

## Environmental Due Diligence Lunch & Learn Series Part 1:

### The Critical Role of Phase I Environmental Site Assessments in Real Estate Transactions

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## WHAT IS A PHASE I ENVIRONMENTAL SITE ASSESSMENT (“ESA”)?

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Generally considered the first step in the process of environmental due diligence, a Phase I ESA is a process that assesses the environmental condition of commercial real estate (including residential property with five or more dwelling units) with respect to the range of contaminants within the scope of the Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”) (42 U.S.C. §9601) and petroleum products.



## WHAT IS CERCLA?

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CERCLA holds responsible parties strictly liable for “response costs” incurred as a result of a “release” or “threatened release” of “hazardous substances” from a “facility.”

CERCLA liability is:

- Retroactive
- Joint and Several
- Strict

CERCLA liability is triggered if:

- Hazardous wastes are present at a facility,
- There is a release (or possibility of a release) of hazardous substances, and
- Response costs have been or will be incurred

A PRP is potentially liable for:

- Cleanup costs
- Damages to natural resources, and
- The costs of certain health assessments

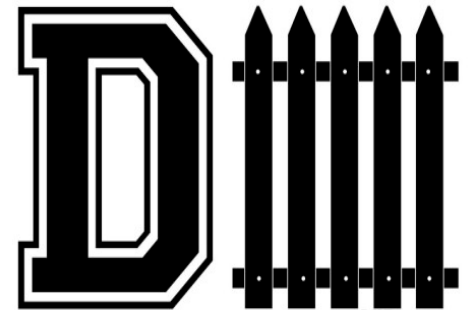
There are four classes of potentially responsible parties (“PRPs”):

- Current owners and operators of a facility,
- Past owners and operators of a facility at the time hazardous wastes were disposed,
- Generators and parties that arranged for the disposal of hazardous substances, and
- Transporters of hazardous substances

## WHY IS A PHASE I ESA PERFORMED?

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- A Phase I's primary purpose is to conduct an inquiry designed to identify “recognized environmental conditions” (“RECs”).
- Phase I's also satisfy the “All Appropriate Inquires” (“AAI”) requirement to qualify for liability defenses to CERCLA.
  - Landowner Liability Protections (“LLPs”)
    - Innocent Landowner Defense;
    - Bona Fide Prospective Purchaser Defense; and
    - Contiguous Property Owner Defense



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## ALL APPROPRIATE INQUIRES (“AAI”)

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- AAI is a process of evaluating a property’s environmental conditions and assessing the likelihood of any contamination.
- The Phase I ESA process conducted under the ASTM E1527-13 standard constitutes AAI into the previous ownership and uses of the property consistent with good commercial and customary practice as defined at 42 U.S.C. § 9601(35)(B).
- A Phase I ESA does not address whether requirements in addition to AAI have been met in order to qualify for the LLPs.

## ARE THERE PHASE I ESA STANDARDS?

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- The American Society for Testing and Materials (“ASTM”) is non-profit standards developing organization.
- Standards for performing a Phase I ESA have been promulgated by EPA and are based on ASTM standard E1527-13.
- ASTM standards are periodically revised to further clarify the standards and/or to reflect changes to the law (Phase I ASTM standards revised in 2013).



## WHERE IS A PHASE I ESA PERFORMED?

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- A Phase I ESA is performed on a parcel of commercial real estate, which can include:



Apartments or Multi-Dwelling Units



Undeveloped or Agricultural Land



Shopping Centers



Gas Stations



Industrial or Commercial Buildings

## WHAT ARE RECOGNIZED ENVIRONMENTAL CONDITIONS (“RECS”)?

### ■ REC

- The definition of a REC, as revised in 2013, is: “the presence or likely presence of any hazardous substances or petroleum products in, on or at a property: (1) due to any release to the environment; (2) under conditions indicative of a release to the environment; or (3) under conditions that pose a material threat of future release to the environment.”
- The term was revised in 2013 to focus more directly on “releases to the environment” than the mere presence of hazardous substances.





## HRECS & CRECS

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### ▪HREC

Historical RECs were more narrowly redefined in 2013 to include sites cleaned up to an unrestricted residential use standard *without* being subjected to institutional and/or engineering controls.

### ▪CREC

- The Controlled REC category was added in 2013. The CREC concept was introduced to address contaminated sites that have received risk-based regulatory closure, where no further remediation is required but residual contamination still exists at a site and the property is subject to some sort of control or use restriction.
- Ongoing or future obligations on the owner (such as special precautions during construction or grading activities).



## WHO PERFORMS A PHASE I ESA?

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An Environmental Professional who possesses the education, training, and experience requirements as set forth in 40 C.F.R. § 312.10(b)

An Environmental Professional must have:

- A Professional Engineer's or Professional Geologist's license or registration and three years of full-time relevant experience;
- A license or certification to perform such assessments and three years of full-time relevant experience;
- A Baccalaureate or higher degree in engineering or related science and have five years of full-time relevant experience; or
- Ten years of full-time relevant experience.



## WHEN IS A PHASE I ESA PERFORMED?

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### ■ The most common circumstances....

- Purchase of real property;
- Contemplation by a lender to provide a loan on real property;
- Corporate transactions (e.g., asset sale/purchase involving real property);
- Existing property owner's desire to understand contamination history;
- Compulsion by a regulatory agency that suspects contamination on the real property; or
- Qualification for certain government incentive programs (i.e., Brownfields, discussed in Part IV of this Lunch and Learn series).

■ A Phase I ESA should always be conducted *before* purchasing real property, lending money to be secured by real property, or purchasing a business that includes real property.



## WHAT FALLS WITHIN THE SCOPE OF A PHASE I ESA?

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### ■ Four components to a Phase I ESA:

- Records Review;
- Site Reconnaissance;
- Interviews; and
- Report Preparation



## RECORDS REVIEW

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- **A review of property records and public information sources such as:**

- file banks for aerial and topographic maps, and
- state and federal databases of hazardous waste and spill sites.

- **Not limited to the subject real property -- “approximate minimum search distance”**



## SITE RECONNAISSANCE

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- **Interior walk-through and exterior inspection of the property to indentify and record areas of potential environmental concern**
  - It is not expected that more than one site visit to property shall be necessary in connection with a Phase I ESA.





## INTERVIEWS

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- Current owners, operators, and occupants of the property as well as others who may have knowledge of the property's current and past uses
- Key Site Manager
- State and local government officials



## REPORT PREPARATION

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- **A report should generally include:**
  - Executive summary;
  - Statement of the purpose and scope of the assessment;
  - Description of past and current operations;
  - Photos of potential environmental hazards; associated site maps and diagrams;
  - Summary of record searches;
  - Conclusions and opinions about identified RECs; and
  - Although not required, recommendations for additional inquiries or other services are desired to be included in the report.

## WHAT IS OUTSIDE THE SCOPE?

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- A Phase I ESA is limited to a visual inspection, documentation review, and interviews.
- Actual sampling and testing are not within the scope of a Phase I ESA.
- Sampling and chemical testing are conducted within the scope of a Phase II ESA.



Phase II ESA



## WHAT ARE “NON-SCOPE” ISSUES?

Examples:



Threatened/Endangered  
Species



Mold



Asbestos Pipe Wrap



Lead-Based Paint



Wetlands

## WHAT ARE CONTRACT CONSIDERATIONS REGARDING A PHASE I ESA?

- How long will the buyer have to conduct a Phase I ESA?
- Who will pay for a Phase I ESA?
- Who will perform the Phase I ESA?
- What “non-scope” issues should be included?
- Should the Phase I ESA report be kept confidential?



## WHAT ARE SOME PITFALLS TO AVOID REGARDING A PHASE I ESA?

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### Failure to meet the current Phase I ESA standard and requirements

- Compliance with the outdated pre-2013 ASTM standard no longer satisfies the AAI requirement.



## WHAT ARE SOME PITFALLS TO AVOID REGARDING A PHASE I ESA?

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**Failure to carefully review and negotiate the Environmental Professional's contract**

- Do not assume the terms and conditions of the Environment Professional's contract are reasonable.





## WHAT ARE SOME PITFALLS TO AVOID REGARDING A PHASE I ESA?

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### Waiting until the last minute

- Proper and thorough Phase I ESAs take time and may lead to further time consuming requirements, such as a Phase II ESA, site remediation, and mandated reporting to government agencies.



## WHAT ARE SOME PITFALLS TO AVOID REGARDING A PHASE I ESA?

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### Relying on an old Phase I ESA

- Reliance on an older report may be tempting to save money, but such reliance may not satisfy the AAI requirement under federal law.



## WHAT ARE SOME PITFALLS TO AVOID REGARDING A PHASE I ESA?

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Assuming that a Phase I ESA is all the environmental due diligence you need

- Environmental due diligence at minimum should include an appropriate Phase I ESA.



## WHAT ARE SOME PITFALLS TO AVOID REGARDING A PHASE I ESA?

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Simply relying on the  
recommendations set forth in the  
Phase I ESA

- When reviewing an Environmental Professional's Phase I ESA report, the findings and recommendations should not be accepted without some skepticism and further diligence.





## WHAT ARE SOME PITFALLS TO AVOID REGARDING A PHASE I ESA?

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### Not all Phase I ESAs are created equal

- If an environmental consulting firm is providing a Phase I estimate at half the cost of other firms' estimates, this could be a red-flag.





# Questions?

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