major occupant is identified as tenant, subtenant or other party who uses at least 40% of the leasable area of Property or an Anchor Tenant of a shopping center. *Id.* § 3.3.20.

94. *Id.* § 1.1.1.

95. *Id.* § 9.5.2.2.

96. "Helpful" documents include: Environmental site assessment reports, environmental audit reports, environmental permits (for example, solid waste disposal

- their knowledge of any past, present, or threatened litigation or administrative proceedings, or any governmental notices with regard to certain environmental issues.⁹⁷

The Practice recognizes that customary practice usually involves interviews not only with parties involved with the site, but with local government offices as well. Again, the method, manner and time of the questions are left to the environmental consultant except that the questions must be directed at identification of recognized environmental conditions at the site.⁹⁸ The environmental consultant should identify and interview one of the following local governmental agencies serving the property:

- local fire department;
- local health agency or office of state health agency; or
- local agency or office of state agency with authority regarding hazardous waste disposal.⁹⁹

While the Practice permits reliance on answers provided by the same interviewees in a prior Phase I conducted under the Practice, the feedback should be updated from the date of the prior Phase I. Recognizing that information requested may be unknown to the interviewees, or that parties other than the user or key site manager may not cooperate with the environmental consultant, the Practice nonetheless does not invalidate the entire process, and in the latter case requires the environmental consultant to make a written record of attempts, including at least one follow-up to contact the party being sought for interview.

A final caveat: environmental due diligence will be worthless if an investor is unable to properly document its efforts at a later date. Thus, as an evidentiary matter, the information gathered during the record review, site reconnaissance and interviews must be memorialized in a manner which adequately establishes the basis for the investor's decision at the time it acquired the interest in the property. The environmental consulting industry has developed as many types of reports as there are types of assessments and consultants.

permits, hazardous waste disposal permits, wastewater permits, NPDES permits), registrations for underground and above ground storage tanks, material safety data sheets, community right-to-know plans, safety plans (including those of preparedness and prevention, spill prevention, countermeasure and control, etc.), reports regarding hydrogeologic conditions on the property or surrounding area, notices from any government agency relating to past or current violations of environmental laws with respect to the property (or relating to environmental liens encumbering the property), hazardous waste generator notices or reports, and geotechnical studies. These should be reviewed prior to, or at the commencement of, the site visit. *Id.* § 9.8.1-9.8.1.11.

97. *Id.* § 9.9.

98. *Id.* § 10.2.

99. *Id.* §§ 10.5.1-10.5.1.3.

4. Report Preparation/Evaluation

As an articulation of “good commercial or customary practice,”¹⁰⁰ the Standard provides a detailed process to develop and report the findings of the Phase I conducted by the environmental consultant. The Standard expressly recommends that (unless a user requires otherwise) an environmental consultant use a specific general format to report a conforming Phase I Environmental Site Assessment.¹⁰¹

The Practice requires that a report of the findings of a Phase I shall:

- contain the documentation supporting its analysis, opinions and conclusions;
- sufficiently identify all sources (including indeterminate sources) to memorialize the process undertaken and permit the later retrieval of information allowing reconstruction of the inquiry;
- identify the tenants interviewed and the duration of their occupancy;
- encompass all of the due diligence performed in conformance with the Practice;
- separately identify any information reported by the user;
- clearly enumerate all conditions and circumstances limiting the inquiry conducted;
- separately list and detail all deletions and deviations from the Practice;
- list all additions to the Practice;
- contain the name of the environmental professional(s) who performed the inquiry;
- include a qualification statement of the responsible environmental professional(s) for the Phase I report, including individual and corporate qualifications relevant to the inquiry undertaken (or a separate written qualification statement developed to user);
- describe in full all evidence of recognized environmental conditions;
- include the opinion of the environmental professional on recognized environmental condition’s impact on the property;
- contain one of the following as a finding and conclusion:
We have performed a Phase I Environmental Site Assessment in conformance with the scope and limitations of ASTM Standard Practice E 1527 of [insert address or legal description], the Property. Any exceptions to, or deletions from, the Standard Practice are described in Section [] of this report. This assessment has revealed no evidence of recognized environmental conditions in connection with the property,¹⁰²

or

We have performed a Phase I Environmental Site Assessment in conformance with the scope and limitations of ASTM Standard Practice E 1527 of [insert address or legal description], the prop-

100. *Id.* § 1.1.

101. *Id.* § 11.1.

102. *Id.* § 11.6.1.

erty. Any exceptions to, or deletions from, the Standard Practice are described in Section [] of this report. This assessment has revealed no evidence of recognized environmental conditions in connection with the property except for the following: (list);¹⁰³

- be signed by the environmental professional(s) responsible for the Phase I.¹⁰⁴

Clearly beyond the scope of this Practice Standard are investigation of additional sources, articulation of more detailed conclusions, evaluation of liability or risk, recommendations for Phase II testing, and remediation techniques. A report in conformance with the Standard should *not* contain such additional items unless expressly and specifically contracted for by a user in its terms of engagement with the environmental consultant.

There are other environmental conditions that a user may want to address. These include, but are not limited to, asbestos, radon, lead-based paint, lead in drinking water and the presence of wetlands. As these issues are beyond the scope of CERCLA, a user would not be required to address such environmental concerns as a part of “appropriate inquiry” under the Standard.¹⁰⁵ Of course, securing the innocent landowner defense is not the only reason for an investor to conduct environmental due diligence with respect to a property, nor is a Phase I all that is encompassed in effective environmental risk management. A Phase I is only one tool available for use in the environmental risk management process. Aside from the reduced profitability resulting from liability for the cost of clean-up of contaminated property, there are the economic risks that the clean-up costs may exceed the investor’s equity investment in the property, or the entire fair market value. Moreover, an investor may wish to determine its risk of liability for civil damages to third parties. In addition, an investor should be concerned about potential liability for failure to comply with environmental quality laws.

IV. LEGAL COMPLIANCE AUDIT

Although the terms “assessment” and “audit” have been used interchangeably and without distinction for some time, distinguishing between the two terms and maintaining a consistency of usage will foster a better understanding of the different tools available for environmental risk management. The Standard expressly recommends not using the term “environmental audit” to describe either Practice.¹⁰⁶ While a site assessment (Phase I) is a limited inquiry which attempts to identify recognized environmental conditions at a particular site, a compliance audit would be an attempt to identify the environmental laws

103. *Id.* § 11.6.2.

104. *Id.* §§ 11.2-11.8.

105. *Id.* §§ 12.1.1-12.1.4.

106. *Id.* § 3.3.10.

and regulations and industry codes of general application, and any site-specific orders or directives applicable to a particular property and to its current use such as:

- determination of whether the property, its use, or the operations and processes performed on it adversely affect critical environmental resources;
- cataloging what licenses, permits and other governmental consents are required for use and operations;
- determination of whether the licenses, permits, etc. have been obtained, and are being properly complied with by the owners, operators, or occupants of the property.

The legal compliance audit can be conducted periodically throughout the term of the investment provided the transaction documents provide for the other party's obligation to cooperate with the audit and to provide licenses, certificates, reports and a general legal compliance certificate on a regular periodic basis. The party wishing to conduct such an audit should not rely on a "general compliance with law" clause or a "books and records examination" clause of its transaction documents. A right of the investor to audit the property's legal compliance should be expressly and clearly stated, and the failure to provide access, compliance documents or a general legal compliance certificate to the investor upon request should be deemed a material default under the transaction documents.

V. CONTINUING DUE DILIGENCE/COMPLIANCE

Environmental risk management should not be viewed as a one-step answer to a static problem, but rather should be adopted and implemented as a continual process of risk prevention and liability avoidance. Clearly, the prophylactic value of an initial "snapshot" of appropriate inquiry taken at the time of acquisition will be corrupted by both the passage of time and the investor's ignorance of subsequent developments at a property. Due diligence and legal compliance should continue during the term of any real estate investment to assure the investor that the underwriting decision to invest in a property will *not* be jeopardized by subsequent events which could have been discovered, prevented, or at least mitigated by the investor, or initially disclosed to it. Thus, regardless of an investor's due diligence, the potential risk of an environmental problem is ongoing and should be dealt with in the contract, conveyance, lease, management or finance documents executed by the parties to a real estate transaction at the time of a party's acquisition of an interest in the property.

A. *Transaction Documents*

Parties may want the transaction documents to shift the liability (to the extent possible) to the other parties, to a third-party guarantor or third-party service provider.

At a minimum, the transaction documents should contain specific provisions dealing with environmental issues. Reliance upon general compliance with law, legal use, waste, indemnification and other non-specific clauses may be misplaced. The scope and relative unfairness of specific provisions negotiated in a particular transaction will depend upon the relative economic bargaining power of the parties, the needs of the parties and the supply/demand nature of real estate markets. As these terms and conditions become more prevalent in transactions, it will become easier to negotiate the clauses in a manner which will coordinate the various interests of the several parties to a real estate transaction. Concern over "sandwich" liability for non-reciprocal obligations and indemnities should fuel a desire for consistency and mutuality of obligation and liability. Among the pertinent provisions of transaction documents would be:

- representations and warranties that:
 - the property has not been used nor is it now used in a manner which violates applicable federal state or local environmental laws,
 - the party has not received any notice from a government agency for a violation of such laws, and
 - the party has no intention to use, cause, or allow the property to be used in such a manner;
- covenants that the party:
 - as the recipient, shall immediately notify the other party if such notice is received,
 - will not cause such a violation,
 - will not permit or suffer another to cause such a violation,
 - will not permit or suffer any environmental liens to be placed on the property,
 - will deliver all permits, licenses and reports obtained, and
 - grants the other party the right to inspect the property;
- further warrants that the party indemnifies and holds the other party harmless for:
 - certain specified environmental risks, and
 - related litigation costs.

The representations and warranties, covenants and indemnifications for environmental risk should be carved out of any personal liability exculpation provisions contained in the transaction documents.¹⁰⁷ Indeed, the transaction structure, investment vehicles, or financial capacity of a party may require that third-party credit support or

107. This may be of particular importance to a lender releasing or covenanting not to sue a borrower who delivers a deed in lieu of foreclosure to the lender.

transaction credit enhancement be provided as further assurance of both compliance with law and of the party's financial capacity to respond to any environmental problem. Because of the recharacterization and other liability risks attendant to exercise of control over another party in a transaction, an investor's involvement may be limited to an appropriate scheme of consent and approval of action or inaction rather than direct involvement, direction or supervision which may lead to claims of interference.

B. *Title Insurance*

Title insurance offers little or no protection to the investor because environmental liens are not always filed in the land records and sometimes attach retroactively. In 1984, ALTA changed its standard policies to exclude from coverage "[a]ny law, ordinance or governmental regulation . . . relating to . . . environmental protection . . ."¹⁰⁸ The trend among title insurers is to deny requests for specific affirmative coverage endorsements. In fact, the Connecticut Insurance Commissioner has ruled that a title company's authority to issue coverage does not extend to the issuance of environmental coverage. The 1987 and new 1990 ALTA forms of title insurance policies clearly exclude environmental risks. The problem is compounded in these forms by a new, more limited, definition of "public records" in the title policy, which limits the liability of title insurers that do not search the public environmental records in a jurisdiction where they are not part of the land records. In March of 1987, Fannie Mae negotiated with ALTA for an environmental lien endorsement for residential loan policies only (Form 8.1), although from time to time such endorsements have been obtained in commercial real estate transactions.

While liability insurers continue to disclaim coverage under traditional comprehensive general liability policies, there are some types of environmental impairment liability insurance coverage available, although most are marketed to lenders. Earlier policies had generally been offered only after the insurance company's consultant had conducted a comprehensive engineering study of the insured property. Yet in spite of the insurance industry's prior bad experiences with environmental insurance coverage, several insurance companies have begun to offer several different types of insurance coverage including site assessment insurance.¹⁰⁹ It is hoped that the Transaction Screen Practice may enable some insurers to provide coverage for small transactions that efficiently employ the process. Unfortunately, envi-

108. ALTA Form, LOAN POLICY OF TITLE INSURANCE, Exclusions from Coverage § 1, 1970 (amended 10/17/70 and 10/17/84).

109. RICHARD D. JONES, THE GENESIS AND GROWTH OF INSURANCE FOR "NO-FAULT" ENVIRONMENTAL LIABILITY IN REAL ESTATE TRANSACTION (Oct. 1992) (forthcoming ACREL Papers, to be published by the Real Property Probate and Trust Section of the American Bar Association) (Chicago, Ill.).

ronmental impairment insurance coverage is probably still not available to the extent that it could be viewed as a reliable alternative.

C. *Post-Contractual Risk Management*

Beyond documentary protections and possible insurance coverage, a standard program should be implemented for proper risk management, including periodic site inspections to monitor the condition and use of the property and to detect visible changes. Other potentially useful implementations might include obtaining and reviewing annual rent rolls and focusing on new tenants in problem businesses. In addition, if a property is located in a problem area, environmental records should be periodically checked much the same as the tax records are reviewed. Transfers of property should be carefully screened as well, so that a purchaser's business or intended use of the property may be determined. Care should be taken in any subsequent transaction modifications not to intentionally (or unintentionally by changing material terms) release prior owners who might have been contractually liable for any environmental damages. A court will recognize a release of liability between two parties, although such release will have no effect on the government's right to proceed against either or both parties for the environmental claim.

Again, the best due diligence is futile if an investor is unable to document its efforts satisfactorily at a later date. Thus, an adequate and diligent information and record-keeping system must be an integrated part of any property management operation. All telephone notes, inspections, reports, surveys or studies should be recorded and maintained in a manner allowing retrieval on a property specific basis. If a party desires to limit its liability, adequately establishing the basis for all decisions may be as important as conducting the diligence itself.

VI. INTERNAL ENVIRONMENTAL POLICIES

The transaction documents as executed by the parties and delivered at closing will govern all subsequent relations between the parties to the transaction. However, they do not provide guidance for a party prior to contract. As a result, investors — individuals as well as institutions — should consider preparing, adopting and implementing written environmental risk management guidelines for use in their investment strategy, their transaction vehicle and structure decisions, their negotiation tactics, and for their risk avoidance, allocation or acceptance policies. The scope and content of such guidelines are beyond the scope of this article, but must offer *practical* guidance to their users. A broad and nebulous statement of policy may cause more harm than good as parties seek to implement its ill-defined pronouncements, and do so inadequately and inconsistently. Any guidelines should be written in conformance with the ASTM Standards and

with customary practice to assure a proper and practical baseline for due diligence and legal compliance. They should also seek to avoid inadvertently increasing the investor's liability by the investor having not properly complied with its own "higher" customized practice.

Nonetheless, Phase I reports, legal compliance audits, transaction documents and environmental risk management policies are useless unless the parties and their respective agents and employees are trained in the environmental risk management program which has been adopted and which must be implemented on a day-to-day basis for individual transactions. Education of employees and agents, as well as directors, officers, managers and partners, will alleviate some of the risk by sensitizing the party to the relevant issues and the approved (as well as appropriate) institutional response. While not all institutions will have technical personnel, trained employees will assure that consistency of approach and uniformity of response is an achievable goal. Institutions should also consider designating a separate function or job description in their organization to review and confirm property compliance with law on a continuing basis.

Moreover, to assure quality control, the investor may contract for an external audit of legal compliance to confirm the internal audit system and to police the program for compliance with the internal guidelines. Adopting an internal risk management program and a staff training program, and setting up an audit procedure will aid in the development of a sound business policy with respect to the environment.

VII. ENVIRONMENTAL CONSULTANTS

It may seem a trite pun, but the computer saying "garbage in, garbage out" neatly applies to Phase I Environmental Site Assessments. The product of the inquiry will only be as good as the environmental consultant responsible for performing and reporting it. The ASTM Standard defines an "Environmental Professional" as:

[A] person possessing sufficient training and experience necessary to conduct a site reconnaissance, interviews, and other activities in accordance with this practice, and from the information generated by such activities, having the ability to develop conclusions regarding recognized environmental conditions in connection with the property in question. An individual's status as an environmental professional may be limited to the type of assessment to be performed or to specific segments of the assessment for which the professional is responsible. The person may be an independent contractor or an employee of the user.¹¹⁰

The Standard assumes, therefore, that the environmental professional who conducts the inquiry is qualified. Experience tells us

110. E 1527-93, *supra* note 5, § 3.3.11.

otherwise. As in all service businesses, not everyone is qualified. Unfortunately, the environmental consulting industry, which grew in response to the environmental concerns of investors over the last few years, is not a homogenous group.

A. *Selecting a Consultant*

Environmental consultants encompass an array of professions and disciplines (including computer specialists) who have a variety of differing skills and competence. Therefore, the selection of an environmental consultant qualified to conduct a particular inquiry into a specific property can be the most critical decision in the environmental risk management process. The continuing proliferation of firms further complicates an already difficult choice. Because of the fragmentation of the industry, and the lack of a nationally recognized professional association for certification of environmental consultants, it is difficult to attempt to select a consultant solely on the basis of credentials. Although relying on the "approved list" of a major institutional investor to select a consultant would be an easy method, it will nonetheless present risks unless it is known what went into the list, and how it was used. There are, however, several related factors to be considered in creating this type of list: first, establish what service is to be performed (*e.g.*, Phase I or asbestos abatement). That being decided, it will be somewhat easier to determine what type of consultant should be retained. Second, understand the expertise necessary, and gather the names of several consultants by referrals or otherwise that can perform the required services. Finally, identify several consultants, and meet with them to determine their qualifications and availability to handle the investor's specific requirements.

Initially, this process will be a difficult and time-consuming exercise, but the result will prove critical to the process of any environmental risk management program. Some of the relevant criteria an investor should evaluate in its decision-making process include: the academic background of the consultant(s) involved in rendering services as well as any professional certifications and prior governmental affiliations; specific client references and the nature of the consulting arrangements and specific service engagements performed; the availability of the specific consultant(s) retained and the ability to interface with consultant(s) during the inquiry process; the matching of the skills and expertise of the consultant(s) with the specific service needed; discussions of what the consultant(s) think the scope of service should be; the capacity and capability of the support personnel of the consultant(s) to handle the engagement; the time schedule proposed; the type and amount of insurance carried; and any prior involvements with the particular property or conflicts of interest with other parties to the transaction.

The expense issue should not be determinative of qualification, but cost often directly impacts the viability of a transaction. As one would imagine when dealing with such an amorphous, diverse and fragmented industry, the range of charges as well as methods of billing for environmental services vary widely. From the large national engineering firms to the local freelance solo consultants, the methods used include hourly billing with separate out-of-pocket and overhead expense charges, and a set percentage of transaction value. Balancing the proffered services, the time schedule, and the consultant's "people" skills with the relative cost of the inquiry, an investor should be able to make a reasonable decision as to a consultant's qualification to perform a particular service.

Over time, an investor may be able to develop its own environmental guidelines list of approved environmental consultants, uniform scopes of services and other investor requirements, and a standard request for proposal. Development of this kind of personal list will expedite the selection process.

B. *Contracting With the Consultant*

After the investor has identified an environmental consultant, it must formally retain the consultant to perform the contemplated environmental services for the transaction. Of course, the environmental consultant will attempt to have the investor execute its pro-consultant standard form contract for professional services with the usual self-serving and protective boilerplate language attempting to limit the consultant's liability and allocating his risk to the investor.

The typical boilerplate provisions in a consultant's form of agreement include a dollar limitation on the consultant's liability to an arbitrary set amount (*e.g.*, the amount of the fee paid for the services, or the maximum coverage of the consultant's insurance policy); a time limitation on an investor's right to bring suit; investor indemnification of the consultant against third-party claims, and an investor waiver of any claim for loss or reduction of property value due to the professional services rendered. These specific provisions and other unacceptable terms should be negotiated to protect the investor's interest. Most reputable consultants will modify their contracts when pressed in larger transactions. For example, if the consultant's insurance policy is adequate, the policy maximums may be an acceptable alternative to the consultant's fee as a liability cap under the contract.

There are, however, several other very crucial aspects of the investor's relationship with its environmental consultant that should be addressed at the contract stage to prevent problems from arising later. Most of these issues focus on the information and documents gathered and analyzed by the environmental consultant in the performance of professional contractual obligations. The use and misuse of information about the environmental condition of a property can have signifi-

cant impact upon a property's value or development potential, and upon the reputation and investment of its owner. Therefore, control of access, retention, use and dissemination of information and documents in such situations is a prudent and prolific course of investment strategy. The contract should expressly provide for the confidentiality of the consultant's work product as the property of the investor alone. Interim progress reports and the initial presentation of the environmental consultant's final report should be oral rather than written. The more internal memoranda, notes and correspondence that exist, the greater the likelihood that a paper trail will be created which may result in obvious consequences in government and private citizen litigation.

C. *Managing the Consultant*

Notwithstanding contract provisions which recognize and protect the investor's interest, the exercise is futile unless the consultant is actually managed and directed in the performance of his professional services. As the investor is legally responsible for the inquiry and compliance,¹¹¹ it should monitor the consultant's activities and cooperate in the production of information. The consultant should not make the business decisions (which are for the investor) or the legal decisions (which are for the investor's counsel). Extraordinary cost expenditures and any submissions to government agencies, if outside the contracted-for scope of work, should be subject to prior review by, and approval of, the investor. After the work is completed, the investor should meet with the consultant for an oral presentation of the findings and for a review of a preliminary draft of the report. A meeting with the consultant will allow the investor to clarify and explore the issues raised in the report, and enable the investor to make a reasonable business decision about the property. Communication to and from the consultant should be monitored by the investor.

To assure confidentiality, excessive or redundant materials can be destroyed and certain controls placed on any material which remains in the consultant's files. Confidentiality is, for obvious reasons, a very difficult issue because of statutory disclosure requirements and discovery in litigation and governmental proceedings. It is not always clear what documents and communications constitute work product between the consultant and the investor. Often an investor will involve its transaction attorney in the process in the hope of protecting the information from discovery. Yet, if the counsel merely acts as a conduit, the possibility of protecting the work product will decrease. As counsel becomes more involved in the management of the consultant's performance of services, the potential for work product protection should increase. In accordance with better industry practice, the

111. *Id.* § X1.1.1.4 n.8(1).

ASTM Standard recognizes that the scope of work should expressly provide that the consultant will *not* make any recommendations in its Phase I report.

D. *Disclosure Obligations*

Probably the most controversial aspect of both the consulting relationship and the due diligence process is the question of the disclosure obligations of the parties making inquiries into the environmental condition of a property. In other words, where a consultant becomes aware of an environmental condition in performance of his professional services does he, or the party who retained him, have a legal obligation to notify federal, state or local governmental authorities as well as lenders or insurance companies of the discovery? Under federal law, any "person in charge of" a property on or from which hazardous substances are released, and any owner or operator of a property on or from which hazardous substances are released, treated or disposed of (except pursuant to certain permits and in other limited circumstances) has the obligation to notify federal authorities.¹¹² On the state and local level, the reporting obligation is strictly a matter of specific state statute or local ordinance. Because due diligence is often performed by or for someone other than the owner or operator of a property, the question of disclosure obligations depends on the parties' status within the transaction. Thus, under the federal statutes a seller would be responsible to notify the federal authorities. It is not entirely clear whether a buyer, lender, or the respective environmental consultant would have an obligation to disclose the discovery of an environmental problem. There are, however, statutes which impose on environmental consultants the obligation to notify state and local authorities of discharges.¹¹³ In any event, because disclosure of an environmental condition may attract publicity, retention of a public relations specialist to manage the ensuing issues is suggested.

Aside from environmental laws, parties other than the owner or operator of a property may be concerned with potential common law liability for the ensuing damages from the disclosure. Therefore, counsel should be consulted whenever a party discovers a condition which it feels must be disclosed, especially if the disclosure is to be made to lenders or insurance carriers. Considering the number of times that a Phase II investigation has disproved the existence of an environmental problem, the risk of wrongful disclosure is real and the damages to the wronged party can be substantial. This risk is exacer-

112. Certain duties to notify the National Response Center and to keep specific records thereof are established under the Clean Water Act and/or EPA. There are severe penalties for failure to meet these duties. 42 U.S.C. §§ 9603(a)-(f) (1988 & Supp. II 1990).

113. *E.g.*, N.J. STAT. ANN. §§ 58:10A-28(a) (West 1992) (underground storage tanks).

bated because a well-meaning environmental consultant may use Phase I reports as marketing tools to encourage Phase II intrusive investigations and perhaps even engage in Phase III remediation work.

E. *Using Phase I Reports*

Investor reliance upon the performance of Phase I Environmental Site Assessments by environmental consultants as an effective tool for environmental risk management is misplaced if the investor, the party legally responsible for making appropriate inquiry, cannot understand or interpret the resulting Phase I report prepared by the environmental consultant at the conclusion of his inquiry. Simply retaining an environmental consultant to perform a Phase I and to prepare a Phase I report, taken alone, is not effective environmental risk management. Taking a Phase I report and filing it away ignores the investor's obligation of appropriate inquiry. Proper risk management requires the active participation of the investor in the entire process. A Phase I inquiry represents not the end of risk management, but the beginning of a continuing process. Although for many investors a Phase I report completes the entire process, it is more appropriately a tool to be used in *completing* the process. The investor should take the consultant's "findings and conclusions" of the report, assess the information, and integrate those conclusions into its business decision process. To do otherwise will allow the environmental consultant to make the investor's decision by default.

As a threshold matter, it is important that an investor recognize that a Phase I report is *not*:

- a certification that a property is clean;
- an intrusive evaluation, *i.e.*, there is no sampling or testing;
- an analysis of non-site specific issues which arise in some non-real estate oriented business transactions;
- an investigation of non-CERCLA conditions; or
- a legal compliance audit.

What, then, is a Phase I? It is a limited inquiry into the environmental condition of a property by an environmental consultant who opines on the existence or likelihood of contamination on the basis of non-intrusive data gathered from records, interviews and observation of the property.¹¹⁴ Yet, there is currently no uniform industry-wide agreement on what constitutes a Phase I. Real estate investors are intimidated by environmental consultants who sometimes rely on scientific terminology and investor ignorance to assume the mantle of scientific process. But to successfully use a Phase I in risk management, the investor should develop the scope and content of the consultant's work.

114. E 1527-93, *supra* note 5, § 6.

Although popularly misconstrued as defining the particular risks to be addressed, a Phase I will actually encompass the consultant's scope of work. Thus, to achieve the investor's specific purpose in retaining the consultant, the investor must take part in defining the scope and content of the inquiry. The business context of the environmental inquiry — the nature of the transaction and the property (or business) type — should affect the design of the due diligence program. A Phase I is *not* a predetermined or mechanical process.

Another factor to be considered in the process is the investor's risk tolerance which may be determined by its communications with the consultant about its concerns with the transaction, and its knowledge of the property. An investor should ask and fully comprehend not only what the consultant proposes to do, but also what it itself can do. The investor must work with the consultant to quantify, assess and react to the risks identified. By avoiding the interactive process, the investor abandons its business judgment and substitutes the consultant's judgment by default. To encourage communication and to actively manage the process, the investor should be available to the consultant, keep its counsel involved, hold regular meetings, and require a draft report to be delivered for analysis and discussion before issuance of the final report.

As others will undoubtedly be reviewing the report, counsel should assist the consultant to clarify the raw data, confirm the investor's needs and risk tolerance, keep the consultant focused, and provide his own independent input. The Phase I report should reflect the investor's stated risk tolerance and *not* the consultant's lowest level of acceptable environmental risk. Consultants are prone to overstate the risks for two reasons: fear of litigation by investors viewing reports as guarantees, and personal perception that the investor wants zero risk, *i.e.*, all possible risks reported. Use of the Phase I involves participation in the ongoing process as well as utilization of the report. A Phase I report properly managed by the investor is a useful framework for informed decision-making about the environmental risks of a property.

CONCLUSION

To constitute "appropriate inquiry," environmental due diligence must be consistent with good commercial or customary practice of the *real estate* industry. The legislative history of the innocent landowner defense reveals a Congressional intent that:

good commercial or customary practice with respect to inquiry in an effort to minimize liability shall mean that a reasonable inquiry

must have been made in all circumstances, in light of *best business* and *land transfer* principles.¹¹⁵

The ASTM process is a concerted attempt by an organized real estate industry to memorialize commercially prudent and reasonable inquiry. But the Standard is voluntary, and not required for an investor to be deemed to have made appropriate inquiry. The ASTM Standard recognizes that the appropriate degree of inquiry varies with particular circumstances,¹¹⁶ and that circumstances may not even require an environmental site assessment.¹¹⁷ It is clearly not intended as the only approach, nor is it even a suggested minimum approach. Although courts may view the Standard as a required level of inquiry, the Subcommittee intends that it clarify an industry standard which will serve as guidance for the legal interpretation of "appropriate inquiry" under CERCLA.

Yet environmental due diligence does not end, but rather begins with appropriate inquiry upon the acquisition of the property. To best protect an investment and avoid liability, an investor should adopt and implement an environmental risk management process at all stages of the investment in the property, to include: managing environmental consultants in the assessment process; using Phase I reports as an effective business decision-making tool; modifying transaction documents; conducting legal compliance audits as appropriate; continuing due diligence after closing; adopting internal environmental policies; managing environmental information about the property; and practicing pollution prevention.

The real estate industry is interested in reducing or eliminating its environmental risk and protecting the value of its properties and investments. The environmental consulting industry is interested in selling and performing professional services — from environmental site assessments (Phase I), to intrusive sampling and testing (Phase II), to remediation (Phase III) of recognized environmental conditions. The real estate industry cannot afford to abandon its statutorily-recognized, standard-setting status to the environmental consulting industry. Rather, it must continue through the ASTM review process and otherwise, to foster the development of good customary or commercial environmental due diligence practices.

Although the approaches to, and components of, environmental risk management may be viewed as susceptible to categorization and standardization, the purposes and uses of environmental risk management tools available to the real estate industry in the market place will continue to be as diverse and varied as the needs and risk-taking appetite of a particular investor. Obviously, real estate developers, own-

115. H.R. REP. NO. 962, 99th Cong. 2d Sess. 186 (1986) *reprinted in* 1986 U.S.C.C.A.N. 3276, 3280 (emphasis added).

116. E 1527-93, *supra* note 5, § X1.3.2.1.

117. *Id.* § X1.3.3.3.

ers, sellers, buyers, lessees and lenders, as well as brokers, property managers and business operators will have differing perspectives with regard to the same issues in specific transactions. CERCLA liability aside, each party to a transaction will approach and use the information gathered in the due diligence process to fulfill its respective business agenda within the larger context of its business judgment regarding, and appetite for, risk. The same information will frame different issues to be weighed in the party's determination to acknowledge and avoid, allocate or accept a form of risk.**

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