

Environmental Liability Protection and Due Diligence

Best Practices for Purchasers

By Arthur Siegal

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)¹ allows the federal government to clean up contaminated sites and can impose cleanup liability on owners that acquire property. It also provides means for innocent purchasers to avoid liability.² Michigan's CERCLA counterpart is Part 201 of the Michigan Environmental Code.³

A key element to avoiding liability is environmental due diligence. Done well, due diligence can enable a buyer to avoid problem sites, assess the risk of a problem site to allow the buyer to proceed with its purchase, or take steps to protect itself from liability.

The industry standard for a Phase I environmental site assessment (ESA) is ASTM E 1527.⁴ A Phase I ESA following this standard would satisfy the U.S. Environmental Protection Act All Appropriate Inquiry (AAI) rule,⁵ which is key to establishing either no knowledge of contamination (innocence) or knowledge of contamination (bona fide purchaser), either of which is important for liability protection. Phase I may help a prospective tenant or purchaser establish liability protection via qualifying for a CERCLA defense as an innocent landowner, contiguous property owner, or bona fide prospective purchaser.

Hiring a consultant

The first step is retaining an environmental consultant. There are threshold requirements for education, training, and experience,⁶ but you may choose a national firm, a local firm, or a solo practitioner. If your transaction involves a lender, confirm that the lender accepts that consultant. Read the consultant's proposal — make sure you're getting what you need and examine the consultant's terms. Consultants often include limits that can be negotiated away beforehand. As examples, look for dollar limits of liability, liability limited to the consultant's available insurance (what if they don't have any?), and a ban on consequential damages. That term may vary by jurisdiction, but allowing the consultant immunity from lost profits or delay damages is problematic. Your client should want protection from *all* losses if the consultant negligently missed something.

Occasionally, a seller will have hired a consultant and even conducted a Phase I ESA and will ask the purchaser to rely on that person's judgment. It may be cost effective for the purchaser to rely on the seller's prior work, but there are pitfalls to doing so. First, confirm that the existing Phase I

ESA will be less than six months old at closing.⁷ Also, seek a reliance letter to avoid any argument and give the client recourse if the consultant erred and missed something important.

What is a Phase I ESA?

The goal of a Phase I ESA is to identify recognized environmental conditions (RECs) — the presence or likely presence of any hazardous substances in, on, or at a property due to a release to the environment or which pose a threatened future release.⁸ The Phase I process evaluation is relative to the property and the surrounding area's history, visible conditions, and information known to various governmental bodies and generally.

What is not in a Phase I ESA?

A Phase I ESA likely won't confirm if the property's soil or groundwater are contaminated. That information may not be provided until a later due-diligence phase.

While a Phase I ESA may satisfy the AAI rule and provide CERCLA liability protection, it does not protect purchasers from myriad other environmental responsibilities and liabilities. For example, a Phase I

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does not assess issues such as asbestos, lead-based paint, lead in drinking water, mold, radon, and biological agents. Emerging contaminants such as per- and poly-fluoroalkyl substances, better known as PFAS, are not evaluated by a Phase I unless you ask for it.

Equally important, compliance with environmental laws and regulations is not included. Does the business have the proper permits and, if so, are they complying with them? Is the business complying with laws and rules? Did the business dispose of materials at an off-site location that requires cleanup? These questions are not answered in a typical Phase I ESA. When buying stock or assets to be used in an ongoing business, those questions are just as important as if soil or groundwater are contaminated.

Receiving Phase I results

In my experience, a Phase I ESA typically costs upwards of \$2,500 and takes three to four weeks to complete. When it's done, it is tempting to read the report's conclusions for the magic words that there are no RECs and proceed to closing.

Read the entire report — there may be gaps in data that can be filled, new questions that may be raised, or you may spot something the consultant missed or thought was unimportant. This doesn't happen often, but it does happen. A more common occurrence is that the consultant states conclusions without explaining how they were reached; if the report needs to be defended, it's better to document the conclusions.

If you are satisfied that the Phase I ESA shows no RECs and meets the required standards, the transaction may close, and your client falls into the so-called “due diligence

safe harbor” protecting them from cleanup liability.⁹ AAI does not immunize a buyer from the impact on property use or value if unknown contamination is later discovered.

If the Phase I shows an REC that is not historic (resolved) or controlled, proceed to a Phase II ESA. This is more expensive and invasive. It requires sampling and testing of some sort — typically borings to evaluate soil and groundwater — and may require further discussions with the seller to address business disruption, post-work restoration, and data management.

Should you always do a Phase I ESA?

If buying real estate, the client should minimally conduct a Phase I ESA even when doing an intracompany transfer. Generally, if there is a deed, do a Phase I ESA. The same is true for many leases — a tenant may be deemed an operator or owner subject to liability. When buying assets without land or tenancy, a Phase I ESA may not be necessary, although a compliance audit is advisable. In a stock transaction, your client is stepping into the owner's shoes; you should evaluate what your client is stepping into as opposed to simply looking at the seller's due diligence from acquisition and its liability protection, which your client is inheriting.

Michigan's protection — the BEA

If the Phase II ESA shows contamination, it is time to consult with an environmental expert. In Michigan, some contamination is deemed so low risk that the property is considered acceptable for residential use without restrictions.¹⁰ If the property is contaminated, your consultant can prepare a

baseline environmental assessment (BEA) which under Michigan law provides extensive, but not absolute, protection.¹¹ The BEA is a summary document that “wraps around” your Phase I and II ESA reports. One can only get BEA protection if the site is contaminated. Pursuant to an agreement between the U.S. Environmental Protection Agency (EPA) and the state, the EPA respects and abides by BEA statutory protection except in extreme cases.¹²

In Michigan, you must complete a BEA within 45 days of first taking possession, ownership, or foreclosure of a property and the BEA must be submitted to the state within six months of that same trigger date.¹³ BEAs are *not* transferrable. If the seller has a BEA, your client should expect to receive a copy of it as required by law¹⁴ and prepare one of their own.

The BEA protects a buyer from Part 201 and CERCLA cleanup liability, but it is no panacea because:

1. It's only available in Michigan. Other states have similar (or better) programs;¹⁵
2. Your client will have due-care obligations to protect the public, which may be as minimal as maintaining the status quo and may include tasks like installing expensive sub-slab depressurization to keep volatile chemicals from bubbling up into the occupied space;¹⁶
3. When transferring the property (including leasing), the owner must inform the transferee of the contamination and provide the BEA; if contamination is migrating offsite, owner must notify the state and the owner of the affected property;¹⁷
4. In a stock deal, a BEA isn't available and, as noted above, the purchaser steps into all seller's liabilities (including operational and offsite disposal); and
5. It does *not* protect your client from liability under specified environmental laws.

Regarding the final point, more clients are looking at properties used to treat, store, or dispose of hazardous wastes. A BEA does not protect the client from Resource Conservation and Recovery Act (RCRA)/Part 111¹⁸ liability or under the Toxic Substances Control Act¹⁹ relating to PCBs and certain other

chemicals. That liability is broader and often more expensive than regular cleanup liability and covers the entire site that was regulated under Part 111 — not just the acreage the client bought. The client may be obligated to clean up property they didn't even buy! Be sure to inquire about these issues. Title review is often helpful; the title should include a recorded form of notice,²⁰ but that doesn't always happen. A property owner may be able to limit RCRA liability by pursuing various agreements or comfort letters from EPA or the Michigan Department of Environment, Great Lakes, and Energy.

Conclusion

Well-done due diligence provides comfort regarding environmental liabilities. However, one should not stop at Phase I and Phase II ESAs. Lenders, buyers, and even tenants in some cases should consider issues outside the typical scope of work. A purchaser benefits from a diligent environmental team with an understanding of diverse liability protections, the nature of the target business, and the structure of the deal

to ensure the client understands the risks it acquires and minimizes those risks to the extent the law allows. ■



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ENDNOTES

- 42 USC 9601 *et seq.*
- More recent CERCLA amendments allow a knowing purchaser of contaminated property to avoid liability as a "bona fide purchaser" if it meets certain post-acquisition requirements. 42 USC 9601(35), 42 USC 9601(40), and 42 USC 9607(r).
- MCL 324.20101 *et seq.*
- ASTM E1527-13: Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process, ASTM Int'l <<https://www.astm.org/Standards/E1527.htm>> [<https://perma.cc/CFL5JEKV>]. This standard, which has been in its current form since 2013, is undergoing revisions.
- 40 CFR 312.
- 40 CFR 312.10(b).
- Id.*
- ASTM E1527-13.
- 42 USC 9607(b)(3). See, e.g., *RE Goodson Const Co v Int'l Paper Co*, opinion of the United States District Court United States District Court for the District of South Carolina, issued December 15, 2006 (Civil Action No 4:02-4184-RBH).
- MCL 324.20101(s).
- MCL 324.20126(1)(c).
- Addendum II to Superfund Memorandum of Agreement between Michigan Dept of Environmental Quality and EPA, Region 5 (March 24, 1997), available at <https://www.michigan.gov/documents/deq/deq-rrd-sf-smoa2_321421_7.pdf> [<https://perma.cc/AJ62Z2KY>].
- MCL 324.20126(1)(c). There are some mechanisms available for excusing late submission. I recommend avoiding them as they are totally within the state's discretion.
- MCL 324.20126(1)(c)(i).
- See, e.g., Ohio Rev Code 3746.122 and Kentucky Rev Statutes 224.1-415.
- MCL 324.20107 and Mich Admin Code, R 299.51001-299.51021.
- MCL 324.20116 and 324.20126(c)(i).
- 42 USC 6901 *et seq.* and MCL 324.11101 *et seq.*
- 15 USC 2601 *et seq.*
- Mich Admin Code, R 299.9525.

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