

## ENVIRONMENTAL AMENDMENTS WILL AFFECT TRANSACTIONS INVOLVING REAL PROPERTY

President Bush recently signed the Small Business Liability Relief and Brownfields Revitalization Act (the "Act") into law. This new law amends the federal Comprehensive Environmental Response, Compensation and Liability Act, more commonly known as "Superfund" or by its acronym "CERCLA." As explained in greater detail below, the Act will affect environmental aspects of transactions involving real property.

### Background

By way of brief background, CERCLA holds four categories of parties liable for cleanup of hazardous substances. These are: (a) current owners and operators of contaminated property; (b) owners and operators at the time of disposal; (c) persons who arrange for the disposal of hazardous substances (commonly referred to as "generators"); and (d) certain transporters of hazardous substances. Liability has been interpreted to be retroactive, strict, joint and several.

### The Act

The Act has two primary purposes: (1) to provide liability relief to certain small generators; and (2) to encourage the redevelopment of certain contaminated properties known as "brownfields."

As to the former, the Act sets forth circumstances under which parties that sent less than 110 gallons of liquids or 200 pounds of solids and small businesses that sent only municipal wastes to federal Superfund sites will be exempt from CERCLA liability.

As to the latter, the Act establishes funding for brownfield redevelopment and provides assurances that federal enforcement will not be undertaken with respect to certain sites being addressed under state programs. In addition, the Act provides three landowner defenses to CERCLA liability: (1) the "innocent landowner" defense; (2) the "contiguous property" defense; and (3) the "bona fide prospective purchaser" defense. The first defense existed previously in the statute; the other two are new but were emerging through policies and guidance implemented by the United States Environmental Protection Agency ("EPA"). Issues associated with these three defenses are the aspects of the Act most likely to have a direct impact on transactions involving real property.

### Innocent Landowner Defense

To establish an "innocent landowner" defense under CERCLA prior to the Act, parties had to prove that: (1) they acquired the property after the disposal of hazardous substances; (2) they had undertaken all appropriate inquiry at the time of acquisition, and did not know and had no reason to know of the hazardous substances at issue; and (3) they used due care with respect to the

hazardous substances concerned. CERCLA required the pre-acquisition inquiry to have been "consistent with good commercial or customary practice." The vagueness of CERCLA prompted ASTM International (the voluntary standards development organization formerly known as the American Society of Testing and Materials) to issue a standard practice for Phase I environmental site assessments. The "innocent landowner" defense is still available under the Act, but was amended as explained below.

Rather than adopt the ASTM standard as "all appropriate inquiry," the Act directs EPA to define "all appropriate inquiry" by regulation within two years. Until then, the Act provides that a Phase I performed in accordance with ASTM procedures, including ASTM Standard E1527-97 for Phase I Environmental Site Assessments, will satisfy the requirement for transactions dated May 31, 1997 and later. For transactions occurring prior to May 31, 1997, various factors, including specialized knowledge, purchase price and availability of information, will be taken into account. (Different requirements apply to the transfer of residential property.) Depending on the outcome, EPA's new regulations may impose more stringent due diligence standards than those commonly in use today. As to transactions between now and the time the EPA standard takes effect, whether "all appropriate inquiry" was undertaken would be evaluated by reference to ASTM procedures, in particular the 1997 standard for Phase Is, even though the standard was revised in 2000 (primarily to address non-CERCLA issues).

The Act also imposes certain post-closing burdens on landowners hoping to preserve an "innocent landowner" defense. Under prior law, a landowner needed to use "due care" with respect to hazardous substances identified at the property post-closing. Under the new law, the landowner must cooperate in response actions, must have taken reasonable steps to address releases of hazardous substances, must have adhered to and not impeded applicable institutional controls and land use restrictions, and must meet other specified criteria. In connection with transactions, parties may begin to see provisions (covenants in loan documents for example) specifically addressing these points.

### **Contiguous Property Defense**

Where contamination has spread from an adjacent property, the landowner must meet the same criteria applicable to the innocent landowner defense plus certain others in order to establish a "contiguous property" defense. For example, the landowner must not be potentially liable for the release or affiliated with any party that is, must have complied with EPA information requests, must provide all legally required notices of the release and must not have caused, contributed or consented to the release. Certain of these obligations arguably are new. Thus, in the context of transactions, greater focus on the environmental condition of adjacent properties will likely result.

### **Bona Fide Prospective Purchaser Defense**

The "bona fide prospective purchaser" defense provides a possible defense to liability where the purchaser knew at the time of acquisition that the property was contaminated. To preserve the defense, the purchaser must have acquired the property after January 11, 2002, establish that the

disposal of the hazardous substance took place prior to acquisition, and meet the criteria described above (except that knowledge of the contamination will not defeat the defense). The Act provides further that the government may impose a lien on the property for unrecovered governmental funds expended to clean up the site up to the increase in value resulting from the cleanup. As a practical matter, it appears that the defense will most likely play a role with respect to the transfer of abandoned properties or to situations where the transferor is either judgment-proof or not otherwise liable itself for the contamination.

### **Conclusion**

It may be some time before we know the full impact of the Act on business transactions involving real property. Among other things, state laws and other federal laws have different liability schemes to which the defenses described above would not apply. Further, as a practical matter, the landowner could still incur cleanup costs to meet the criteria of the Act, to meet the requirements of other laws (e.g., those applicable to polychlorinated biphenyls or petroleum contamination), or in connection with development of the property. Finally, whether the criteria for a defense have been met in a particular circumstance could be a matter of dispute.

At this juncture, it appears that the innocent landowner, contiguous property and bona fide prospective purchaser defenses could affect parties engaged in transactions in the following ways: for parties acquiring real property, the new law may broaden the scope and cost of environmental due diligence; for landowners that later find contamination on their properties, the new law may impose new burdens; and for parties purchasing contaminated properties, the law may ease the transfer once the parameters of the bona fide prospective purchaser defense are more fully established.

Should you have any questions on the foregoing, please call Carolyn W. Conkling at (202) 429-4720 in Willkie Farr & Gallagher's Environmental Department in Washington, D.C.

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