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Spill Act Innocent Purchaser Defense: What Does Due Diligence Really Provide?

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Since 1993, purchasers of land in New Jersey have had access to a statutory safe harbor from the potentially significant obligation under the New Jersey Spill Compensation and Control Act (Spill Act) to respond to discharges of hazardous substances that occurred prior to ownership. For many, however, status as an "innocent purchaser" has remained elusive. New Jersey courts have found purchasers unable to support the defense because they did not perform adequate pre-acquisition due diligence. Adequate due diligence necessary to establish innocence is not always straightforward. Accordingly, counsel should carefully discuss with their clients the appropriate level of pre-acquisition environmental due diligence to be conducted before proceeding with any land transaction, even for property that does not seem to pose environmental risk, including residential property.

The Spill Act places the cost of cleaning up pollution not only on the dischargers of hazardous substances but also on any person who can be deemed to be "in any way responsible" for the pollution. Prior to 1993, however, the purchase of already-contaminated land was not necessarily sufficient to impose Spill Act liability. *See NJDEP v. Ventron Corp.*, 94 N.J. 473 (stating while ownership or control at the time of discharge is sufficient, "[t]he subsequent acquisition of land on which hazardous substances have been dumped may be insufficient to hold the owner responsible.") Since 1993, amendments to the Spill Act have clarified that post-1993 purchasers of contaminated land who knew or should have known through due diligence about previous discharges will be held liable. N.J.S.A. 58:10-23.11g(c)(3). Notwithstanding this provision, purchasers have argued, based on *NJDEP v. Dimant*, 212 N.J. 153 (2012), that they cannot be held liable for pre-existing contamination because they did not have a sufficient "nexus" to the discharge. Our courts, however, have rejected these arguments, confirming that a defendant who conducts less than the required due diligence before purchase establishes a connection with the discharge and becomes "responsible" for it. *See, State Farm Fire & Cas Co. v. Shea,* 2012 N.J. Super. Unpub. LEXIS 2208 (App. Div.)*; Casino Reinvestment Dev. Auth. v. Lin,* Docket No. ATL-L-338-12 (Law Div. Dec. 9, 2015).

The Spill Act contains no liability clause similar to N.J.S.A. 58:10-23.11g(c)(3) that is applicable to pre-1993 purchasers. The act was amended in 2001, however, to include an innocent purchaser defense for pre-1993 purchasers. N.J.S.A. 58:10-23.11g(d)(5). The Appellate Division has relied on the creation of the defense to hold that pre-1993 purchasers of already contaminated land are liable unless they are innocent purchasers. *New Jersey Schools Dev. Auth. v. Marc antuone,* 428 N.J. Super. 546 (App. Div. 2012), *certif. den*. 213 N.J. 535 (2013) (finding no need for

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the defense if there is no liability). Accordingly, as interpreted by our courts, the Spill Act casts a broad liability net which includes purchasers of contaminated property who failed to conduct appropriate due diligence.

To avail oneself of the Spill Act innocent purchaser defense, a purchaser must demonstrate that it did not know and had no reason to know of prior discharges of hazardous substances at the property by performing "all appropriate inquiry" prior to purchase. What constitutes "all appropriate inquiry" differs depending upon whether the purchase occurred before or after 1993. Post-1993 purchasers must perform a "preliminary assessment" and, if necessary, a site investigation in accordance with New Jersey Department of Environmental Protection requirements (DEP). Significantly, if a purchaser discovers contamination as part of its investigation, it loses innocent purchaser status under the Spill Act, at least for the contamination it discovered, if it purchases the property. It is important to keep in mind that performing a Phase I Environmental Site Assessment, which constitutes all appropriate inquiry under the federal Superfund law, will not suffice under the Spill Act. The appropriate due diligence for pre-1993 purchasers is determined by generally accepted good and customary standards at the time of purchase. N.J.S.A. 58:10-23.11g(d)(5).

Post-1993 Due Diligence

For post-1993 purchasers, sufficient due diligence must consist, at a minimum, of a preliminary assessment. *DEP v. Navillus Group*, 2015 WL 9700541 (App. Div. Jan. 14, 2016). The defendants in *Navillus* asserted that they were innocent purchasers and not responsible for pre-existing contamination because, prior to purchase, their principal interpreted an EPA Mini Pollution Report for the property to mean that no environmental problems were present. The defendants also argued that their inquiry of local officials and the NJDEP satisfied the preliminary assessment element of the defense. The Appellate Division strongly disagreed. The court was not persuaded a subjective and incorrect conclusion following review of the EPA Mini Report could qualify the purchaser as innocent. Fundamentally, upon finding that requirements for a preliminary assessment entail a significantly greater inquiry than the defendants performed, the court stated unequivocally that the defendants' failure to undertake a preliminary assessment meant the innocent-purchaser defense is unavailable.

Performing a Phase I Environmental Site Assessment, which constitutes all appropriate inquiry under the federal Superfund law, will not suffice under the Spill Act.

Post-1993 purchasers of property intended for residential use must also be on alert. The Spill Act does not differentiate between residential, commercial or industrial properties. A recent trial court opinion held that a purchaser's visual inspection of residential property, which was to be converted into three apartments, was insufficient to satisfy the due diligence required of an innocent purchaser. *Casino Reinvestment Dev. Auth. (CRDA) v. Ping Lin*, Docket No. ATL-L-338-12 (Law Div. Dec. 9, 2015). The defendant conceded that she did not conduct a preliminary assessment prior to purchase. Rather, she argued that her visual inspection of the property, which at the time of purchase was heated with natural gas, raised no concern to lead her to conclude that further investigation would be necessary. *Cf., State Farm v. Shea* (where the court found defendant's failure to inquire about pipes sticking out of the ground at residential property was not appropriate inquiry, but did not hold that a preliminary assessment was necessary).

Even though the court "appreciated" the defendant's argument, it held that the Spill Act clearly provides that a preliminary assessment must be conducted in order

to satisfy the innocent-purchaser defense. Nonetheless, the *CRDA* court distinguished the defendant from a purely residential purchaser based upon her intent to derive income by renting two of the three apartments. Thus, the *CRDA* and *Shea* cases may leave the door slightly ajar for a single-family residential purchaser to argue that something less than a preliminary assessment, for example a tank sweep, constitutes sufficient due diligence to qualify as an innocent purchaser. To accept that argument, however, a court would have to ignore the express language of the Spill Act, which calls for a preliminary assessment and makes no special allowance for residential property.

Pre-1993 Due Diligence

The standard of due diligence to be applied to a pre-1993 purchase is not as clear. What was considered good and customary due diligence prior to 1993 has yet to be decided in the courts and will largely depend upon the facts and circumstances of the property purchase at issue. Factors to be considered will include not only the date of purchase—as environmental awareness increases the later the date—but also the type of property involved. What was good and customary practice for an industrial property in 1962 should certainly differ from what was good and customary in 1992 and should differ even further for a residential property, distinctions not explicitly available to post-1993 purchasers. Parties seeking to demonstrate that their pre-1993 due diligence was adequate will likely require expert assistance to establish good and customary standards for any particular transaction.

Considerations for Purchasers

Purchasers today need to be aware that performing a preliminary assessment is the minimum due diligence essential to having a basis to successfully assert the Spill Act innocent-purchaser defense. Notwithstanding, a preliminary assessment, while necessary, may not always be sufficient to constitute all appropriate inquiry. Often, the timing pressures of a transaction may result in deviations and omissions from NJDEP requirements for preliminary assessments, which require a search for and evaluation of existing site, operational and environmental information that can take time to obtain, if it is even available. Deviations and omissions could negate the protection to be afforded by the preliminary assessment. Accordingly, attempts to comply with the requirements should be carefully documented along with detailed descriptions of why any deviations or omissions were unavoidable in an effort to establish the thoroughness of the inquiry.

If the preliminary assessment identifies suspected contamination, the act explicitly requires a Site Investigation. In some instances, NJDEP guidance permits deferral of the investigation of certain potential areas of contamination, for example suspected historically applied pesticides. The impact of a deferred investigation on innocent-purchaser status is unclear, however. If a purchaser complies with the guidance and defers investigation, will it lose all innocent-purchaser protection or, will it have at least partial protection for those contaminants investigated other than pesticides?

Purchasers of property in New Jersey should be aware that performance of a preliminary assessment is the minimum level of inquiry necessary to demonstrate adequate due diligence for the innocent-purchaser defense. Even if innocent-purchaser status is not achieved, information obtained during due diligence will provide an environmental baseline that will allow the purchaser to make decisions, for example, about price and indemnities, factoring in potential environmental liabilities. Purchasers should also consider that the next buyer will likely want to perform due diligence and may discover a problem that will have to be addressed before the property can be sold. Given the potential for costly and unwelcome surprises, whether to perform, at least, a pre-acquisition preliminary assessment should be carefully considered and not left to chance.■