"Due Diligence Requirements for Acquisition of Real Property"

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Last year's federal brownfields law[1] focused attention on due diligence when it exempted persons who undertake "all appropriate inquiry" before buying property from Superfund liability, and directed the U.S. Environmental Protection Agency to define "appropriate inquiry" by rule, referencing an ASTM standard for carrying out site assessments in the meantime.

Why should a municipality care about due diligence as a preliminary step to acquiring real property? Because as owner of real estate, a municipality can, just like any other property owner, be liable for the cleanup of environmental contamination, and it should therefore attempt to learn of possible environmental problems before, and not after, taking title. Even if risks cannot always be entirely avoided, they should as much as possible be understood and planned for. Further, if the due diligence process does not provide a clear guide to action, lenders and developers may be scared away from property that the municipality does not own or intend to acquire, but that is the site for desired municipal redevelopment. Municipal attorneys should, therefore, know what due diligence involves, and how to carry it out.

The Legal Background

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), also known as the Superfund Law,[2] casts a very wide net of legal responsibility for release of a broad range of hazardous substances. Included under the statute as "potentially responsible parties" or PRPs are persons who own or operate a "facility," or who owned or operated a facility when hazardous substances were disposed of; persons who arranged for the disposal of hazardous substances at a facility; and persons who transported hazardous substances to a facility.[3]

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1 The Small Business Liability Relief and Brownfields Revitalization Act, Pub. Law No. 107-118, signed into law January 11, 2002 (the "Brownfields Act").

2 42 U.S.C. § 9601 et seq.

3 42 U.S.C. § 9607(a)(1)-(4).

Superfund liability for cleanup costs and damage to natural resources is strict, joint and several, and retroactive.[4] Prior to the 2002 Brownfields Act, defenses to liability were only available to those who could establish that a release and any resulting damage were due to an act of God, an act of war, or an act or omission of a third party, but only (in the latter case) if the otherwise responsible party had no relationship, contractual or otherwise, with the third party, and could demonstrate that it acted with due care and took precautions against the foreseeable acts or omissions of the third party.[5]

The statutory definition of "contractual relationship" required that the property owner or operator had to have "no reason to know" of any release after "appropriate inquiry," taking into account the owner's or operator's specialized knowledge or experience, the relationship of the property's purchase price to what the price would have been if the property had been uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the owner's or operator's ability to detect the contamination by "appropriate inspection."[6]

Instances of the successful application of this "innocent landowner" defense were few and far between.[7]

The Brownfields Act

The 2002 Brownfields Act modified the CERCLA "innocent landowner" defense and added two other related defenses, one for non-responsible contiguous property owners and another for *bona fide* prospective purchasers. In all cases, persons who prove their entitlement to these defenses are excluded from the Superfund owner or operator PRP category. All three defenses require the proponent of the defense to show (by a preponderance of the evidence) that it undertook "all appropriate inquiries into the previous ownership and uses of the facility in accordance with generally accepted good commercial and customary standards and practices," but to encourage the involvement of previously unrelated parties in possibly contaminated sites, those who qualify as *bona fide* prospective purchasers are given a big advantage: they are entitled to their defense even if their due diligence discloses a release, while innocent landowners and non-responsible contiguous property owners lose the defense if their search finds contamination.[8]

Under the Brownfields Act, EPA is required to define "appropriate inquiries" within two years (i.e., by January, 2004) based on ten criteria: the results of an inquiry by an "environmental professional;" interviews with past and present owners, operators and

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4 United States v. Alcan Aluminum Corp., 990 F.2d 711 (2d Cir. 1993).

5 42 U.S.C. § 9607(b).

6 42 U.S.C. § 9601(35).

7 One example is State of New York v. Lashins Arcade, 91 F.3d 353 (2d Cir. 1996).

8 42 U.S.C. § 9601(40)(B). Compare 42 U.S.C. § 9601(35)(A)(i) (innocent landowners) and 42 U.S.C. § 9607(q)(viii)(II) (contiguous property owners).

occupants of the facility; reviews of historical sources to determine previous uses and occupancies of the property; searches for recorded environmental cleanup liens; reviews of records concerning contamination at or near the property; visual inspections of the property and adjoining properties; any specialized knowledge or experience on the part of property owner; the relationship of the purchase price to the value of the property, if uncontaminated; "commonly known or reasonably ascertainable" information about the property; and the "degree of obviousness" of the presence or likely presence of contamination at the property, and the ability to detect that contamination by appropriate investigation.[9]

For properties purchased before May 31, 1997, the simpler criteria for appropriate inquiry under prior law shall apply: any specialized knowledge or experience on the part of the owner or operator; the relationship of the purchase price to the value of the property, if uncontaminated; commonly known or reasonably ascertainable information about the property; the obviousness of the presence or likely presence of contamination at the property; and the ability of the owner or operator to detect such contamination by appropriate inspection.[10]

For properties purchased on or after May 31, 1997 and until EPA promulgates regulations, the Brownfields Act provides that "compliance with the procedures of the American Society for Testing and Materials, including the document known as 'Standard E1527-97', entitled 'Standard Practice for Environmental Site Assessment: Phase I Environmental Site Assessment Process', shall satisfy the requirements."[11] EPA subsequently issued a final rule stating that use of the updated ASTM standard, E1527-00, will also satisfy appropriate inquiry requirements.[12] Thus as of now, those seeking to carry out appropriate inquiries must focus on the ASTM standard, referred to herein as ASTM E1527. A negotiated rulemaking is under way to assist EPA in developing its rule.[13]

Special Provisions Affecting Municipalities

Municipalities enjoy special exemptions from Superfund coverage in limited circumstances – condemnation and involuntary acquisitions – so that pre-acquisition inquiry is not legally needed to avoid PRP status.

Under CERCLA prior to the Brownfields Act, a government entity that otherwise satisfied the requirements could acquire property by involuntary transfer or by condemnation and assert the innocent landowner defense without inquiry, even if it knew

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9 42 U.S.C. § 9601(35)(B)(iii).

10 42 U.S.C. § 9601(35)(B)(iv)(I).

11 42 U.S.C. § 9601(35)(B)(iv)(II).

12 68 Fed. Reg. 24,888, May 9, 2003.

13 68 Fed. Reg. 10,675, March 6, 2003. I serve as IMLA's representative on the committee set up by EPA to carry out this negotiated rulemaking.

of contamination.[14] The Brownfields Act added restrictions to these governmental rights: a government entity in such a position can still qualify for the innocent landowner defense if it knows of the contamination, but it must now (a) cooperate with and provide access to persons conducting a response action or natural resource restoration; (b) comply with land use restrictions imposed in connection with any response action; and (c) "not impede the effectiveness or integrity" of any institutional controls.[15]

The Brownfields Act did not affect another CERCLA provision benefiting state and local government units that acquire property involuntarily: such governmental units are excluded from the definition of "owner or operator" in the first place, and thus do not need to assert the innocent landowner defense to protect against CERCLA "owner or operator" liability.[16] However, this CERCLA provision does not help state and local governments acquiring property through condemnation or some other voluntary means, as opposed to involuntarily.[17]

However, while these CERCLA provisions make "appropriate inquiry" legally unnecessary for municipalities in the limited circumstances noted, they do not by their terms protect private parties acquiring properties from municipalities or operating such properties, nor do they make it wise for municipalities to acquire property "blind," without investigation as to environmental conditions that could cause post-acquisition expense or delay. These provisions also do not affect the requirements of most, if not all, public and private sources of funding for redevelopment projects (including those established in the Brownfields Act itself)[18] that due diligence be undertaken. Thus for municipalities as for other potential acquirors of real property, we are brought back to the need for "appropriate inquiry," measured as of today by the ASTM standards – at least as a beginning point.

The Elements of an ASTM Site Assessment

The ASTM E1527 standard is intended "to define good commercial and customary practice in the United States of America"[19] for conducting an environmental site assessment of commercial, industrial and multi-family residential properties, generally referred to as a Phase I environmental site assessment. The goal is to identify "recognized environmental conditions," meaning "the presence or likely presence of any hazardous substances or petroleum products on a property under conditions that indicate an existing release, a past release, or a material threat of a release of any hazardous substances or

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14 42 U.S.C. § 9601(35)(A)(ii).

15 42 U.S.C. § 9601(35)(A). The same requirements apply to innocent landowners (id.), *bona fide* prospective purchasers (42 U.S.C. § 9601(40)), and contiguous property owners (42 U.S.C. § 9607(q)).

16 42 U.S.C. § 9601(20)(D).

17 EPA's Lender Liability Rule at 40 C.F.R. § 300.1105 expands on the statutory language; this portion of the Lender Liability Rule was specifically validated by the 1996 Asset Conservation, Lender Liability, and Deposit Insurance Protection Act, Pub. Law No. 104-208, § 2504.

18 Brownfields Act § 211, adding 42 U.S.C. §§ 9601(39), 9604(k).

19 ASTM E1527 § 1.1.

petroleum products into structures on the property or into the ground, groundwater, or surface water of the property."[20]

Environmental Professional

An ASTM Phase I environmental site assessment has four components: a review of records, a visit to the property (or site reconnaissance), interviews with current owners and occupants of the property and with local government officials, and an evaluation and report.[21] The site reconnaissance and the interviews must be conducted by an "environmental professional," and such a person must also review the documents (which may be collected, however, by others) and write the report.[22] Since a failure to use an "environmental professional" disqualifies the assessment from qualifying under ASTM E1527 no matter what its actual content, an initial question for the municipal representative in charge of seeing that a Phase I assessment is carried out, is thus: Who is an "environmental professional?"

The ASTM E1527 standard defines an "environmental professional" (in a somewhat circular fashion) as "a person possessing sufficient training and experience necessary to conduct a site reconnaissance, interviews, and other activities in accordance with this practice, and from the information generated by such activities, having the ability to develop opinions and conclusions regarding recognized environmental conditions in connection with the property in question."[23] This rather unhelpful definition obviously begs the question of how much training and experience is "sufficient." There can be no universal rule, but clearly only firms or individuals with significant experience in undertaking assessments for properties similar in size and complexity to the one under review, excellent references, and relevant professional training should be considered, particularly given the broad discretion that ASTM E1527 gives to the environmental professional. Those seeking to do such work for a municipality should be required to submit full statements of qualifications for critical review. Appendix X3 to ASTM E1527 contains brief suggestions for the selection of an environmental professional.

Records Review

ASTM E1527 provides for searches of specified environmental and historical data bases.[24] Data bases that contain information on properties other than the site in question are to be searched within a certain distance from the site, depending on the data base. For example, the federal National Priorities List is to be searched for facilities within one mile of the site; lists of leaking underground storage tanks are to be searched for facilities

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[20] ASTM E1527 § 1.1.1. Italics indicating defined terms are omitted here and in all subsequent quotes from ASTM E1527.

[21] ASTM E1527 § 6.2.

[22] ASTM E1527 § 6.5.

[23] ASTM E1527 § 3.3.12.

[24] ASTM E1527 § 7.

within one-half mile of the site.[25] All sources searched are to be documented, and facilities found in such searches are to be evaluated by the environmental professional for recognized environmental conditions relating to the property that is the subject of the assessment.[26] "Supporting documentation shall be included in the report or adequately referenced to facilitate reconstruction of the assessment by an environmental professional other than the environmental professional who conducted it."[27]

It is not necessary to locate every conceivable record relating to the site to comply with ASTM E1527: only record information that is "reasonably ascertainable" from standard sources need be reviewed. To be "reasonably ascertainable," information must be publicly available, obtainable within a reasonable time and for a reasonable cost, and practically reviewable, that is, organized so that information on the site in question can be located without unreasonable effort. Usually, according to ASTM E1527, this will mean records that are geographically organized and do not contain "an unmanageable number of sites" within the smallest geographical search unit.[28]

What ASTM E1527 considers standard environmental sources are specified: the federal National Priorities List (NPL); lists of present and former sites on the Comprehensive Environmental Response, Compensation and Liability Information System (CERCLIS); lists of hazardous waste treatment, storage and disposal (TSD) facilities and generators of hazardous waste subject to corrective action under the Resource Conservation and Recovery Act (RCRA); EPA's emergency response notification system (ERNS) list of reported CERCLA hazardous substance releases or spills; state lists of hazardous waste sites identified for investigation or remediation; state landfill lists; and state lists of leaking or registered underground storage tanks (USTs).[29]

Additional environmental record sources that may be checked in the discretion of the environmental professional include local or state lists of brownfield sites; local land records; emergency release reports under Section 304 of the Superfund Amendments and Reauthorization Act of 1986 (SARA); records of contaminated public wells; and records maintained by local departments of health, fire, planning and building, and by local or regional pollution control or water quality agencies.[30]

For the physical setting of the site, a current U.S. Geological Survey 7.5-minute topographic map shall be consulted, and other federal and state maps with information on such matters as soils or groundwater may be.[31]

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25 ASTM E1527 § 7.1.2.

26 ASTM E1527 § 7.1.9.

27 ASTM E1527 § 7.1.8.

28 ASTM E1527 § 7.1.4.

29 ASTM E1527 § 7.2.1.

30 ASTM E1527 § 7.2.2.

31 ASTM E1527 § 7.2.3.

Historical sources are to be consulted "to develop a history of the previous uses of the property and surrounding area, in order to help identify the likelihood of past uses having led to recognized environmental conditions in connection with the property."[32] The use history is to go back as far as the property's first obvious developed use or to 1940, whichever is earlier, in reliance upon "only as many of the standard historical sources. . . as are necessary and both reasonably ascertainable and likely to be useful." "The term 'developed use' includes agricultural uses and placement of fill." Gaps in the history of use shall be identified and explained.[33]

Reviews of standard historical sources at intervals of fewer than five years are not required, and if the specific use appears unchanged over a period longer than five years, then searching the use during that period is not required.[34] Where the general type of use found is industrial or manufacturing, an effort shall be made to identify a more specific use.[35]

The standard historical sources specified in ASTM E1527 are aerial photographs; fire insurance maps; property tax files and recorded land title records (which cannot be the only historical source consulted); U.S. Geological Survey 7.5-minute topographic maps; local street directories; building department records; and zoning and land use records. Other historical sources include newspaper archives and records obtained from the property owner or occupants.[36]

Site Visit

The environmental professional must under ASTM E1527 "visually and physically observe the property and any structure(s) located on the property to the extent not obstructed by bodies of water, adjacent buildings, or other obstacles."[37] The periphery of the property and all buildings on the property shall be observed, the property shall be viewed from all adjacent public thoroughfares, and the uses of roads or paths with no apparent outlets (which might have been associated with surreptitious disposal of wastes) shall be identified.[38] Within buildings, accessible common areas, maintenance and repair areas and a representative sample of occupant spaces shall be observed, but "[i]t is not necessary to look under floors, above ceilings, or behind walls."[39] The methodology used in the visit and any limitations imposed by site circumstances shall be documented.[40]

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[32] ASTM E1527 § 7.3.1.

[33] ASTM E1527 § 7.3.2.

[34] ASTM E1527 § 7.3.2.1.

[35] ASTM E1527 § 7.3.2.2.

[36] ASTM E1527 § 7.3.4.

[37] ASTM E1527 § 8.2.

[38] ASTM E1527 § 8.2.1.

[39] ASTM E1527 § 8.2.2.

[40] ASTM E1527 §§ 8.2.3, 8.2.4.

Before the visit, the environmental professional is to ask the property owner or the person commissioning the assessment, if that person is the owner, to identify a "key site manager," defined as "a person with good knowledge of the uses and the physical characteristics of the property."[41] The environmental professional must then ask the property owner, the person commissioning the assessment (if different) and the key site manager for certain "helpful documents," and must review any of them that are made available before the site visit.[42] The "helpful documents" are: environmental site assessment and audit reports; environmental permits; storage tank registrations (both above-ground and underground); material safety data sheets; a community right-to-know plan; safety, preparedness and prevention plans; reports on hydrogeologic conditions on the property or in the surrounding area; notices or correspondence from government agencies relating to past or current environmental law violations relating to the property or environmental liens encumbering the property; hazardous waste generator notices or reports; and geotechnical studies.[43]

The environmental professional must also ask the property owner, the person commissioning the assessment (if different) and the key site manager before the site visit whether they know of certain matters involving or affecting the property: pending, threatened or past litigation or administrative proceedings relating to hazardous substances or petroleum products, and notices from any governmental entity concerning possible violations of environmental laws or liability relating to hazardous substances or petroleum products.[44]

An attempt is to be made to arrange for the site visit to take place when the key site manager is present; if that can be accomplished, the key site manager is to be interviewed during the site visit. If not, the environmental professional is, when conducting the site visit, to ask for another key site manager or other person with good knowledge of the uses and the physical characteristics of the property, and to interview that person, if available.[45]

To the extent possible, the environmental professional conducting the site visit is to note the site setting (present and past uses of the site, adjoining properties and the surrounding area, geologic, hydrogeologic, hydrologic and topographic conditions, structures, roads, and the water supply and sewage system); hazardous substances and petroleum products connected to present and past uses; and signs of environmental conditions such as storage tanks, odors, pools of liquid, drums, unidentified containers and electrical or hydraulic equipment that could contain PCBs.[46]

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41 ASTM E1527 § 9.5.1.

42 ASTM E1527 § 9.8.

43 ASTM E1527 § 9.8.1.

44 ASTM E1527 § 9.9.

45 ASTM E1527 § 9.5.1.

46 ASTM E1527 §§ 8.4.1, 8.4.2.

Within buildings, the heating and cooling system shall be identified, and floor drains and sumps shall be noted, as well as chemical staining and corrosion.[47] Outside, pits, ponds and lagoons shall be noted, including those observable on adjoining property, plus stained soil or pavement, stressed vegetation, solid waste disposal areas, waste water discharges, wells of any kind and any on-site septic systems or cesspools.[48] The exterior observations are to be the subject of questions during the interviews of owners and occupants (and presumably during the interview of the key site manager, although ASTM E1527 does not so specify).[49]

Interviews with Owners and Occupants

As noted above, the environmental professional must seek certain information from the property owner, occupants of the property, the key site manager and the person commissioning the assessment through interviews. These interviews may be conducted in person, by telephone or in writing, and may take place before, during or after the site visit, except for the questions about helpful documents and proceedings involving the property, which are required to be asked before the site visit.[50]

Besides the property owner, the key site manager and the person commissioning the assessment, the environmental professional is to make "[a] reasonable attempt . . . to interview a reasonable number of occupants of the property."[51] If the property has five or fewer occupants, a reasonable attempt shall be made to interview a representative of each. If there are more than five occupants, a reasonable attempt shall be made to interview major occupants (those occupying at least 40% of the leasable area and any anchor tenant in a shopping center) and others whose operations "are likely to indicate recognized environmental conditions." Residential occupants of multi-family residential properties need not be interviewed.[52]

If the person being interviewed is the person commissioning the assessment, that person has an obligation to answer all questions in good faith to the extent of his or her actual knowledge, or to designate a key site manager to do so. Non-responses or incomplete responses from others do not make the assessment itself incomplete, provided that the questions have been asked in person, by telephone or in writing (with a written record kept), and in the case of written requests, there has been follow up (by telephone or in writing).[53]

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47 ASTM E1527 § 8.4.3.

48 ASTM E1527 § 8.4.4.

49 ASTM E1527 § 8.4.

50 ASTM E1527 §§ 9.3, 9.4.

51 ASTM E1527 § 9.5.2.

52 ASTM E1527 §§ 9.5.2.1, 9.5.2.2.

53 ASTM E1527 §§ 9.7.1, 9.7.2.

Interviews with Local Government Officials

The environmental professional is to make a "reasonable attempt" to interview at least one staff member of one of the following agencies with a view to identifying recognized environmental conditions in connection with the property: the local fire department serving the property; the local or regional state health office serving the area where the property is located; or the local or regional state office of the agency with jurisdiction over hazardous waste disposal or other environmental matters in the area where the property is located.[54]

The interview can take place in person or by telephone.[55] The person answering should be asked to be as specific as possible and to answer in good faith and to the extent of his or her knowledge.[56] As in the case of interviews of property owners and occupants, non-responses or incomplete responses from government officials do not make the assessment itself incomplete, provided that the questions have been asked and written records kept.[57]

Evaluation and Report Preparation

The report to be prepared and signed by the environmental professional upon completion of the site assessment must contain a description of services performed, a findings section identifying known or suspected environmental conditions, the environmental professional's opinion of the impact on the property of the known or suspected environmental conditions, and a conclusions section that summarizes all recognized environmental conditions and their impact on the property.[58] One of two prescribed statements shall be included, confirming that the assessment has been carried out in conformity with ASTM E1527 and asserting either that there are no recognized environmental conditions or listing them.[59]

The report must include supporting documentation, references and a statement of the qualifications of the environmental professional who prepared it.[60] Instances in which ASTM E1527 has not been followed in carrying out the assessment (deletions, deviations or additions) shall be listed "individually and in detail."[61]

The format report should follow that set forth in Appendix X2 to ASTM E1527 unless the person commissioning the report requires otherwise.

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54 ASTM E1527 § 10.5.

55 ASTM E1527 § 10.3.

56 ASTM E1527 § 10.7.

57 ASTM E1527 § 10.8.

58 ASTM E1527 §§ 11.4, 11.5, 11.6, 11.7.

59 ASTM E1527 §§ 11.7.1.1, 11.7.1.2.

60 ASTM E1527 §§ 11.2, 11.10, 11.12.

61 ASTM E1527 § 11.8.

Limitations on Scope

Because ASTM E1527 was originally drafted to provide a standard for "appropriate inquiry" as one element of the innocent landowner defense to CERCLA liability, it is rather narrowly focused on the question whether releases to structures, the ground, groundwater or surface water of those contaminants that are "hazardous substances" under CERCLA have occurred, are occurring or may occur. But as the standard notes, "some substances may be present on a property in quantities and under conditions that may lead to contamination of the property or of nearby properties but are not included in CERCLA's definition of hazardous substances. . . or do not otherwise present potential CERCLA liability."[62] Among the potential contaminants or environmental issues that are not included within the scope of ASTM E1527 are: asbestos, radon, lead paint, wetlands, regulatory compliance, industrial hygiene, health and safety, endangered species, indoor air quality and high voltage powerlines.[63] Releases to air are also apparently excluded, except to the extent they occur within a structure.

If one is concerned with one of these excluded items, or in general with business environmental risk more broadly defined than just a release of CERCLA hazardous substances, it will be necessary to expand the scope of the investigation contemplated by ASTM E1527.

Summary and Conclusions

By undertaking "appropriate inquiry," even if environmental problems are found, a purchaser of contaminated property may qualify as a *bona fide* prospective purchaser and avoid liability for CERCLA response costs. Until EPA issues its rule defining "appropriate inquiry," compliance with ASTM E1527 satisfies the "appropriate inquiry" requirement pursuant to the Brownfields Act. Municipalities acquiring property by condemnation or involuntarily may not need this protection against CERCLA, as they may qualify for other CERCLA defenses. But private developers will need protection, and site investigations are in any case a requirement of most if not all private and public funding sources, bringing us back almost always to ASTM E1527.

However, ASTM E1527 is hardly self-executing. Its requirements are detailed, and much discretion is required at all stages of the process, beginning with the selection of the environmental professional required to undertake the assessment. A municipality, like any property purchaser, must proceed cautiously and carefully, mindful always that it will bear the burden, if challenged, to demonstrate by a preponderance of the evidence that it has satisfied the ASTM E1527 requirements. Given that an assessment will only be challenged if something has gone wrong, the possibility for after-the-fact second-guessing is very real. To limit these risks, the environmental professional's report must be subjected to thorough critical review, to be certain that each instance in which the environmental professional has exercised discretion (for example, in choosing whom to

62 ASTM E1527 § 12.1.1.

63 ASTM E1527 § 12.1.4.

interview, what records to review, or how completely to inspect a site) is painstakingly explained and justified as reasonable in the circumstances. In many borderline cases, it may well be appropriate to require the environmental professional to supplement prior work, so as to lighten the municipality's evidentiary burden.

Further, if the municipality's concerns are not just with CERCLA liability but also with avoiding environmental issues that could derail or delay a desired project, blind reliance on ASTM E1527 alone is misplaced, since it is focused not on environmental risks in general, but rather narrowly on uncovering releases of CERCLA hazardous substances. To reveal broader environmental risks reliably, an expansion of the scope of a site assessment beyond ASTM E1527 may be required.