

# Flawed Phase 1 CREC Definition Poses Challenges to Property Owners and Lenders

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**Purchasers should not assume that a CREC means human exposures are safely controlled.**

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**IN MY LAST ARTICLE**, I discussed the changes to the ASTM E1527 Phase 1 standard which included several new and revised definitions. Now, after little more than a half-year experience with the new E1527-13, it is becoming clear that one of the new definitions—Controlled Recognized Environmental Condition or “CREC”—is more complicated than the ASTM task group that approved this term may have contemplated. As a result, lawyers are disputing CREC determinations and environmental professionals to provide fuller explanations justifying their opinions.

The confusion over the CREC definition is not surprising since it was controversial when it was initially conceived and then was adopted over objections filed by several prominent environmental lawyers. While the ASTM task group deemed the negative comments as “non-persuasive,” readers will see instead that the warnings were quite prescient in predicting the confusion that is now being encountered. In this article, we will provide an in-depth analysis of the CREC concept and to help property owners, lenders and their attorneys not only understand the CREC concept but also its limits. But first a little background.

**BACKGROUND** • Owners or operators (e.g., tenants, licensees) of property contaminated from releases of hazardous substances may be strictly liable under the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)<sup>1</sup> and comparable state laws even if the contamination occurred prior to the time the owner acquired title or the operator came into possession of the property. This strict liability extends not only to cleanup costs incurred by the federal government but also expenses incurred by private parties or local governments.

There are a number of affirmative defenses that property owners or operators could assert in cost recovery or contribution actions that may be filed against them. These defenses include:

- The third-party defense;<sup>2</sup>
- The innocent landowner (ILO) defense;<sup>3</sup>
- The BFPP (bona fide prospective purchaser);<sup>4</sup> and
- The contiguous property owner (CPO);<sup>5</sup>

To satisfy the third-party defense, an owner or operator has to demonstrate by a preponderance of the evidence that: (i) the release was solely caused by a third party; (ii) whom the defendant did not have a direct or indirect contractual relationship; (iii) the defendant exercised due care with respect to the contamination; and (iv) took steps against foreseeable acts or omissions of third parties.

Most courts have broadly construed a direct or indirect “contractual relationship” to encompass most forms of real estate conveyances so that purchasers or tenants would be barred from asserting the defense even if they acquired title or possession of the property after the contamination occurred.

As a result, Congress added an innocent purchaser defense in 1986 that provided that a landowner would not be considered to be in a “contractual relationship” with the person responsible for the contamination if the landowner performed an appropriate inquiry into the past use and ownership of the property. If as a result of this appropriate inquiry, the landowner did not know or have reason to know of contamination, it would be deemed not to have a contractual relationship but would still have to demonstrate compliance with the due care and precautionary elements of the defense.

The 1986 amendments contained five criteria that courts could use in determining if a landowner had implemented an all appropriate inquiry. Courts did not uniformly apply these criteria and often found that if a property owner did not identify contamination during a pre-acquisition investigation, it probably did not perform an appropriate inquiry and therefore could not assert the defense.

In 2002, Congress amended CERCLA to add the BFPP and CPO landowner liability protections (LLPs). As part of these amendments, Congress instructed EPA to issue a regulation establishing the requirements to comply with AAI. When EPA promulgated its all appropriate inquiries (AAI) rule in November 2005<sup>6</sup>, the agency determined that E1527-05 could be used to satisfy AAI.

To qualify for the BFPP, a property owner or operator must establish the following pre-acquisition requirements:

- All disposal of hazardous substances occurred before the purchaser acquired the facility;<sup>7</sup>
- The purchaser is not a potentially responsible party (PRP) or affiliated with any other PRP for the property through any direct or indirect familial relationship, any contractual or corpo-

<sup>1</sup> 42 U.S.C. §9601 et seq

<sup>2</sup> 42 U.S.C. §9607(b) (3).

<sup>3</sup> 42 U.S.C. §9601(35)(A)

<sup>4</sup> 42 U.S.C. §9601(40)

<sup>5</sup> 42 U.S.C. §9607(q).

<sup>6</sup> The AAI rule was published on November 1, 2005(70 Fed. Reg. 66,070 and became effective on November 1, 2006.

<sup>7</sup> 42 U.S.C. §9601(40)(A)

rate relationship, or as a result of a reorganization of a business entity that was a PRP;<sup>8</sup>

- The purchaser conducted all appropriate inquiries into the past use and ownership of the site.<sup>9</sup>

After taking title, a purchaser must comply with number of “continuing obligations” to maintain its BFPP status. The “continuing obligation” relevant to the BFPP cases is the requirement to exercise “appropriate care” by “taking reasonable steps” to:

- Stop any continuing release;
- Prevent any threatened future release; and
- Prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance.<sup>10</sup>

The CPO defense is available to owners of property that have been impacted by contamination from a contiguous or adjacent property. A CPO will not generally be required to conduct groundwater investigations or groundwater remediation. A person seeking to qualify for the CPO must comply with the same pre-and post-acquisition obligations as a BFPP. However, while the BFPP can knowingly acquire contaminated property, a CPO must not know or have reason to know of the contamination after it has completed its pre-acquisition AAI investigation. On the other hand, EPA is authorized

to issue assurance letters to CPOs that no enforcement action will be initiated under CERCLA and to provide protection against claims for contribution or cost recovery. If an owner cannot qualify for the CPO defense because, for example, it had knowledge of the contamination from an adjacent property, it may still be able to qualify for the BFPP defense. The contiguous property owner may also assert any other defense to liability that may be available under any other law.

The party seeking to assert one of the LLPs has the burden of establishing by a preponderance of the evidence that it meets all of the elements of the LLPs. Moreover, the LLPs are self-implementing meaning a property owner can assert the liability protection without formal determination by EPA. As a result, the downside of the self-implementing nature of the LLPs is that a party that thinks it may have achieved one of the LLPs may later learn that a court holds otherwise.

### **ALL APPROPRIATE INQUIRIES AND**

**ASTM E1527** • ASTM initially published the E1527 standard in 1993 to define “good commercial and customary practice” for establishing the innocent landowner defense.<sup>11</sup> Since then, E1527 has become the accepted industry standard for satisfying the pre-acquisition AAI Rule.

Before 2000, there were only two types of conditions that had to be evaluated in an ASTM Phase 1 report by an environmental consultant: a Recognized Environmental Condition (REC) or a *de minimis* condition. The term REC does not appear in CERCLA but was developed by ASTM to help consultants distinguish minor spills from those conditions that would be required to be investigated or remediated. If a consultant identified minor spills or releases that did not pose a risk to human health or the environment, and that would not result in

<sup>8</sup> 42 U.S.C. §9601(40)(H)

<sup>9</sup> 42 U.S.C. §9601(40)(B). EPA promulgated its AAI rule at 40 C.F.R. pt. 312.

<sup>10</sup> 42 U.S.C. §9601(40)(D). The other continuing obligations are complying with all release reporting requirements; cooperating, assisting, and providing access to persons authorized to conduct response actions or natural resource restoration at the property; complying with any land use restrictions established as part of a response action and not impeding the effectiveness or integrity of any institutional control used at the site; provide access to persons authorized to operate, maintain, or otherwise ensure the integrity of land use controls at the site; and comply with any the EPA request for information or administrative subpoena issued under CERCLA. See 42 U.S.C. §9601(40)(C), (E)-(G)

<sup>11</sup> ASTM initially published E1527 in 1993 (E1527-93). The standard has subsequently been revised in 1994 (E1527-94), 1997 (E-1527-97), 2000 (E1527-00) and 2005 (E1527-05).

enforcement actions if brought to the attention of regulators could be classified as a *de minimis* condition.

The 2000 revisions to E1527 added the term Historical Recognized Environmental Conditions (HREC) which was intended to be used for sites where contamination was remediated to applicable standards. Instead of labeling the former contamination as a REC, consultants could now identify the former spill as an HREC, confirming that it has been remediated and no longer poses a risk to human health of the environment. The HREC concept was a useful tool since it prevents property from continuing to be stigmatized by the existence of a former release in state or federal databases.

Unfortunately, consultants did not consistently apply the HREC term so that similar situations were classified as HRECs, RECs or *de minimis* conditions. Some made HREC determinations without verifying the cleanup standard used in the past was still valid and that the remedy (i.e., engineering or institutional controls) was still protective and functioning as designed. See “Agency File Reviews: The Dark Secret of Phase 1 Reports” which appeared in the May 2012 issue of *The Practical Real Estate Lawyer*. Other consultants identified the continuing presence of residual contamination a REC notwithstanding regulatory approval. This was a significant concern since most cleanups now employ risk-based approaches where some remnant of contamination is allowed to remain so long as institutional or engineering controls are used to prevent unreasonable exposure to the residual contamination.

To promote more consistency in how these remediated RECs were described and presented in phase 1 reports, the ASTM E1527 task group revised the HREC definition and added the new CREC designation. The HREC term was intended to apply to cleanups that had achieved unrestricted residential cleanup standard while the CREC term for cleanups where residual contamination

remained and the site was subject to institutional or engineering controls (known as Activity and Use Limitations or “AULs” in ASTM parlance). As a result, there are now four types of conditions that may be identified in an ASTM E1527 phase 1 report: REC, HREC, CREC, and *de minimis* conditions.

**WHAT IS A CREC?** • The task group hoped that creating the CREC term would help alert purchasers if there were controls on future use of the property as well as develop plans for complying with the controls that are in place so that they can satisfy their post-acquisition “continuing obligations” and maintain their liability protections. A CREC will not require further action so long as the “controlled” conditions remain in effect.

As originally drafted, the CREC term would be limited to circumstances where ECs/ICs were actually created or recorded against the property and the environmental professional would be required to verify that the EC/ICs were properly maintained/recorded. However, the environmental consultant representatives on the task group pushed back on these requirements as being too onerous. As a result, the final CREC definition approved by the task group did not require consultants to actually verify that the controls are in place or are properly working.<sup>12</sup>

The final definition adopted by ASTM provides that a CREC is:

“ a recognized environmental condition resulting from a past release of hazardous substances or petroleum products that has been addressed to the satisfaction of the applicable regulatory authority

<sup>12</sup> The CREC definition states in 3.18.1 that “A condition identified as a controlled recognized environmental condition does not imply that the environmental professional has evaluated or confirmed the adequacy, implementation, or continued effectiveness of the required control that has been, or is intended to be, implemented

(for example, as evidenced by the issuance of a no further action letter or equivalent, or meeting risk-based criteria established by regulatory authority), with hazardous substances or petroleum products allowed to remain in place subject to the implementation of required controls (for example, property use restrictions, activity and use limitations, institutional controls, or engineering controls).”<sup>13</sup>

A number of negative comments were filed on the final CREC definition by E1527 task group during the ASTM balloting process to approve the E1527-13 phase 1 standard. Some environmental consultants argued that the HREC had caused confusion and that adding yet another term would exacerbate the uncertainty. They felt that consultants “should be able to describe the different types of RECs identified or ruled out on a property without having to resort to listing different types of RECs.”

Several prominent environmental lawyers objected to the CREC term, asserting that the CREC term added a needless level of complexity and was unnecessary because conditions that had been addressed to the satisfaction of regulators should be considered a “*de minimis* condition.” One particularly prescient negative comment stated that “the new definition of CREC was not consistent with the common understanding of the term ‘control’ or ‘controlled’ and was misleading because it implied that residual contamination was under ‘control’ when in fact consultants were not required confirm that controls were actually in place and effective.”

The ASTM task group found these negative comments “non-persuasive,” emphasizing that the CREC definition stated that the condition was “subject to the implementation of required controls,” not that the condition is “under control.” The task group also pointed to the note at the end of the definition stating that a consultant identifying a condition identified as a CREC was not im-

plying that it has evaluated or confirmed the adequacy, implementation, or continued effectiveness of the required control that has been, or is intended to be, implemented.”) Finally, the task group dismissed concerns about marketplace confusion by asserting that it had undertaken nationwide industry outreach to gauge how this new term would be received and concluded that the CREC concept had overwhelming support among these stakeholders.<sup>14</sup>

### **WHAT DOES THE CREC DESIGNATION MAN FOR YOUR PROPERTY?**

• It is important to remember that all a phase 1 has to do to satisfy AAI is to identify a REC, HERC, CREC or *de minimis* condition. No further investigation or remediation is required to comply with AAI. However, once a party takes title or possession of a property, it will have to comply with its “continuing obligations” to MAINTAIN liability protection. The CREC may be able to help satisfy these obligations controls.

Because ASTM did not limit CRECs to those conditions where formal AULS have been implemented and did not require the consultant to verify if the “control” has been properly implemented and remains effective, the usefulness of CREC and the extent that an owner, lender or their counsel can rely on the designation will depend on the type of CRECs that exists for the property. At one end of the CREC continuum are those sites where enforceable AULs have been recorded against the property such as a deed restriction and the spe-

<sup>13</sup> ASTM E1527-13 §3.18.

<sup>14</sup> The author who has been an active member of the ASTM E50 task force for ten years and served as chair of the legal subgroup that drafted the legal appendix and business environmental appendix and his experience is that the active membership of task force is dominated by a handful of environmental consultant firms and lawyers. Many sectors of the real estate and financial industry were not represented during the E1527-13 revisions including CMBS originators, private equity and REITs to name a few important market participants.

cific cleanup standards has been memorialized in the NFA letter. In such circumstances, then owner, its lender and counsel will be able to determine if “control” has in fact been implemented, can assess if it remains protective and if it continues to be in compliance with current cleanup standards.

At the other end of the spectrum are cleanups that were done without any oversight by the regulator (commonly known as “self-directed” or “at-risk” cleanups) where the developer or property owner implemented a cleanup on its own to avoid regulatory delays. Because the cleanup would not have been completed “the satisfaction of the applicable Regulatory Authority”, this cleanup would not qualify as a CREC and probably have to be identified as a REC subject to post-remedial confirmatory sampling. An exception would be if the cleanup was supervised by a licensed environmental professional in a state with a licensed environmental professional program such as Massachusetts, Connecticut or New Jersey and the licensed professional opines that the cleanup met “risk-based criteria established by regulatory authority”

The more challenging CRECs will be those within the murky middle of the continuum where a regulator may have signed off on a cleanup without referencing a formal control. Many state regulators have signed off on risk-based cleanups without referencing any AULs, particularly with petroleum-contaminated sites where many state programs rely on natural degradation of petroleum and only require removal of grossly contaminated soils/source materials. There is still petroleum contamination in the ground but no actual “control” in place. The contamination has been addressed to the satisfaction of the regulator but often times the records are archived or destroyed so the consultant cannot verify the actual levels that were left in the ground. In such an instance, the note to the CREC definition advises consultants that they can look to the

data and infer an implied control.<sup>15</sup> In other words, the consultant can assume that if the site was a gas station or a commercial property with a UST, the cleanup was approved by the state on the condition that the property would continue to be used only for commercial purposes.<sup>16</sup> How this assumption will help property owners or operators comply with their continuing obligations remains unclear.

Then there are the situations where regulatory controls may be implemented but human exposures remain because of the potential for vapor intrusion. Some states allow local governments to adopt groundwater ordinances that prohibit the use of groundwater to facilitate cleanups. The groundwater ordinance serves as a “control” that could qualify as a CREC. However, many states do not take into account potential human exposures from vapor intrusion. In such a situation, while the groundwater “control” is in place but human exposure is not controlled. This is particular so in states with dry cleaner trust funds. Most state programs rank sites for funding based solely on impacts to drinking water. If the groundwater is not used, the site will receive a low priority ranking for cleanup. While the property owner waits years for the dry cleaner fund to get around to funding the cleanup, the groundwater plume could be migrating off-site and posing a risk of vapor intrusion to nearby residences.

For example, the author recently was involved in a transaction involving a shopping center where a plume from a dry cleaner had migrated off-site

<sup>15</sup> “Note 1-For example, if a leaking underground storage tank has been cleaned up to a commercial use standard, but does not meet unrestricted residential cleanup criteria, this would be considered a controlled recognized environmental condition. The “control” is represented by the restriction that the property use remain commercial.”

<sup>16</sup> ASTM trainers are emphasizing to consultants that AULs are just one indication of a past or present release but not the only evidence that a property may not be used for unrestricted use. Consultants are also being instructed that if there are no formal AULs, they should look at the data and ask if the “dirt is eatable and the water drinkable.”

and was within 30 feet of single-family residences. Because the local government had passed a groundwater ordinance, the state issued an NFA letter. However, the soil gas near the residential community was found to be 8,951 micrograms per cubic meter ( $\text{ug}/\text{m}^3$ ) which was far above the EPA residential screening level of  $470 \text{ ug}/\text{m}^3$ . In a different state where vapor intrusion is evaluated as part of a cleanup, closure would not have been granted, the dry cleaner plume would have been identified as a REC and the owner additional investigation would have been required to assess the extent of the REC. However, in this state which allowed for pathway elimination by ordinance, closure was granted and the dry cleaner contamination was identified as a CREC with no further investigation recommended even though there was a strong likelihood that human exposures were not “controlled”. In other words, the same condition in a different state would have a different designation even though in both situations human exposures were not controlled.

In essence, because of the regulatory program of this state, what might have been a REC in another state was transformed into a Business Environmental Risk in the form of a potential toxic tort claim. Fortunately, counsel for both the lender and property owner recognized the potential liability and a pollution legal liability policy was obtained to protect against potential third party claims for bodily injury or property damage.

Since the task group declined to follow what turned out to be sage advice of several seasoned environmental transactional attorneys and approved a flawed CREC definition, what are property owners, lenders or counsel to do? E1527-13 does require that CRECs be listed in the findings and conclusions section of a phase 1 report,<sup>17</sup> and consultants are also required to explain their reasoning related to the impact of the CREC on the

property.<sup>18</sup> So users of phase 1 reports, particularly purchasers who will need to take reasonable steps to stop continuing releases and prevent exposure to existing releases to maintain their liability protection, should carefully review the discussion of any CREC and be prepared to ask the consultants the following questions:

- Did they review the NFA letter or decision document by the licensed professional concluding that the cleanup met state standards;
- Identify what the cleanup standard was and if it remains in effect or has been changed since the NFA letter or its equivalent was issued;
- Identify the “controls” that it has identified as the basis for concluding the condition is a CREC;
- Have the consultant verify if the “control” has in fact been properly implemented (e.g., recorded in the land records, sub-slab depressurization is properly working, engineering control is properly maintained, etc) and remains protective of human health;
- If the consultant is inferring a control, provide justification for concluding the control is applicable to the site; and
- Ask the consultant to determine if human exposures such as vapor intrusion are under “control.”

If the environmental consultant cannot verify what cleanup standard was used or that it remains the correct standard, this could be viewed as a significant data gap that would have to be verified to be in compliance with AAI.

If the consultant believes in its professional judgment that the condition is continuing to pose a risk of human exposure, the condition should be a REC and not a CREC even if regulatory closure has been granted-especially where the consultant is representing a purchaser. Appropriately identifying

<sup>17</sup> E1527-13 §12.8

<sup>18</sup> E1527-13 §12.6

the condition as a REC early enough in the transaction will enable the parties to further evaluate the issue or negotiate some risk allocation mechanism for the condition.

The CREC definition is what it is. Until ASTM takes another look at the definition, owners and possessors of property should be prepared to ask hard questions of the environmental professionals to make sure that they are not lulled into a false sense of comfort only to inadvertently forfeit their liability protections because they failed to comply with “controls” they did not anticipate after they taking title or possession of the property.

As we discussed in a prior column<sup>19</sup> lenders are positioned differently than property owners from a liability standpoint and therefore may have risk tol-

erances that are different from those who take title to potentially contaminated property. Since understanding a CREC will likely be vital to maintaining liability protections, purchasers should not simply rely on consultants retained by their lenders but be prepared to retain their own professionals to independently verify the CRECs and their underlying controls.

**CONCLUSION** • A CREC only applies to regulatory “controls” (i.e., institutional and engineering controls) and not human exposures. Purchasers should not assume that a CREC means human exposures are safely controlled. The purchaser who fails to have their consultant verify that if human exposures are under control may later learn that they have bought themselves into a toxic tort lawsuit.

<sup>19</sup> “How Phase 1 Reports Can Hurt Your Clients,” *The Practical Real Estate Lawyer*, November 2011

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