



Why a Clean Phase I Still Doesn't Mean You're All Clear

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"I have a Phase I environmental report with no recognized environmental conditions. We don't need any environmental insurance."

Update: The United States Environmental Protection Agency (USEPA) recently recognized the ASTM E1527-21 Phase I Environmental Site Assessment (ESA) standard to comply with the All-Appropriate Inquiries (AAI) Rule under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). Announced on December 15, 2022, in the Federal Register, compliance is effective February 13, 2023.

The previous Phase I ESA standard, ASTM E1527-13, will be phased out and no longer recognized as meeting AAI in one year, on February 13, 2024. For savvy and proactive investors and owners/operators of commercial real estate, now is the time to transition to the new standard!

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What is an ASTM E1527-21 Compliant Phase I Environmental Site Assessment?

An ASTM E1527-21 Phase I Environmental Site Assessment is the guidance document used as a baseline by the environmental due diligence community to assess environmental conditions at a commercial property. Conducting a quality Phase I ESA in conformance with the E1527-21 standard is often the first step that a prospective buyer or investor undertakes to assess potential risks at the subject property. The Phase I ESA is also utilized during financing of commercial properties. As the deal progresses, the Phase I ESA report is reviewed to understand current and historic conditions at the subject and adjoining properties. The Phase I is a “snapshot” in time – giving insight based upon a site visit and document research that reveals the present-day conditions, as well as insights into historical operations. While valuable, this information may be limited based upon information that was available at the time of the assessment. Ongoing activities at the subject property may result in subsequent operational exposures such as mold, legionella, disinfection and new releases that may occur during the day-to-day operations of a site. The ongoing focus on emerging contaminants, including per- and polyfluoroalkyl substances (PFAS), at both the state and federal levels necessitates an increased level of scrutiny related to on-site and off-site operations. Operational exposures exist in just about every class of business, and it is incredibly important to ensure that you are protected.

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Important Information Garnered from a Phase I ESA Report

Let's start out with what is required to be an ASTM E1527-21 compliant Phase I report. An ASTM E1527-21 compliant Phase I report must include the following elements: current site visit, interviews, database research, historical research, AUL/lien search, and non-scope

considerations, comprehensively yet succinctly summarized in a detailed narrative report. The entire Phase I ESA research and reporting process should be overseen by an environmental professional (EP) who meets the educational and experience requirements outlined by ASTM. The final report should be reviewed and signed by both the assessor and the EP responsible for the scope of the Phase I ESA.

Site visit: The site visit of the subject property should be conducted with a knowledgeable site contact who is familiar with the subject property and has complete access, including keys to locked mechanical spaces and access to on-site records and historical documentation.

Interviews: Individuals with current and historical knowledge of the subject property should be interviewed by the EP and/or assessor conducting the Phase I ESA. It is important to understand the current onsite operations, as well as historical operations, particularly regarding dry cleaners, gas stations, automotive repair and industrial operations.

Database review: Third-party providers collect federal, state and tribal records on a regular basis and summarize these records by regulatory agency and list. The data is gathered as it pertains to the subject property, via ASTM designated search radii, as well as adjoining and nearby properties that are located around the subject property.

Historical research: The big four of historical resources are historical topographic maps, Sanborn or other fire insurance maps, city or street directories, and aerial photographs. There are additional historical resources that are available through local sources, such as the public library. The availability, quality and usefulness/applicability of the historical resources can vary by geography.

AUL/lien search: The Activity and Use Limitation (AUL) and lien search can be acquired as a supplement to the database report and historical sources research provided by the environmental data companies and can also be obtained through a chain-of-title search. It may be valuable to understand whether the client expects the AUL and lien search to be conducted by the EP or outside counsel, and whether it is included in the Phase

I report or separate reporting. AUL information should be conveyed to the EP if obtained through outside counsel or other sources.

Report writing: The report is the synthesis of the information gathered, or the repository of the on-site assessment activity and research conducted to understand the environmental conditions on-site. It is important to document the information gathered, including the source of that information (thirdparty data provider, site contact, public records, etc.).

Non-scope considerations: While certain environmental conditions are outside the Phase I ESA scope, they are often considered as part of a thorough Phase I. Examples include asbestos-containing materials (ACM), lead-based paint (LBP), lead in drinking water (LDW), radon, wetlands and seismic assessments. Other additions to the Phase I ESA scope of work may include an American Land Title Association survey, zoning report, limited compliance review and/or septic/discharge evaluation. Please note: it is important to watch for emerging contaminants such as PFAS to be added as non-scope considerations in the future, as detailed below. The Phase I ESA report is valid for 180 days per ASTM, and an update can be made easily with an updated database report, historical resources search, AUL/lien search and site visit.

Emerging contaminants and PFAS: A significant development on the horizon is the focus on emerging contaminants, especially per- and polyfluoroalkyl substances (PFAS). In November 2022, USEPA related a report documenting the agency's first year of progress pertaining to the PFAS Strategic Roadmap. This document also highlighted key actions ahead. The EP community is watching closely, as it is widely anticipated that PFAS will be added to USEPA's lists of CERCLA Hazardous substances.

Limitations of a Phase I and Coverage Considerations

One of the most important elements to understand about a Phase I ESA is the user requirements, especially first defining "user" of the report. As an example, a report prepared for a potential buyer will be intent on identifying potential liabilities associated with acquiring, owning and operating the subject property, which

is why it is important to keep in mind caveat emptor, or buyer beware, as once the new owner takes title, they are responsible for environmental conditions on-site, barring an indemnity from the seller. A Phase I ESA prepared for a lender for financing might consider environmental conditions on-site differently, as they are not intending on taking title to the subject property, although that can be a risk when the property is used as collateral in a future foreclosure.

Below are just a few scenarios to consider. They may not be identified in a Phase I report, but they would typically be covered by a pollution policy:

- 1. Illicit abandonment:** During excavation, a large area of buried construction debris was identified. The material was tested and found to contain asbestos-containing material. It was later determined by the state that the area needed to be remediated and the asbestos containing material was required to be hauled off site. This resulted in the site owner having to pay for the remediation, transportation of hazardous materials and delay expenses.
- 2. Underground storage tanks:** As a site was being excavated, the contractor discovered several tanks that were full and some that had leaked and contaminated soil and ground water. The contamination was determined to extend well beyond the boundaries of the site and required a costly cleanup. The cleanup delayed the project for months and required ongoing monitoring and remediation.
- 3. Closed historic release:** Upon purchase of the site, the client conducted a Phase I report that identified a historic spill that had long been closed out by the state. At the time the spill was closed, the levels of contamination had been deemed acceptable. But because regulatory rules had changed since then, the state determined that the levels of contamination at the site now met or exceeded the threshold and required further remediation. The site owner was then on the hook for further remediating the contamination.
- 4. Mold outbreak:** Mold was discovered in a hotel building. Upon further investigation, it was

determined that the mold extended throughout one whole wing of the hotel. The hotel was subsequently shut down for a full mold abatement, resulting in remediation and business interruption expenses, third-party bodily injury claims from guests who were exposed and associated defense fees.

Additional limitations and coverage considerations include the following:

1. Operational exposures: A Phase I environmental site assessment report does a great job of capturing what has happened at the site from the dawn of time until the report is done, but a Phase I typically does not give a risk assessment of the site's current operations. Even what some would consider to be a safe operation may create a future pollution event.

2. Neighboring exposures and impacts from climate change: As we continue to see changes in weather patterns and more severe weather events occurring at a higher frequency, property owners need to understand that they may be held responsible for cleaning up contamination on their property if it results from a severe weather event such as flooding. Increased consideration should be given to flooding risks, given FEMA's tenacity to redraw flood zone maps and the government's push to change flood modeling from historic flood events to prospective flood events. While the contamination may not have originated at the owner's property, if it lands there, they will have to clean it up. While there may be recourse against adjacent property owners, it will take time before that can be proven.

3. Costs to rectify an undisclosed or unidentified condition result in unanticipated expense to the property owner: A Phase I report is only as good as the information available to compile it, which may result in a data gap or newly defined term in the ASTM E1527-21 standard, Significant Data Gap, in which missing information impedes the ability to identify RECs. While unlikely, it is possible that a Phase I report "misses" a recognized environmental condition on the site that the property owner may be responsible for remediating.

Finally, it is important to review all the transaction documentation, such as purchase and sale agreements, environmental indemnities and loan documents to ensure that there is no requirement for environmental coverage and that the client is not exposed through these agreements. Very often we find that these agreements are not as strong as one may think, leaving the client exposed to a potentially costly environmental claim.

The experts of NFP's environmental practice are happy to assist in reviewing any documentation and discuss coverage on any account.

Resources:

<https://www.federalregister.gov/documents/2022/12/15/2022-27044/standards-and-practices-for-all-appropriate-inquiries>

<https://www.epa.gov/pfas>

https://www.astm.org/e1527-21.html?gclid=CjwKCAiAioifBhAXEiwApzCztu8l1qp-C0dsLVejLbRVRMDUg6a0EHKreigrkPTcb3deVF-BH-3vpLSBoCGjMQAvD_BwE

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