

Commercial Real Estate Guide

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Looking for trouble protects dealmakers

Newly effective EPA brownfields due diligence rules

By Greg Korstad

In the more than 20 years since the creation of the Superfund Program and related programs addressing the presence of pollution in real estate deals, Minnesota has claimed its spot as a leader in redevelopment of contaminated sites under Brownfields programs and policies. However, that position has come with plenty of risk-taking by dealmakers as well as creative lawyering to minimize liabilities in the uncertain era of expanding environmental regulations.

The greatest hindrance to Brownfields redevelopment is the all-too-real risk that previously unknown contamination will be unexpectedly encountered, adding to liabilities and costs that could cause a project to fail. Essential to these transactions are the statutes providing that a purchaser of contaminated property, under certain circumstances, could be protected from liability if a thorough pre-purchase investigation of environmental conditions is made. Now the U.S. Environmental Protection Agency (EPA) is implementing new rules defining the scope of the investigation that would qualify for this liability protection.

'All appropriate inquiry'

Since initially adopting the Superfund program, the real estate industry has tried to find the right level of due diligence to apply to a commercial acquisition. The new "all appropriate inquiry" rules from the EPA will help alleviate some of the uncertainty.

The liability risks for buyers have not been completely eliminated, which means it will still be necessary to carefully position both buyer and seller in order to protect the interests of each. Following the new rule will standardize the pre-purchase environmental assessment and increased requirements to provide evaluation and advice about conditions will make the pre-purchase assessment more useful, but no easier to complete. Buyers still need to remember the purpose of the investigation is not simply a compli-



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ance item — a properly completed investigation is key to avoiding environmental liabilities.

Buyers and sellers both have an interest in the investigation

The buyer's interests relating to environmental liability protection in the transaction are threefold:

- 1) Know the full nature and extent of site conditions;
- 2) Assure there are no liabilities associated with the site; and,
- 3) Protect from unknown liability.

Executing a due diligence investigation, and including a site assessment that meets state and federal standards, is important to protecting these interests and minimizing liability. The practice of pre-purchase assessment has become a standard part of most transactions and has evolved into an ordinary compliance item.

The new rule for "all appropriate inquiry" is focused on the third item listed above: protection from liability for unknown conditions. Although the ability to protect from identified contamination problems can be relatively routine, the real strong point of the pre-purchase assessment investigation is avoiding liability for surprises from an apparently "clean" site.

Application of the new "all appropriate inquiry" rule will be much more helpful for buyers than sellers. This is because the new rule is focused on the scope and nature of the buyer's investigation in order to assure qualification as an innocent landowner and to minimize controversy and conflict.

The seller's interests are generally focused on protection from retained liability or problems from subsequent buyer claims relating to the condition of the property. As with the buyers, sellers need protection from liability for both current conditions as well as the potential undetected environmental conditions. The second and occasionally overlooked interest is to assure that the seller is prepared to manage the results of whatever is discovered in the site assessment. This is particularly important in the circumstance of a redevelopment involving significant site excava-

tion work. The new rule does not address this issue.

Practical application of the pre-purchase assessment

We have used the pre-purchase environmental assessment investigation to benefit clients' interests in deals: finding contaminated parts of a target property, focusing the investigation to efficiently meet client needs and providing the tools to obtain Minnesota Pollution Control Agency (MPCA) brownfield assurances.

The pre-purchase assessment is a collaboration of the buyer, environmental consultant and the lawyer. The buyer's goals and expectations for a site need to be well defined in order to give context to the results of the environmental consultant's investigation. Additionally, if contamination is revealed at the property, legal strategies to minimize liability will need to consider site use in order to properly reduce risk. The consultant's role, in addition to the obvious one of conducting the investigation, is to make the investigation fit the deal. The lawyer provides analysis of legal and practical liability considerations and helps buyers fit within the "safe harbor" of "innocent landowner" status.

Specific changes in the new rule

The concept of "all appropriate inquiry" is now defined and not left solely to after-the-fact second-guessing after a dispute arises. The new rules have now defined who is deemed to be competent to perform the pre-purchase assessment. This determination is now based upon licensing, education and training in environmental science. The result should be a more readily defensible assessment work product.

A second key focus of the new rules is to require more completeness in the data collection and analysis of the significance of the results. Consideration of the need for any additional investigation is now a mandatory component of the investigation. Any gaps in data or ability to fully investigate issues now will need to be explained in the report.

Past practice has been to involve sellers only informally (and sometimes quite casually) in assessments. This has changed. Interview

requirements will make an assessment a much more interactive process. Purchase price is now a relevant consideration for the site assessment. The report will need to evaluate any reduction that may be attributed to contamination. The new standard adds a requirement that adjoining properties must be observed or visually inspected. This does not require entry onto the adjoining property, but is more than simply identifying the use.

New issues to watch

In addition to the obvious need to assure the assessment meets the new rules, the buyer will need to be mindful that the rule changes do add some undefined issues. The expanded role of property value in the assessment may be one area

where problems could develop. There still is a generic requirement to evaluate other sources of "reasonable ascertainable information." This could also create site-specific problems.

Also of significance is the fact that the rule only addresses assessment of Superfund hazardous materials and does not address the scope of assessment for other contamination like petroleum or non-hazardous pollutants.

Conclusion

The EPA benefited real estate dealmakers with its current "all appropriate inquiry" rule revisions. The sophisticated dealmakers will maximize benefit from this rule by working with the transaction team of environmental professionals and knowledgeable legal counsel to take full advan-

tage of the liability protections available under federal law. This should occur in addition to the state law considerations and not be a substitute for addressing liability under state Superfund and other liability laws as well.

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