ENVIRONMENTAL ISSUES
IN
REAL ESTATE AND CORPORATE TRANSACTIONS

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I. COMMON ENVIRONMENTAL TERMS

A. CHEMICALS AND CONTAMINANTS-

Acid- A liquid with a low pH (less than 7). Acid dissolves many metals and promotes the movement of metal ions in ground-water systems.

ACM- asbestos-containing materials

Appendix IX constituents- A list of approximately 250 hazardous substances (see 40 CFR 264, Federal Register of July 9, 1987) used for groundwater monitoring under 40 CFR 264.

Aroclor- Trade name for a group of polychlorinated biphenyls. The last two digits of 1200 series Aroclors denote percent chlorine by weight. For example, Aroclor 1254 is approximately 54 percent chlorine. Aroclor 1016 does not follow this system and has a composition approximately like Aroclor 1242.

Base- A liquid with a high pH (greater than 7). Metals tend to precipitate under basic conditions and hence become less mobile in ground-water systems.

Benzene- An organic compound and is a common industrial solvent and building block for many petrochemicals.

Biodegradation- Decomposition of organic compounds by an organism's (animal, plant, microorganism) metabolism.

BOD- Biochemical oxygen demand, a standard measure of the organic matter in a water sample that can be degraded in the presence of oxygen.

BTEX- Abbreviation for benzene, toluene, ethyl benzene, and xylenes, aromatic compounds that are the most water soluble of the major gasoline components, and therefore common indicators of gasoline contamination.

CFCs (chlorofluorocarbons)- inert, non-toxic and easily liquefied chemicals used in refrigeration, packaging, insulation, or as solvents and aerosol propellants.

CO (carbon monoxide)- a colorless gas which is toxic because of its tendency to reduce the oxygen-carrying ability of blood.

COD- Chemical oxygen demand, a measure primarily of the organic matter in water or waste sample that can be chemically oxidized.

DNAPL- Dense Non-Aqueous Phase Liquid. This is a liquid that will not readily dissolve in water but instead sinks to the bottom of the aquifer. It will generally move along the contour of the aquifer and will act as a source of contamination by slowly dissolving into the groundwater. Chlorinated solvents are typical DNAPLs.

Hazardous Air Pollutants (HAPs)- The list of 189 toxic air pollutants regulated by the Clean Air Act

Heavy Metals- includes arsenic, cadmium, chromium, copper, lead and zinc.

Inorganics- Chemicals without organic carbon, including metals and other ions such as chloride, sulfate, and nitrate.

Metal- A chemical element, usually characterized by lustrous appearance, malleability, and the ability to conduct electricity; tends to donate electrons and thereby become positively charged. Over three-quarters of all elements are metals.

NOX (Nitrogen Oxide)- One of the primary pollutants regulated by the CAA. It reacts with VOCs in the presence of heat and sunlight to form ozone.

Ozone- a compound consisting of three oxygen atoms which is the primary constituent of smog.

PCBs (polychlorinated biphenyls)- Highly stabile organic compounds that were used in electrical equipment such as transformers because of their good heat insulating properties.

pH- a measure of the acidity or alkalinity of a solution with 7 being neutral.

PM10- particulate matter emitted into the atmosphere which is at least 10 micrometers in diameter.

Polynuclear aromatic hydrocarbons (PAHs)- A large group of multi-ring organic compounds, some of which are EPA Priority Pollutants. Found naturally in heavy petroleum residues such as tars.

Precipitation- The formation of solids out of constituents that were once dissolved. Precipitation is caused by a change in conditions, such as temperature, chemical concentration, or the presence of seed particles to begin the process.

Priority Pollutants- A group of 126 chemicals (about 110 are organic compounds) that appear on an EPA list because they are toxic and relatively common in industrial discharges.

SO2 (Sulfur Dioxide)- One of the primary pollutants regulated by the CAA.

TCE- Abbreviation for trichloroethylene or trichloroethene, which is an industrial solvent.

TPH- total petroleum hydrocarbons

Trip blank- A sample bottle filled with pure water in a laboratory, which travels unopened to the field and back to the laboratory. Usually employed to determine whether volatile organic compounds are inadvertently added to a sample in transit or in the laboratory.

VOCs- volatile organic compounds including solvents such as trichloroethylene (TCE)

Volatile- The characteristic of a pure chemical that results in easy vaporization from the liquid phase into the gas phase. If the chemical is an organic compound, it is called a volatile organic compound (VOCs).

B SELECTED ENVIRONMENTAL TERMS

Attainment Area- A geographic area where the air quality equals or exceeds the NAAQS for a particular pollutant. An area could be in attainment for one pollutant and a non-attainment area for another pollutant.

CERCLIS- Comprehensive Environmental Response Compensation and Liability Information System.

CMS- RCRA Corrective Measures study

HNu- Photoionization detector (note: HNu is a copyrighted trade name)

HAP- Hazardous Air Pollutants

HWMU- Hazardous Waste management Unit

IRM- Interim remedial measures

LOD- Limit of detection

LUST- Leaking underground storage tank
MG/L- Milligrams per liter
Mg/L- Micrograms per liter
NAAQS- National ambient air quality standards established for the following primary pollutants: Ozone, SO2, NOX, CO, PM10)
NFA- No Further Action Letter
NOV- Notice of Violation
NPDES- National Pollutant Discharge Elimination System
NPL- National priority list
O&M- Operation and maintenance
OVA- Organic vapor analyzer
PID- Photoionization detector
POTW- Publicly owned treatment works
PPB- Parts per billion
PPM- Parts per million
PRP- Potentially responsible party
PSD- Prevention of Significant Deterioration (air permit)
QA/QC- Quality assurance/Quality control
RA- Remedial Action
RAP- Remedial Action Plan
RAW- Remedial Action Workplan
RCRIS- Resource Conservation & Recovery Information System
RFA- RCRA Facility Assessment
RFI- RCRA Remedial Facility Investigation
RQ- Reportable quantity
SIC- Standard Industrial Classification
SITE- Superfund Innovative Technology Evaluation Program
SOW- Statement of Work
SPCC- Spill prevention control and countermeasures
SWMU- Solid Waste Management Unit
TCLP- Toxic characteristic leaching procedures
TSDF- Treatment, Storage or Disposal Facility
TSS- Total suspended solids
UST- Underground storage tank

II. REVIEW OF FEDERAL AND STATE ENVIRONMENTAL LAWS IMPACTING BUSINESS TRANSACTIONS.

A. <u>Clean Air Act (42 U.S.C. 7401 et seq.) ("CAA")</u>- This law prohibits the emission of air pollutants unless authorized by a permit. New sources of air pollution and modifications to existing emission sources must obtain air pollution control permits.

1. National Ambient Air Quality Standards ("NAAQS")- Emission limitations established in air permits are designed to achieve the NAAQS established by the federal government. More stringent emissions limitations may be imposed for new sources, facilities located in regions where air quality exceeds the NAAQS ("non-attainment areas") or in areas where areas that exceed air quality standards ("prevention of significant deterioration"). Since the emission standards established for a particular emission source depend on the air quality where a facility is located, similar plants in different regions of the country may be subject to different emissions standards. Purchasers need to review their review existing permits requirements prior to the closing.

2. New Source Review Program (42 U.S.C. 7501-7508)- Construction of new major air sources or modifications to existing major sources of air pollution will require permit modifications under the New Sources Review ("NSR"). If a purchaser intends to institute changes in operations at a plant such as change in hours of operations, substitution of raw materials or new products, the purchaser may have to obtain permit modifications for the affected existing emission sources which could delay implementation of the operational changes. As a result, purchasers need to also determine what the future permit requirements for a plant will be in addition to reviewing the current regulatory requirements.

The CAA creates five categories of five non-attainment areas. The definition of a "major source" for triggering NSR requirements depends on the air quality where the facility is located. In Marginal and Moderate Non-Attainment areas, the NSR threshold is 100 tons per year (tpy) of VOC and NOX. For Serious Non-Attainment, the cutoff is 50 tpy of VOC and NOX. For Severe Non-Attainment, the level is 25 tpy and for Extreme Non-Attainment areas 10 tpy. (42 U.S.C. 7511a)

Not every change to an existing source constitutes a modification. Usually, the change must result in a specified increase in emissions. However, in Serious, Severe or Extreme areas, any change to an air source that results in increased emission will be considered a modification requiring.

Once it is determined that a change constitutes a modification, the facility must obtain offsetting reductions in the emissions of other sources (emissions trading). The amount of offsets depends on the air quality where the facility is located and range from 1:1 to 1:5. Usually, the offsets have to be obtained by intra-facility reductions from other sources. However, companies may obtain emission reductions from other companies in the area

who have reduced their emissions and registered them as verifiable emission reduction credits ("ERC"). When a change involves a major sources in serious areas that emit less than 100 tpy and the facility agrees to internally offset emissions by at least a ratio of 1:3, the change will not be considered a modification. (42 U.S.C. 7511(a))

4. Air Toxics- The CAA has imposes stringent air emission requirements for hazardous air pollutants ("HAPs"). (42 U.S.C. 7412). EPA has identified 189 HAPs for major and area sources. Chemical plants can have significant emissions from vents and valves as well as stacks so these air toxic programs can require significant operational changes or physical modifications to plants.

A Major Source under the HAP program is a source that emits 10 tpy for any single HAP or 25 tpy for any combo. (42 U.S.C. 7412(a)(1). Area sources are smaller sources that emit relatively low levels of HAPs but whose aggregate emissions impair air quality. (42 U.S.C. 7412(a)(2). The requirements under the HAP program may not only require air emission controls but also work practice or process changes and raw material substitutions.

5. Asbestos Containing Materials ("ACM")- Asbestos has been used extensively in commercial and residential buildings. EPA defines ACM as material containing at least 1% asbestos using polarized light microscopy (40 CFR 61.141). ACM is usually found in three forms in buildings: Thermal Insulation (e.g., pipe insulation, boiler insulation or duct insulation); surfacing materials (e.g., troweled and sprayed decorative plaster, acoustical ACM under decking and fireproofing on structural components); and miscellaneous materials (e.g., sheet flooring, ceiling tile, roofing materials, concrete panels, asbestos sidings used for duct insulation, pipes and siding). ACM may be further classified as friable or non-friable. Friability refers to material that can be crumbled, pulverized or otherwise reduced to power by hand pressure when dry. (40 CFR 61.141).

Asbestos is primarily regulated under the CAA and TSCA (See Part II.E for a discussion of TSCA regulation of asbestos). In 1971, EPA identified asbestos as a HAP and promulgated an asbestos NESHAP in 1973. The asbestos NESHAP applies to regulated ACM ("RACM") which is defined as friable ACM, Category I non-friable ACM (floor or roofing tiles, mastic, gaskets, etc) or Category II (cannot be crumbled such as asbestos cement products) (42 CFR 61.141).Category I materials become RACM when they are subject to mechanical forces (sanding, grinding, cutting or abrading), are in poor condition, become friable or will be demolished by burning. Category II materials such as asbestos cement products like transit will become RACM when they are likely to be pulverized, crumbled or reduced to powder usually during demolition or waste consolidation activities.

For Category I and II non-friable ACM, the greatest risk of fiber release is usually during post-demolition activities such as waste consolidation or recycling. However, EPA issued a manual in 1992 that identified demolition practices that can make Category I and II non-friable ACM into RACM. The manual also identified ACM waste consolidation and off-site handling procedures that could cause Category I and II non-friable ACM to

become RACM and therefore be subject to the asbestos NESHAP. Demolition Practices Under the Asbestos NESHAP (EPA 340/1- 92.013, Sept. 1992).

a. Asbestos NESHAP

The asbestos NESHAP banned the use of ACM that was sprayed or troweled on surfaces for fireproofing/insulating in institutional, commercial and industrial buildings including residential buildings with more than four dwelling units. EPA also banned the use of thermal insulation in 1975 for wet-applied and pre-formed asbestos pipe insulation as well as pre-formed asbestos block insulation on boilers and hot water tanks. In 1978, EPA extended the asbestos NESHAP to spray-applied to ACM used for "decorative" purposes. In 1990, EPA revised the asbestos NESHAP to prohibit spray-on application of materials containing more than 1% asbestos to buildings, structures, pipes, and conduits unless the material was encapsulated with a bituminous or resinous binder during spraying and the materials were not friable after drying. The revised NESHAP still allowed spray-on application of materials on equipment and machinery that contain more than 1% asbestos where the asbestos fibers in the materials are encapsulated with a bituminous or resinous binder during spraying and the materials. The revised NESHAP allowed the application of friable materials where either no visible emissions are discharged to the outside air from spray-on application or specified methods are used to control emissions containing particulate asbestos material before they escaped or were vented to the outside air.

The asbestos NESHAP EPA applies to renovation or demolition projects ("Facilities") where more certain thresholds of regulated ACM. ("RACM") are "stripped, removed, dislodged, cut, drilled or similarly disturbed"(40 CFR 61.145). The thresholds amounts of RACM are more than 260 linear feet of on piping, 160 square feet of RACM on other building components or at least 35 cubic feet of RACM when the length or area cannot be measured.

The Asbestos NESHAPs applies to a "facility" which is defined as any institutional, commercial, public, industrial or residential structure, installation or building (including condominiums or individual dwelling units operated as a residential cooperative but excluding residential buildings having less than four dwelling units.) An "installation" is defined as any building, structure or group of buildings or structures at a renovation or demolition site that are under the control of the same owner or operator. 40 CFR. 61.141

Residential buildings which have four or fewer dwelling units are exempt from the asbestos NESHAP unless they are part of a larger installation (for example, an army base, company housing, apartment or housing complex, part of a group of houses subject to condemnation for a highway right-of-way, an apartment which is an integral part of a commercial facility, etc.). Mobile structures used for non-residential purposes are subject to NESHAP. While owners and operators share responsibility for proper notification, the condominium or co-op board is responsible as the owner. The board should ensure that they are told when work takes place on individual units, so

that they can comply with notification (and other EPA) requirements, especially if multiple operators are involved. 60 F.R. 38725 (July 28, 1995)

Thus, demolition of a single-family residence or a residential building containing four or fewer dwelling units that has been declared a nuisance or public health hazard by the local government is exempt from the asbestos NESHAP rule. The exemption will apply regardless of whether the demolition is performed by an agent of the owner or the local government. The exemption will also apply even if the municipality could be considered the owner or operator of the structure since the exemption is based on the type of building and the type of renovation or demolition that is being performed.

However, the residential building exemption does not apply when more than one residence on a site is being demolished or renovated by the same owner or operator as part of the same project. Residential structures that are demolished as part of an urban renewal project, a highway construction project or to develop a shopping center or other industrial facility do not fall within the "residential building exemption." 60 F.R at 38726. EPA considers demolitions planned at the same time or as part of the same planning or scheduling period to be part of the same project. An owner or operator of multiple residences at a site cannot avoid the asbestos NESHAP by staggering demolition of the buildings. 60 F.R at 38725 n.1 Mobile homes used as single-family dwellings are not subject to Asbestos NESHAP.

EPA has indicated that a site could include several parcels on a city block as well as contiguous blocks. However, the demolition of two residences separated by several city blocks would not be considered demolition at a single site. In any event, owners who renovate or demolish their houses to construct other houses are not required to comply with the asbestos NESHAP. 60 FR at 38726

The ACM NESHAP does not require removal of ACM in buildings if renovation or demolition activities are not conducted. Indeed, to minimize risk to building occupants, EPA recommended in its publication "Managing Asbestos In-place: A Building Owner's Guide to Operations and Maintenance for Asbestos-Containing Materials" (also known as the "Green Book") that in-place management of ACM is preferred over removal. EPA indicated that a well-managed O& M program will be sufficient to control release of asbestos fibers. However, the Green Book suggested that ACM that in highly accessible may have to undergo some form of abated by encapsulation or removal. Damaged or friable ACM must be abated. (40 CFR 61.145)

Actual proof of emissions or visible asbestos dust are not required but simply non-compliance with the NESHAP workpractices. (U.S. v. Walsh, 783 F.Supp. 546 (W.D. Wash, 1991). Violations of the ACM regulations often result in criminal enforcement (See Schnapf Environmental Report for discussions of recent ACM criminal enforcement actions.

Because owners and operators of buildings as well as their management companies

can be liable for violations caused their asbestos contractors, it is important that building owners thoroughly investigate abatement contractors regulatory history and ownership prior to retaining them and take steps to ensure that asbestos abatement projects are properly performed.

b. OSHA Asbestos Regulations

The federal Occupational Safety and Health Administration (OSHA) also has established regulations governing asbestos exposure in the workplace. Under the OSHA asbestos regulations, thermal insulation, surfacing materials and vinyl floor materials in buildings constructed prior to 1981 will be considered Presumed ACM ("PACM").

In 1995, OSHA has promulgated revised regulations governing asbestos exposure in workplaces. These regulations do not distinguish between friable and non-friable. Instead, the rules establish categories of PACM. Thus, non-friable ACM, such as floor tiles, roofs, and gaskets, probably still will have to be removed using approved abatement procedures.

The OSHA asbestos standards establish permissible asbestos exposure levels for asbestos abatement activity. The asbestos PEL is 0.1-fiber/cubic centimeter of air (f/cc) averaged over an eight hour time-weighted period. 29 CFR. 1926.1001(g) In addition, no employee may be exposed to airborne concentrations of asbestos that exceed 0.1-fiber/cubic centimeter averaged over a 30 minute period (“Excursion Limit”).

When workers are exposed or reasonably expected to be exposed to concentrations of asbestos at or above the PEL, the employer must use engineering controls and institute workpractices to reduce asbestos levels below the PEL. 29 CFR. 1926.1001(g). Where these steps are insufficient to bring asbestos concentrations below the PEL, protective clothing and personal respirators must be issued to employees exposed to the excessive asbestos levels. 29 CFR. 1926.1001(f) A medical surveillance program must be instituted for employees exposed to asbestos levels above the action level for 30 days or more per year. 29 CFR. 1926.1001(1).

OSHA also established workpractices and engineering controls based on four categories of asbestos work. Class I work which involves the removal of thermal system insulation or surfacing ACM has the most stringent requirements with the least stringent being category IV asbestos work for custodial or maintenance work that does not disturb PACM or dust/debris from PACM work. One set of work practices has been established for the construction industry (the “Construction Industry Standard”) (29 CFR 1101) while a separate set of workpractice rules apply for all other industries subject to OSHA regulation (the “General Industry Standard”) (29 CFR 1910.1001). If Class I work (removal of thermal system insulation or surfacing) will be performed, there is a presumption that the PEL will be exceeded. Daily or periodic monitoring maybe required depending on the kind of work. If the

PEL is exceeded, the owner/operator must employ engineering controls and workpractices.

The OSHA regulations require employers and building owners (including lessees and management agency) to notify employees and tenants of the presence, location and quantity of PACM. Newly discovered PACM must be disclosed with 24 hr. Owners and employers also have record keeping requirements.

6. Ozone Depleting Substances- CAA extensively regulates the manufacture, use and importing of chlorofluorocarbons ("CFCs") which are contained in variety of substances including refrigeration and air conditioners, and cleaning solvents. (42 U.S.C. 7671-7671q). CFCs may no longer be manufactured and their use is to be phased-out beginning with the year 2000. These restrictions affect vehicle maintenance and building cooling systems, cold storage warehouses, commercial ice machines, industrial process refrigeration, reciprocating chillers, refrigerated transport, residential dehumidifiers, retail food refrigeration, vending machines and water coolers.

Refrigerant recovery and recycling equipment must be used when servicing units containing CFCs or HCFCs to minimize the possibility of releases of ozone-depleting substances into the atmosphere and companies must use technicians who are certified to use these recovery and recycling equipment. EPA recently fined a number of businesses including a Fortune 500 telecommunications company, for allowing ozone-depleting substances to vent into the atmosphere from leaking equipment. In addition, the EPA continues to bring criminal actions against individuals smuggling CFCs into the country or companies that improperly use banned refrigerants.

EPA does allow the sale of "reclaimed" refrigerants. (40 CFR Part 82) Because of the continuing demand for CFCs and HCFCs, a large market has developed for reclaimed refrigerants. As a result, many corporations who have replaced CFC-dependent equipment have stockpiled CFCs and HCFCs to sell or trade these substances to other companies, facilities, equipment manufacturers and brokers in exchange for cash, emissions allowances, goods or services. However, since EPA has adopted stringent rules for transferring reclaimed CFCs or HCFCs, some companies have run afoul of the EPA rules by selling recycled refrigerants which did not qualify as "reclaimed" refrigerant. Thus, it is important that sellers create supporting documentation to establish that the substances qualify as reclaimed refrigerants. This documentation should include the name and location of he facility where the material was reclaimed, the methodology used to purify the material, the purity level achieved as well as the purity verification test that was used.

7. Mold- The CAA does not regulate emissions of air pollutants within buildings. Nevertheless, the past few years have witnessed a dramatic increase in lawsuits for illnesses caused by exposure to contaminants including toxic molds. Several of the lawsuits have been settled for more than $10 million and have resulted in the shutdown of portable classrooms and school buildings. The presence of harmful molds has also been discovered in individual homes, high-rise apartments and office buildings.

There are more than 100,000 species of mold. Most types of mold are not hazardous to healthy individuals though prolonged or excessive exposure can cause or exacerbate asthma or other allergies. Molds sometimes produce chemicals called mycotoxins that can cause illness in sensitive people. The species of greatest concern is Stachybotrys chartarum or Stachybotrys atra which is commonly called black mold. It can grow on materials with a high cellulose content such as drywall sheetrock, dropped ceiling tiles and wood that become chronically moist or water-damaged.

Moisture problems can be caused by a variety of conditions, including roof and plumbing leaks, condensation, and excess humidity. Some moisture problems are a result of recent building design that make buildings more air tight for increased energy efficiency but does not allow moisture to escape easily. The presence of mold may also indicate serious problems with a building HVAC system. While residential buildings may be prone to mold infestations from poor plumbing, the strong HVAC systems in commercial buildings can spread spores from a relatively small mold infestation throughout a building.

EPA has said that some of the moisture problems are also associated with delayed maintenance or insufficient maintenance budgets. EPA recommends that when mold or moisture conditions are discovered, the building owner or manager should first focus on responding to the problem rather than spending scarce financial resources on analyzing the kind of mold that may be present. EPA recommends that building managers or owners immediately wash mold off hard surfaces with bleach or detergent and dry completely. Absorbent materials such as ceiling tiles & carpet that become moldy should be replaced and the source of the leak fixed.

There are no federal standards for mold though the EPA published a guideline for remediating mold in schools and commercial buildings. New York City has established guidelines for assessing and remediating mold. In addition, a number of states in the south and west are considering enacting mold-related legislation.

Many environmental site assessments now require consultants to report on the presence of asbestos and lead-based paint. When a transaction involves office buildings, hotels, or residential buildings, it is also advisable to investigate for the presence of molds. These organisms usually appear because of excessive moisture in a building.

B. CLEAN WATER ACT (33 U.S.C. 1251 et seq.)("CWA")- The law prohibits the **discharge** of pollutants from a **point source** (i.e., ditches, funnels, pipes, conveyances, waste pile) into **waters** of the United States without a permit. This law also regulates stormwater runoff, oil spills and the filling in of wetlands. While businesses that discharge wastewater to publicly-owned treatment plants (POTWs) are not directly regulated by the CWA, the POTWs are required under the CWA to ensure that industrial users of their systems install pollution control equipment so that their discharges do not interfere with the treatment processes of the POTWs. In addition, permitees are required to monitor their discharges and submit the results of the sampling program to state environmental authorities in monthly discharge reports ("DMRs"). Permitees are strictly liable for violations disclosed in the DMRs. Environmental organizations and citizen groups may use the violations contained in the DMRs to seek penalties or injunctive relief from the permitted. Purchasers who acquire the stock of permitees or who assume the liabilities associated with assets that are being conveyed can be held responsible for violations that occurred prior to the transaction. Purchasers will also assume responsibility for any treatment upgrades.

The only defenses to violations of the CWA are an Act of God (must be beyond contemplation of humans, not just bad storm or extremely cold weather), Act of War, or an Act of third party who is not employee, agent or in contractual relationship of the permittee. (33 U.S.C. 1321(f)).

1. NPDES Permit Program- The federal CWA requires industrial facilities and sewage plants that discharge to surface waters to obtain permits that contain limits on the volume and kinds of pollutants that can be discharged. (42 U.S.C. 1342). The CWA does not generally regulate discharges to groundwater unless the groundwater is hydrologically-connected to surface waters. (Mutual Life ins. V. Mobil, 1998 WL 160820 (W.D.N.Y. 1998). However, some state programs do govern discharges to groundwater. Except as noted below, the discharge must come from a point source.

2. Stormwater Permits- Stormwater runoff from residential, commercial, and industrial areas is responsible for 21% of impaired lakes and 45% of impaired estuaries in the United States. Stormwater can become contaminated from a variety of pollutants including oil and grease, heavy metals, fertilizers/nutrients, pesticides, litter and bacteria. Common sources of pollutants include roads, parking lots, and other paved surfaces where materials have spilled or accumulated, outdoor equipment or material storage areas, construction activities, commercial properties where fertilizers and pesticides are used, and outdoor cleaning and maintenance activities that produce large volumes of wastewater like power washing, sandblasting and vehicle washing.

The CWA contains a permit program for stormwater associated with industrial activity, and construction sites larger than 1 acre. (33 U.S.C. 1342(p)). Owners and operators of facilities subject to storm water permits are generally required to prepare Stormwater Pollution Prevention Plans ("SWPPP") and to select best management practices ("BMPs") for controlling pollutants in stormwater.

The Phase II stormwater regulations will become effective March 2003. This rule will require permits for storm water discharges associated with construction site activities disturbing between one to five acres of land. Construction activity disturbing less than one acre may also require a permit if the activity is part of a larger common plan of development or sale disturbing a total of one acre or greater, or if individually designated for permit coverage by the NPDES permitting authority. NPDES permitting authorities may waive the Phase II construction activity requirements where little or no rainfall is expected during the period of construction or when analysis indicates that controls on construction site discharges are not needed to protect water quality. Waivers are not available for construction activity disturbing five acres or greater which are subject to the Phase I stormwater regulations that were promulgated in November 1990. EPA generally enforces these requirement through construction general permits ("CGP")

According to EPA, common stormwater compliance problems at construction sites include:

- The site does not have a stormwater permit, (SPPP) or implemented best management practices such as erosion control.
- The site has erosion control but no SPPP.
- The site lacks qualified personnel to properly perform and document bi-weekly inspections (monthly in areas receiving less than 20 inches of rainfall annually) and inspections after 0.5" inch or more of rain.
- Common problems with SPPP include not having upland controls, detention ponds for common drainage areas with 10 or more acres. These requirements can be replaced with equivalent or superior controls. The SPPP should indicate the alternative controls.
- While erosion is the primary pollutant of concern at construction sites, the SPPP should also address other common construction site pollutants such as diesel tanks, paints, concrete hardeners, hydraulic oils, etc.
- Construction signs are not posted at the entrance of the site in an area accessible to the public.
- Off-site vehicle tracking is a problem at many sites. Sites should have a stabilized construction entrance or alternative methods of removing mud from vehicles exiting disturbed areas.

EPA has begun to focus on unpermitted discharges of stormwater associated with industrial activities. The EPA has been targeting industrial facilities discharging stormwater without a permit, large construction sites that did not obtain a stormwater permit, and industrial or construction stormwater dischargers that have acquired a permit but are not complying with their permit. EPA has also been using its stormwater permitting authority to halt destruction or degradation of wetlands caused by draining or ditching activities.

3. Wetlands Permits- The CWA prohibits the discharge of dredged or fill materials into "navigable waters" which includes wetlands. (33 U.S.C. 1344). The drainage of wetlands is not expressly regulated by the CWA. To prevent the loss of wetlands from ditching or draining activities, the EPA promulgated the "Tulloch Rule" in 1993 which

stated that the incidental fallback of dredged materials would be considered an addition of a pollutant that would require a wetlands permit. In 1998, the Court of Appeals for the District Court invalidated the Tulloch Rule. EPA and the Corps subsequently issued a revised rule that creates a rebuttable presumption that mechanized land-clearing, ditching, channelization, in-stream mining, or other mechanized excavation activity would result in regulated discharges of dredged material. The agencies stated that they believed these activities typically result in redeposit of dredged material that constitutes the “addition of pollutants” unless specialized techniques and equipment are used to ensure that only incidental fallback will result

Activities that would result in the destruction of wetlands must first obtain a wetlands permit from the Army Corps of Engineers ("Corps") unless the proposed activity is exempt by statute or is covered by "nationwide" permits. (33 U.S.C. 1344(f)(1)). Even if the project is approved by the Corps, EPA retains the authority to veto the project. (33 U.S.C. 1344(c))

a. **What are Wetlands?-** Identified by analyzing three characteristics (soils, hydrology, vegetation). Land that is dry most of the year can be considered wetlands.

b. **Wetlands Permits**- A permit will not be issued if the activity would cause or contribute to a violation, federal, state, water quality standards, toxic effluent standards or statutes protecting marine sanctuaries; the activity will cause or contribute to significant degradation of the nation's waters; and the project fails to minimize the potentially adverse impact.

A permit will also not be issued if there is a practicable alternative to the project site which will have a less adverse act on the aquatic environment. For non-water dependent activities such as shopping malls, there is a rebuttable presumption that a practicable alternative exists. The practicable alternative may include land not presently owned by the applicant. EPA determines the existence of the practicable alternative at the time the land was acquired or activity was proposed and not the time the permit application is filed. (40 CFR 230.10(a)).

c. **Mitigation**- If there is no practicable alternative for the project, the applications will be required to minimize loss of wetlands by providing so-called "mitigation" in which each acre of wetlands lost must be replaced by artificially-created wetlands. EPA prefers that wetland mitigation take place on the site where the wetlands are lost but mitigation may be performed at off-site locations when an off-site location will likely produce a more viable and function wetlands. Indeed, wetlands banks have been created where developers can purchase mitigation credits rather than creating new wetlands.

Another option is for the developer to make payments in-lieu of mitigation. EPA recently issued a guidance document clarifying when developers could use payments in lieu fees. While the guidance document states that mitigation banks are the preferred means of compensation for wetlands losses when on-site

mitigation is not practicable or is less environmentally preferable, the agency said in-lieu fees may be paid when a mitigation bank does not provide "in kind" mitigation or when the only credits available are for preservation, not for restoration, creation, or enhancement. The in-lieu fee may be used for both individual wetlands permits and general or nationwide permits.

An in lieu-fee would not normally satisfy the mitigation banking requirements set forth in the 1995 mitigation bank guidance because the mitigation effort would not be completed in advance of the impacts from the project. Also, there is usually no timetable for the implementation of the mitigation effort.

In-lieu fees may be paid to a so-called in-lieu sponsor who will usually be a natural resource management entity. The in-lieu sponsor will be responsible for implementing and monitoring wetland or aquatic resource development projects, and for insuring that the project has adequate funds. The sponsor will have to enter into an agreement with the Corps prior to accepting in-lieu fees and for providing regular progress reports to the Corps. The funds must be used to replace wetlands functions and values, and not to finance non-mitigation activities such as education. Funds collected should be sufficient to provide at least a one-acre for one-acre replacement though mitigation rations may be increased to compensate for temporary losses in wetlands function and values. Land acquisition and initial biological or physical improvements should be completed by the first growing season following collection of the initial in-lieu funds.

4. Non-Point Sources- The CWA has historically addressed pollution that is discharged from point sources. However, contaminated runoff is coming under increasing scrutiny because of the impact to water quality. Under section 319, EPA provides funding to states to help develop best management practices ("BMPs") for non-point sources. However, the program is significantly under-funded. EPA has estimated that 40,000 plans are required to control non-point source pollution across the country but that only 1,000 have were approved from 1972 to 1998. (33 U.S.C. 1329).

EPA recently revised its Total Maximum Daily Load ("TMDL") regulations that take effect in April 2003. The TMDL regulations require states to establish the maximum pollutant concentrations that surface waters may absorb without impairing water quality. Initially, states were required to develop TMDLs for point sources only. However, new TMDL regulations now apply to certain types of non-point sources that impair water quality.

Under a different rulemaking, EPA also required large new and significantly expanding dischargers obtain and maintain offsets of one and a half to one. The specific requirements for an individual discharger would be dependent upon the type of pollutant for which the water body is impaired and that the discharger is proposing to discharge, the source from which the discharger is proposing to obtain and maintain the offsetting load reductions, and the large new or significantly expanding discharger itself. These offsets would have to be obtained from existing point sources or non-point sources located on the same water body as the new discharger or existing discharger undergoing a significant expansion

It is likely that the new TMDL rules will stimulate the use of effluent trading where facilities with point sources may pay farmers or other sources of non-point source water pollution to adopt BMPs that will reduce the volume of non-point source runoff. The facilities would then receive credit for these reductions and not have to further reduce their discharges from their point source. Limited effluent trading has been adopted in the NYC Watershed where municipal sewer plants can receive credits for phosphorus limitations in exchange for paying BMPs at local farms which reduce phosphorus runoff.

5. Oil Spills- The Oil Pollution Control Act of 1990 expanded the authority of the CWA to address oil spills. The CWA imposes strict and joint liability on owners and operators of vessels or facilities for all removal costs associated with discharges of oil as well as damages to natural resources and economic damages. Spills of petroleum that cause a sheen are required to be reported (33 U.S.C. 1321).

Any facility that stores more than 1320 gallons of oil or oil derivative in aboveground storage tanks must develop SPCC plans and must implement these plans by installing secondary containment, such as concrete structures, around storage tanks and other areas where oil could be spilled. These plans must be certified by a professional engineer and must be reviewed at least once every three years. These facilities must also FRPs which describe how the facility will respond to oil spills. The FRP should identify the response personnel and equipment, flow path of potential spills and vulnerable natural resources, evacuation and notification plans, and response training programs, including drills and exercises.

A copy of the SPCC plan must be maintained at the facility if it is normally attended for at least eight hours per day. Otherwise, it must be kept at the nearest field office. The SPCC plan must be available to the EPA for on-site review and inspection during normal working hours. To ensure that facilities comply with the spill-prevention regulations, EPA periodically conducts on-site facility inspections. EPA also requires owners and operators of facilities that experience two or more oil spills within a 12-month period to submit their SPCC plans and other information to EPA for review. Recent EPA investigations are revealing large scale compliance problems, such as pipeline breaks, leaking tanks, faulty valves, overturned trucks, leaking ships, and illegal dumping.

6. Sewer System Discharges- Many businesses do not discharge wastewater directly into rivers or other water bodies but instead into the local sewer system. Sewer pipes have a tendency to leak so that contaminants discharged into the system can end up seeping into soil and groundwater. Indeed, a 1992 California study found that the primary source of contamination from dry cleaners was discharges of wastewater into leaking sewer lines.

In addition, discharges from commercial or industrial operations often contain toxic substances that may disrupt the treatment process of the sewer plants and also contaminate the sludge generated as a byproduct of the treatment. As a result, while these so-called indirect dischargers may not required to obtain a permit under the CWA, they

may have to obtain permits from the local sewer authority and may have to comply with the industrial pretreatment standards established by EPA.

Under section 307 of the CWA, the local sewer authority is required to develop local pretreatment programs which require indirect dischargers to install pollution control equipment to prevent industrial pollutants from interfering with the treatment process, from passing through the sewer system untreated or that are otherwise incompatible with the sewer plant. In addition, indirect dischargers may not discharge pollutants that create a risk of fire or explosion will cause corrosive structural damage to the sewer system, solid or viscous pollutants in amounts that will obstruct flow into the sewer system or heated pollutants that inhibit biological activity.

When performing due diligence on a business that discharges into the sewer system such as a medical laboratory that develops x-rays, it is advisable to determine if the discharge requires a local permit and meets the local pre-treatment program. It is also important to determine if the business is regularly maintaining the treatment system.

Purchasers of restaurants and commercial businesses that are likely to generate grease and other products that can clog sewer pipes or affect the treatment process of the local sewerage plant should make sure that these issues are addressed during the due diligence period. The local sewer authority should be contacted to determine if the business is required to obtain a permit and if it is in compliance with any discharge permit or authorization. The compliance of the treatment plant should also be checked. If a sewer plant is unable to meet the conditions of its permit, it may impose pretreatment requirements on its commercial customers or impose surcharges based on the volume of wastewater discharged into the system. For large commercial businesses, these surcharges can be significant.

7. Septic Tanks- Septic tanks are designed to discharge water into soil. States generally have standards for construction of septic systems but generally do not require water pollution discharge permits**.** Nevertheless, septic systems that serve commercial operations can be a source of groundwater contamination even if a business does not discharge large quantities of wastewater or use significant volumes of hazardous materials. Over the course of years, groundwater quality can be impacted from workers washing chemicals from their hands or pouring small volumes of chemicals into sinks or drains. Thus, it is advisable to collect samples from a septic leach field during due diligence to determine if the septic system has impacted the groundwater.

8. Coordination with Endangered Species Act- Recently, EPA has been integrating requirements of the CWA with the Endangered Species Act ("ESA"). Under this approach, environmental agencies will not only be required to evaluate the impact of wastewater discharges on water quality but may also have to include additional permit conditions to protect aquatic wildlife and their habitats. For example, when developing pollution loadings for rivers, agencies may not only consider the pollutants normally address by water permits but also other factors such as excessive temperature. Also, CGPs issued in 1998 contained new conditions to ensure that the construction activities

do not adversely effect endangered or threatened species listed under the Endangered Species Act as well as their critical habitats.

C. RESOURCE CONSERVATION AND RECOVERY ACT (42 U.S.C. 6901 et seq.) ("RCRA")- This law establishes standards for the generation, storage, treatment and disposal of Hazardous Wastes under Subtitle "C". (42 U.S.C. 6921-6939b). RCRA also established standards in Subtitle "D" for facilities receiving wastes such as municipal waste that are not regulated as Hazardous Wastes. (42 U.S.C. 6941-6949a)

1. Definition of Hazardous Waste- A substance may either be listed by EPA as a Hazardous Waste or may become regulated as a non-listed Hazardous Waste if it exhibit one of the following Hazardous Waste characteristics: Ignitability, Corrosivity, Reactivity or Toxicity. (40 CFR 261.20). Raw materials are not regulated under RCRA unless they have been discarded or have expired so that they may no longer be used for their intended purpose (e.g. paint). (40 CFR 261.2) If Hazardous Waste is mixed with non-Hazardous Waste, the entire mixture can become a Hazardous Waste. (40 CFR 261.3(a)). Some types of wastes that are recycled or reclaimed may be exempt from RCRA Subtitle C regulation (e.g. used oil see below).

2. Generators- This is a person who produces a hazardous waste or causes a waste to be regulated as a hazardous waste. They can range from large industrial plants to small businesses. Generators must determine if wastes should be classified as Hazardous Wastes. They must also obtain EPA Identification number for each facility, must comply with hazardous wastes storage standards, may not accumulate hazardous wastes for more than 90 days, must conduct employee training, preparing emergency contingency plans and procedures, prepare manifests when shipping waste off-site and make sure that their Hazardous Waste is sent to an approved RCRA facility and have certain record-keeping requirements. Generators who store wastes beyond the mandated period will be regulated as a TSDF. (42 U.S.C. 6922).

a. **Small Quantity Generators ("SQG")-** Generators who produce between 100-1000 kg. of Hazardous Waste may accumulate Hazardous Waste up to 180 days. They are not required to have written emergency response plans or a formal training program though employees must be familiarized with proper handling procedures. (42 U.S.C. 6921(d)

b. Conditionally Exempt Small Quantity Generators ("CESQG")- Generators who produce less than 100 kilograms (220 pounds) of Hazardous Waste or 1 kilogram of acutely Hazardous Waste per month of Hazardous Waste do not have to comply with the full range of RCRA Generator requirements. They do not have to obtain ID. numbers nor satisfy all of the waste management requirements but must still comply with the storage requirements and ensure that wastes are properly disposed and manifested. (40 CFR 262.5(g))

3. **Transporters**- Transporters take wastes from Generator to the ultimate treatment or disposal facility. Transporters must obtain RCRA ID numbers, may not accept hazardous wastes that are not accompanied by a manifest unless the waste is from a SQG and is to be recycled. Transporters may temporarily hold Hazardous Waste at a transfer facility for up to 10 days but the facility will be regulated as a TSDF if the ten-day period is

exceeded. Transporters must also take immediate action if hazardous wastes are spilled during transportation. (40 CFR Part 263)

4. **Treatment, Storage and Disposal Facilities ("TSDF")-** All TSDFs are required to obtain RCRA permits. However, facilities that become subject to RCRA because they begin handling a RCRA-regulated wastes or because an existing waste stream becomes subject to RCRA. These facilities must submit a permit application and while their application is pending, they will be allowed to operate as "interim" facilities. EPA has established operating and design standards (e.g., liners for lagoons, containment for storage tanks, etc.) for permitted and interim TSDFs. The standards are designed to prevent hazardous wastes from leaking into the environment (40 CFR Parts 264, 265). Facilities that recycle certain types of materials such as lead batteries, precious metals and used oil (see below) are exempt from many of the TSDF requirements but still must properly manage the wastes. Facilities that treat, store, dispose or recycle hazardous waste from CESQG or wastes that are exempt from RCRA Subtitle C but must comply with the less stringent Subtitle D requirements.

a. **Design Standards**- RCRA imposes standards for different kinds of hazardous waste management units ("HWMU") such as landfills, impoundments, waste piles, tanks, and land treatment units.

b. **Closure**- Owners and operators of TSDF or HWMU are required to prepare closure plans that describe how a facility will remove wastes or manage wastes left in place so that they do not pose a risk. The owner or operator must notify EPA or the delegated state agency at least 60 days before the owner/operator expects to begin closure of a surface impoundment, waste pile or land treatment unit or 45 days prior to the expected closure date of a storage tank, container or incinerator. The date when an owner "expects to begin closure" is either 30 days after the HWMU receives its last volume of hazardous wastes or if there is a reasonable possibility that the HWMU will receive additional hazardous wastes, no later than one year after the date the HWMU received its most recent volume of waste Closure must begin within 30 days after the TSDF receives its last shipment of waste. If all wastes are to be removed, this is called "clean closure". If wastes are to remain, the owner or operator must take steps to minimize the possibility that hazardous waste constituents will escape into the environment from the HWMU or TSDF such as capping or treating the waste. EPA has established general closure standards for all TSDFs and specific closure requirements for certain kinds of HWMUs.

c. **Post-Closure**- If the TSDF is intended as the final resting place for wastes or not all wastes are to be removed, the owner or operator must prepare a post-closure plan that will provide for groundwater monitoring and maintaining waste containment systems such as covers, caps and liners. The post-closure period begins 60 days after closure is certified as being completed and usually last 30 years.

d. Financial Assurances- Because closure and post-closure takes place after the active life of a TSDF, owners and operators are required to maintain financial assurances sufficient to cover the estimated closure and post-closure costs as well as to compensate third parties for bodily injury and property damage. The financial assurance can be in the

form of a trust fund, surety bond (payment or performance bond), irrevocable standby letter of credit, financial test, corporate guarantee or an insurance policy. When the business or facility has used an insurance policy for the financial assurance, purchasers will review the rating of the insurer. Owners and operators must maintain the following minimum amounts of financial assurance regardless of the number of facilities that they own or operate:

- For sudden accidental occurrences, at least $1 million per occurrence with an annual aggregate of $2 million
- For non-sudden occurrences (e.g., leaks to soil and groundwater), at least $3 million per occurrence with annual aggregate of $6 million

During due diligence, purchasers often assume that the financial assurances established by a business or facility are sufficient to cover the estimated closure or post-closure costs if EPA or a delegated state agency has approved the closure plan or financial assurances. Instead, they usually simply evaluate if the financial assurances remain in full force and effect.

However, closure or post-closure cost estimates may not reflect the actual remediation costs for a facility. For example, a facility is only required to estimate closure costs for RCRA-regulated HWMUs and not solid waste management units ("SWMUs"). During post-closure, though, a facility will usually be required to investigate and remediate SWMUs that have impacted the environment. In addition, the closure estimates for HWMUs such as a landfill are only required to include groundwater monitoring and not groundwater remediation.

Further complicating the situation is that the facility may become subject to a corrective action order (see next section) that may accelerate cleanup costs that a business did not anticipate to spend for another decade or two as well as costs that were not included in the original estimates such as groundwater remediation or cleanup of SWMUs.

In addition, there are different methods that may be used to calculate the amount of closure costs. For example, the owner of a landfill may apply a portion of the tipping fees received towards its closure obligations or may develop closure costs by multiplying the disposal rate by the remaining disposal capacity of the landfill. As a result, it is important for purchasers to review the assumptions and calculations used to develop the closure and post-closure costs.

5. Corrective Action- Generators and TSDF may also be required to take corrective action to remediate soil and groundwater that is contaminated with hazardous wastes and their constituents. Permitted TSDFs will usually have corrective action requirements in their permits. Under RCRA section 3004(u), an owner or operator may be required to remediated current or former HWMUs as well as SWMUs where solid or hazardous wastes may have been managed in the past.(42 U.S.C. 6924(u). Under RCRA section 3004(v), TSDFs may be required to remediate releases that have migrated beyond the facility boundary. (42 U.S.C. 6924(v).

For interim status facilities or generators, EPA may require corrective action by issuing a corrective action order under RCRA section 3008(h). (42 U.S.C. 6938(h)). EPA can also seek a court order to compel a person who has contributed to the present or past handling, storage treatment, transportation or disposal of a solid waste or hazardous waste that is posing an “imminent and substantial endangerment”.

The RCRA corrective action process is similar to the procedures used in the CERCLA program though the cleanup standards can differ. The first phase of corrective action is a RCRA Facility Assessment (“RFA”) which identifies areas that may require further investigation. If releases are identified in the RFA, the next step is performing a RCRA Facility Investigation (“RFI”). If contamination is detected above RCRA action levels, the owner or operator will then be required to perform a Corrective Measures Study (“CMS”) where remedial alternatives are evaluated. The TSDF may also implement interim measures which are short term actions to minimize risks posed by releases while the CMS is being performed. Once the CMS is completed, the agency will select the remedy in a document known as a statement of basis. Once the remedy is selected, the final stage of the RCRA remedial process is the Corrective Measure Implementation ("CMI”). It is important for the purchaser to determine if the seller has agreed to undertake any corrective action since the purchaser will assume responsibility for these future obligations.

The RCRA Corrective Action Management Unit Rule (“CAMU”) established a category of remediation wastes such as contaminated soil generated during corrective action or closure activities that could be managed, consolidated or placed into discrete areas at a RCRA facility known as a CAMU without triggering the RCRA LDRs standards and minimum technical requirements (“MTR”) for land-based units (e.g., landfills, surface impoundments, waste piles). The CAMU rule originally provided that the only wastes that might be placed in CAMUs were those found on or originating from the facility where the cleanup occurred. Hazardous remediation wastes sent to other locations generally were required to be managed in accordance with full RCRA Subtitle C standards for “as-generated" hazardous waste (i.e., hazardous waste derived from on-going industrial processes). Recently, EPA modified the CAMU rule to allow hazardous remediation waste resulting from the treatment of hazardous wastes in CAMUs to be placed in hazardous waste landfills that meet RCRA standards for new landfills and has a RCRA permit. The new landfill standards are more stringent that the minimum CAMU standards which are based on EPA's standards for municipal solid waste landfills. The proposal would not allow CAMU-eligible wastes to be placed in “interim status" hazardous waste landfills

To facilitate the redevelopment of RCRA brownfield sites, EPA has issued a memorandum “Comfort/Status Letters for RCRA Brownfield Sites” authorizing the use of comfort letters for brownfield sites associated with TSDF or generator-only facilities. The guidance document indicated that the letters may be used to facilitate cleanup or reuse of a brownfield site where there is a realistic perception or probability that EPA will initiate a RCRA cleanup and there is no other mechanism to adequately address the party’s concerns. Examples of such letters include a letter indicating that corrective

action is being or has been performed under supervision by a delegated state and that EPA intends to rely on the state to resolve any current or future closure or corrective action. Another type of letter is that corrective action has been performed or is about to be completed at the facility and that EPA does not anticipate further work will be required once the activities have been successfully completed. The last letter suggested by the guidance is that the property has not been identified as being subject to RCRA and therefore EPA does not anticipate initiating any response actions at the site

During the past few years, state environmental agencies have begun issuing no further action ("NFA") letters under their state superfund, voluntary cleanup and UST programs so that property owners can demonstrate that their sites have been adequately remediated. However, there has not been any comparable closure document under the RCRA program. EPA has also issued authorized regional offices and delegated states to issue what amounts to RCRA no further action letters. For facilities with RCRA corrective requirements in their permits, the permitting agency would modify the permit to indicate that the corrective action has been completed. If there are no other conditions in the permit, the expiration date of the permit could be moved up. At non-permitted facilities with facility-wide corrective action, the completion may be acknowledged by terminating the interim status through the administrative procedures for denying permits. However, the regulatory agency may choose to use alternative terminology such as a "no permit necessary determination". Where the corrective action only involves a portion of a facility, a partial completion determination could be issued. For example, a facility that has completed closure at a SWMU but still conducting post-closure care at a HWMU would not have its interim status terminated

6. Land Disposal Restrictions ("LDR")- The RCRA land disposal restrictions ("LDR") requires listed and characteristic hazardous wastes to meet treatment standards for those wastes before they may be disposed in a land disposal unit. The LDR applies to persons who generate, store or dispose certain hazardous waste. The treatment standards may be a designated technology identified as Best Demonstrated Available Technology ("BDAT") or a concentration-based standard expressed as a numeric value. Wastes may not be diluted to achieved the numeric concentration standard.

For characteristic wastes, EPA is not limited to regulating only hazardous constituents which cause a waste to be listed but may also develop treatment standards for additional constituents to protect human health and the environment. As a result, characteristic hazardous wastes must meet the universal treatment standards ("UTS") for all underlying hazardous constituents ("UHCs"), not just those that caused the waste to be considered hazardous. The definition of UHC includes all constituents listed in 40 CFR 268.48 which are reasonably expected to be present at the point of waste generation.

Prior to the LDR Phase IV rule, generators who excavated contaminated soil and sludges and wanted to dispose them on land had to treat the contaminated soil to the same LDR standards that were established for industrial process wastes. This approach discouraged the remediation of soils contaminated with organic wastes because the LDR treatment standard usually required incineration which can be a very expensive and controversial

remedy. As a result, many generators chose to leave contaminated soils in place and place caps on them.

Under the LDR Phase IV Rule, EPA established soil treatment standards based on non-combustion technology to encourage the remediation of soils contaminated with hazardous wastes. For soil that contained a listed hazardous waste or exhibited a toxicity characteristic because of the presence of metals, the rule provided that generators would have to treat UHC to ten times the UTS for that constituent or 90 Percent reduction of the total UHC in the soil, whichever is greater.

After the LDR Phase IV Standards was promulgated, though, EPA issued its PCB Disposal Rule which allowed "bulk PCB remediation wastes" including soils contaminated with more than 50 ppm of PCBs to be disposed without treatment in a TSCA disposal facility or RCRA-approved landfill. The purpose of this rule was to promote remediation of PCB-contaminated soils. However, EPA received information that cleanups of soils which exhibited the toxic characteristic because of metals and had PCBs as a UHC were being seriously delayed or had stopped because of a shortage of facilities that could treat PCBs to the required UHC standard (100 ppm) without using combustion. In addition, many of these are mobile units face permitting delays at non-Superfund sites. EPA hopes that the deferral will expedite the remediation of PCB-contaminated soils.

7. Used Oil- Some states regulate used oil as a Hazardous Waste. EPA will only regulate used oil as Hazardous Waste if it is disposed. EPA presumes used oil will be recycled and will not require persons handling the used oil to comply with the Subtitle C requirements unless the used oil has been mixed with Hazardous Waste and exhibits a Hazardous Waste characteristic or if it is mixed with solvents and exhibits toxicity characteristic. (40 CFR Part 279).

8. Underground Storage Tanks ("USTs")- Subtitle I of RCRA imposes a full range of regulatory requirements on owners and operators of USTs used to store petroleum or hazardous substances. (42 U.S.C. 6991-6991I). These requirements include notification of existing USTs within 30 days of use, design standards for USTs (spill/overfill, release detection, corrosion), release reporting, investigation and corrective action, closure and financial responsibility. (40 CFR Part 280).

a. **Regulated USTs**- USTs storing Hazardous wastes are subject to the RCRA Subtitle "C" program. A key exclusion is USTs storing heating oil for on-site consumptive use and residential or farm USTs less than 1,100 gallons storing motor fuel for non-commercial use. (40 CFR 280.10). However, some states regulate heating oil tanks. NY only exempts heating only USTs with capacities below 1100 gallons.

b. **UST Standards-**USTs that were in use prior to December 22, 1988 were required to be upgraded to meet the UST design standards for new tanks or be taken out of service by December 22, 1998. (40 CFR 280.21).

c. **Release Reporting**- Owners or operators must report spills or overflow of 25 or more gallons of petroleum or releases of hazardous substances that exceed the reportable quantity for the particular hazardous substances. They are also required to report suspected releases which can include the discovery of leak or vapors in soil, sewers, etc. Unusual operating conditions (sudden loss of product, water in tank, erratic behavior) can also constitute a suspected release. The federal UST program requires that suspected release be investigated and results reported within seven days. (40 CFR 280.50-.53). Some states only require release reporting when a release is confirmed.

d. Corrective Action- Confirmed releases must be remediated. Immediate action must be take to abate or mitigate further danger (empty tank, remove free product, etc.). Then an investigation and remediation of soil and groundwater contamination must be performed. (40 CFR 280.60)

d. **UST Closure-**When an owner or operator of a UST takes the tank permanently out of service, it must notify EPA within 30 days and comply with the UST Closure requirements. If the owner/operator plans to bring the USTs back into service, the USTs may temporarily be closed for up to 12 months. During temporary closure, the USTs must be emptied, vent lines must be left open, the other lines piping must be plugged, and leak detection/anti-corrosion protection and release reporting/corrective action requirements must be satisfied. (40 CFR 280.70-.71).

In transactions, prospective purchasers should be concerned about old, unregistered USTs which can be buried under a parking lot. They should look for old fill or vent pipes. Also, carefully examine how closed tanks were closed. Prior to the mid-1980s, the USTs were usually filled with sand and left in place so residual contamination may still exist. Although residential heating tanks are exempt from regulation, homeowners are still responsible for cleaning up leaks so heating oil USTs should be tested prior to the closing.

9. ASTS- Owners and operators of ASTs may be required to prepare a SPCC Plan and install secondary containment around the AST. New SPCC regulations issued July 2002 apply to owners or operators of non-transportation facilities that store or use oil such as electrical substations, facilities containing transformers and certain hydraulic or manufacturing facilities. These non-storage systems do not necessarily have to be equipped with secondary containment so long as they have diversionary structures to prevent discharges of oil from reaching navigable waters. The geographic scope of the rule was extended from facilities that could discharge oil to navigable waters to facilities that could have oil discharges to shorelines and offshore waters.

In addition, the regulatory threshold for the SPCC rule was raised to facilities that have 1,320 gallons of aboveground storage capacity. The old rule also applied to facilities that had individual containers with capacities of at least 660 gallons. The revised rule contains

a de minimis exemption so that only containers with a capacity at least 55 gallons or more are counted when calculating the aboveground storage capacity.

Facilities with underground storage of at least 42,000 gallons are also subject to the SPCC rules. However, USTs regulated under a state or federal UST program or that have been permanently closed in accordance with the UST regulations will not be counted when calculating the underground storage capacity of the facility for SPCC regulatory threshold purposes.

The definition of oil under the revised rule is not limited to petroleum products. Facilities that store mineral oil, vegetable oil, synthetic oil, animal fats or grease, seed oil may be subject to the SPCC rules if they meet the regulatory thresholds issued by EPA

Some states require secondary containment for small ASTs. During due diligence, it is advisable to determine if ASTs must be equipped with secondary containment. Even where not required, secondary containment may be a best management practice for ASTs because of their location such as near floor drains to minimize the possibility that oil could be discharged into the environment.

10. Section 7002 Citizen Suits- Section 7002 of RCRA has been used by current property owners to try to recover cleanup costs or to force prior owners or operators of a site to cleanup petroleum contamination. (42 U.S.C. 6972). This section has been relied on because CERCLA does not cover petroleum contamination. Plaintiffs may commence action against anyone who has "c**ontributing to** present or past handling.... disposal of **solid or hazardous wastes** presenting **imminent and substantial endangerment".**

> **a**. **Contributing to**- Plaintiff must show that the defendant somehow caused or contributed to the contamination. Mere status as landowner is not enough. Past owners may not be liable if they can they did not use the tanks or had reason to know of leak.
>
> **b**. **Imminent and Substantial Endangerment**- This element does not require actual harm, just threatened risk. Thus, leaking UST or elevated levels may be enough. Nature of contaminants and how they disperse may be key. Use of word "may" means that the plaintiff does not have to prove present emergency. Unclear if an action can be brought when there was danger in the past but it was remediated and no longer exists.
>
> **c**. **Defenses**- There are no enumerated statutory defenses so common law defenses are presumably available. Thus, parties who may not otherwise qualify for the CERCLA Innocent landowner's defense or third party defense (see below) might be able to assert defenses for section 7002 actions.

11. EPA Injunctive Relief Authority- RCRA section 7003 authorizes EPA to take a broad range of action when it has evidence that the past or present handling, storage, treatment, transportation or disposal of any solid or hazardous waste poses an imminent and substantial endangerment to health or the environment. (42 U.S.C. 6973). Congress

intended section 7003 to codify and expand the common law of nuisance. Thus, courts have held that liability under this section is joint and several where the harm is indivisible. This section also been interpreted to impose strict liability. (US v. Valentine, 856 F.Supp. 627 (D.Wyo. 1994)).

12. Criminal Enforcement- Criminal liability may attach for improper disposal of Hazardous Waste even if a defendant did not know the waste was hazardous. (*US v. Kelley Technical Coatings, 157 F.3d 432 (6th Cir. 1998))*. Common violations that have led to enforcement actions include: Failure to comply with storage, labeling and record keeping requirements; disposing of Hazardous Wastes with trash (e.g., solvent-soaked rags), improper handling of used oil and improper closing of underground storage tanks. Criminal liability has been imposed on auto repairers for illegal transportation, storage or disposal of Hazardous Wastes and dumping of radiator fluids and lead-containing wastes in soil and trash bin with no labeling nor training of employees.

13. NY Bulk Petroleum Storage Act

In 1983, the State Legislature enacted Article 17, Title 10 of the Environmental Conservation Law, entitled "Control of the Bulk Storage of Petroleum." The Law applies both to Underground Storage Tanks (USTs) and Aboveground Storage Tanks (ASTs), or groupings of such tanks with a combined storage capacity of more than 1,100 gallons. Exempted from this law because they are regulated under other programs are: oil production facilities; facilities licensed under the Navigation Law; and, facilities regulated under the Natural Gas Act.

Under the regulations (6NYCRR 612-614) promulgated in 1985, owners are required to register storage facilities with DEC by December 27, 1986. Facilities must be re-registered every five years. Registration fees vary from $100 to $500 per facility, depending on capacity.

Some 100,000 tanks, holding a total of nearly 3.5 billion gallons, are registered in New York. New facilities must be registered before being placed into service. DEC must be notified within 30 days prior to substantial modifications.

Nassau, Suffolk, Rockland, Westchester and Cortland Counties administer the program in these localities, pursuant to delegation from DEC. Because these counties may have more stringent requirements than the State, owners and operators should contact the county to learn of specific local requirements.

All facilities regulated under Article 17, Title 10 must meet certain handling and storage requirements established by DEC. Existing USTs and ASTs must observe rules for color coding of fill ports, shutoff valves, gauges and check valves. Aboveground tanks must be provided with secondary containment (i.e., berms or other devices to contain spills).

Operators of USTs must keep daily inventory records, reconcile them on a 10 day basis (and maintain them for five years) and notify DEC and the tank owner within 48 hours of unexplained inventory losses. They must also test tanks and pipes every five years or monitor the interstitial space of double-walled equipment.

Operators of ASTs must conduct monthly visual inspections. Every 10 years they must clean out the tanks that are resting on grade, remove the sludge from the bottom, inspect for structural integrity and test for tightness.

Tanks that are temporarily out of service (30 days or more) must be drained of product to the lowest draw off point. Fill lines and gauge openings must be capped or plugged. Inspection and registration must continue. Those tanks that are permanently out of service must be emptied of liquid, sludge and vapors. The tanks that are permanently out of service must then either be removed or if left in place USTs must be filled with solid inert material such as sand or concrete slurry. DEC must be notified 30 days prior to filling or removal.

Part 614 applies to all new and modified facilities. New USTs must either be made of fiberglass reinforced plastic; cathodically protected steel (to protect against the corrosion caused by contact between steel and soil); or steel clad with fiberglass reinforced plastic. Secondary containment such as a double-walled tank,or a vault, must be provided. If tank is double walled, monitoring of the interstitial space is required, otherwise use of an in-tank monitoring system or one or more observation wells is required.

New ASTs must be constructed of steel. If their bottom rests on the ground, the tank must have cathodic protection. An impermeable barrier must be installed under the tank bottom, with monitoring between the barrier and the bottom.

New underground piping systems must be designed with a 30-year life expectancy. If made of steel, they must be cathodically protected. Pipes may be constructed of fiberglass-reinforced plastic or other equivalent non-corrodible materials.

14. Chemical Bulk Storage

Article 40, Hazardous Substances Bulk Storage Act, regulates the sale, storage and handling of hazardous substances. These State laws were among the first of their kind in the Nation designed to prevent chemical spills and leaks.

The Department has enacted Chemical Bulk Storage Regulations (6NYCRR Parts 595-599) which set forth rules as follows:

Over 1,000 substances are listed;
Requirements for release reporting, response and corrective action are outlined;
Chemical manufacturers/distributors must supply their buyers with guidance on proper storage and handling of chemicals and to file the guidance with DEC;
New storage equipment (tanks, pipes, transfer stations and associated equipment) must meet State standards;
Tanks and pipes must be tested and inspected for soundness;
Important past due deadlines are:

By August 11, 1996, owners were required to develop and keep up-to-date a plan for spill prevention. This is called a spill prevention report or "SPR."
By December 22, 1998 underground tanks and piping systems were required to be replaced with double-walled walled systems.
By December 22, 1999 aboveground tanks and transfer stations were required to have secondary containment and be upgraded to meet State standards.
By December 22, 1999 non-stationary tanks were required to be stored in dedicated areas with spill containment.
The transfer of hazardous substances is prohibited if the facility is unregistered or where the manufacturer/distributor fails to provide buyers with recommended practices and guidance on proper methods for storage and handling of such substances.

To date, nearly 1,600 facilities are registered and nearly 100 manufacturers/distributors have submitted the technical guidance to DEC.

|D. COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, and LIABILITY Act (42 U.S.C. 9601 et seq.) ("CERCLA")- Under CERCLA, environmental authorities can undertake a cleanup of contaminated sites and seek reimbursement from potentially responsible parties ("PRPs) or order PRPs to cleanup sites. In addition, private persons and PRPs who incur cleanup costs can seek reimbursement from other PRPs.

1. Reporting Obligation- Section 103 (42 U.S.C. 9603) requires anyone who is in charge of a facility or vessel to immediately report releases of hazardous substances that they become aware of which exceed the reportable quantity threshold established by EPA. It is unclear to what extent historical contamination that is newly discovered must be reported since it is difficult to determine the quantity that was released.

2. EPA Information Gathering Authority- Under section 104 (42 U.S.C. 9604), EPA has broad investigatory powers to inspect sites where there may be releases or threatened release, to obtain information about the materials at the site, to determine the nature of the release, to evaluate the ability of the facility's owner to pay for a cleanup, and to copy records or documents. As part of this process, EPA typically requires PRPs to complete detailed and lengthy questionnaires about the generation and disposal of hazardous substances. The information obtained is generally available to the public unless the PRP demonstrates that disclosure would divulge information protected as a trade secret under 18 U.S.C. § 1905 and also meets certain requirements, such as confirming that steps have been taken to protect the confidentiality of such information.

3. EPA Injunctive Authority- Under section 106 (42 U.S.C. 9606), EPA and certain other federal agencies may issue an administrative order or seek injunctive relief directing PRPs to abate releases or threatened releases of hazardous substances that "may be an imminent and substantial endangerment to the public health or welfare or the environment. The "imminent" requirement of section 106 has been held not to mandate the existence of immediate harm but simply that conditions exist that may lead to harm in the future. Likewise, "substantial" does not require precise proof of harm but only that there is reasonable cause for concern that someone or something may be exposed to a risk of harm if remedial action is not taken. The United States Court of Appeals for the Ninth Circuit recently held that the word "substantial" implies that the release must present more than a "minimal threat" to human health, welfare or the environment. The term "endangerment" does not require an emergency or actual harm but only that there is a probability of potential harm.

4. Recovery of Costs by EPA or Private Parties- Section 107 (42 U.S.C. 9607) authorizes the government and private parties to recover their costs to investigate or clean up a site where there has been a release or threatened release of hazardous substances ("response costs"). The government is entitled to recover all of its costs that are "not inconsistent" with the NCP. Courts have generally held that the word "not" means that the government's costs are presumed to be consistent with the NCP unless the defendants can introduce evidence rebutting this presumption. State agencies also enjoy the

presumption of consistency but municipalities and private parties are not entitled to the presumption of consistency.

Some courts allow parties who have incurred cleanup costs to bring cost recovery actions where the plaintiff can seek reimbursement of all of its costs. However, the majority rule is that only parties who are not PRPs or who could assert a defense to liability may file a cost recovery action. However, section 113 (42 U.S.C. 9613) allows PRPs to bring contribution actions when they have incurred more than their fair share of the costs of a cleanup at a site. (see below)

5. Elements of CERCLA Liability- To establish liability under CERCLA, a plaintiff must establish that there was a release or threatened release of a hazardous substance from a facility which causes the incurrence of response costs.

a. Release or Threatened Release – CERCLA broadly defines a release so that it includes any conceivable contact of a hazardous substance with the environment. There is no minimum amount to qualify for a release. A “threatened release" is even more broadly defined and include abandonment of drums, improper storage of materials, lack of experience of a facility owner in handling hazardous substances, the mere presence of contaminated dust on the floor of a warehouse that could be carried outside on the clothes or shoes of workers, and the absorption of hazardous substances into a concrete floor. However, the reporting obligations for disclosing "releases" to Government authorities are not triggered until certain minimal amounts known as "reportable quantities" are released. (42 U.S.C. 9601(22))

Certain types of releases are exempt from CERCLA. Those most notable for transactions include releases from products that are part of the structure of a residential or commercial building (e.g., asbestos), Releases of naturally occurring substances in their unaltered form (radon gas) and releases which result in exposure to persons solely within a workplace. (42 U.S.C. 9604(a)(3))

b. Hazardous Substance - Includes those substances which the EPA has specifically designated as a CERCLA hazardous substance, hazardous substances designated under § 311 of the Clean Water Act, a toxic pollutant under § 307(a) of the Clean Water Act, any RCRA Hazardous Waste, hazardous air pollutants under § 112 of the Clean Air Act and any imminently hazardous chemical which the EPA has taken action under § 7 of the Toxic Substances Control Act (TSCA). Hazardous substances do not include petroleum or any fractions (e.g. gasoline) Thus, property owners may not use CERCLA to recover the cleanup costs associated petroleum contamination. However, if the petroleum has been contaminated with hazardous substances that are not normally added during the refining process such as used oil that is mixed with solvents or PCBs, the petroleum exclusion no longer applies. (42 U.S.C. 9601(14))

c. Facility - Includes any building, structure site, land area, pipe, equipment, pit, lagoon, storage container, motor vehicle, railcar or aircraft where hazardous substances have been "deposited, stored, disposed of, or placed or otherwise have

come to be located." (42 U.S.C. 9601(9))

d. Caused the incurrence of response costs - The plaintiff must show that the release caused the incurrence of response costs. Plaintiffs are not required to "fingerprint" hazardous substances to a particular defendant. It is generally sufficient for a plaintiff to show that a defendant sent wastes which are similar to those that are found at the site. *(U.S. v. Wade, 577 F.Supp. 1326 (E.D. Pa. 1983))*. When the government seeks recovery of costs, it must demonstrate that its costs were not inconsistent with the National Contingency Plan (NCP) while private parties seeking recovery must demonstrate that these costs were necessary and consistent. (42 U.S.C. 9607(a)(4)(A))

6. Liable Parties-CERCLA imposes liability on four classes of potentially responsible parties ("PRPs") for the cleanup of releases or threatened releases of hazardous substances. PRPs are strictly and retroactively liable for the cleanup costs at a site. When the government brings an action to recover cleanup costs, liability is also joint which means that one PRP could be liable for the entire costs of cleaning up a site. This, if a company qualifies as a generator because it sent hazardous substances to a site which subsequently were released into the environment, the generator may be liable to the government for all of the cleanup costs associated with that site even though there may be other PRPs for that site. If the government decides to proceed only against that one generator, the defendant could have to file its own action for contribution against the other PRPs at the site. However, in a contribution action between PRPs, liability is not joint but proportional based on equitable factors.

a. Current and Past Owners - Any person having legal or equitable title to a vessel or facility that is contaminated with hazardous substances may be liable for the cleanup of releases of hazardous substances. The following types of entities have been found liable as owners: bankruptcy estates, trustees, passive landlords, developers, lenders, individual shareholders, corporate officers, successor corporations, parent corporations, municipalities, easement holders and franchisees. (42 U.S.C. 9607(a)(1) and (a)(2)

1.) State or local governments who acquire title to a contaminated facility involuntarily through bankruptcy, tax delinquency, eminent domain, etc. are exempt from definition of owner/property unless they contributed to the release. (42 U.S.C. 9601(35)(A)(ii)).

2.) Lenders who without participating in the management of a facility hold indicia of ownership to protect a security interest in the facility are also exempt from liability. 42 U.S.C. 9601(20)(A). However, banks who have foreclosed on property or have been overly involved in the management of a borrower's operation have been held liable as owners or operators of the property. *U.S. v. Fleet Factors, 901 F.2d 1550 (11th Cir. 1990); U.S. v. Maryland Bank & Trust, 632 F.Supp. 573 (D. Md. 1986)*

Some courts have adopted the position that a person who formerly owned or operated a facility at the time hazardous substances were simply leaking or migrating ("passive migration") will be liable as a past owner or operator even if the hazardous substances were deposited before that person's ownership of the facility. *Briggs & Stratton Corp. v. Concrete Sales & Services, Inc., 20 F.Supp. 2d 1356 (M.D. 1998)*. However, some courts (including the Second Circuit) require that the past owner actively disposed of the hazardous substances. *ABB Industrial Systems Inc. v. Prime Tech Inc., 120 F.2d 1351 (2nd Cir. 1997)*. Thus, in those jurisdictions which require active disposal, there can be a slight difference in the scope of liability for current and past owners since current owners are strictly liable for whatever contamination is at the property unless of course they qualify for an innocent purchaser's defense (see below).

b. Current and Past Operators - This class of PRPs includes persons who currently operate a facility or vessel or who operated it at the time of disposal of the hazardous substances. 42 U.S.C. 9607(a)(1) and (2). The key to operator liability is whether the person had "control" over the facility or vessel. Some courts require actual control. (*Lansford-Coaldale Joint Water Authority v. Tonnolli Corp., 4 F.3d 1209 (3rd Cir. 1993))* while others simply require the ability to control the site. *(U.S. v. High Point Chemical Corp., 7 F.Supp. 2d 770 (W.D. Va. 1998))*. This issue can arise with tenants where there may be an issue as to whether they had the right to use a UST that leaked hazardous substances into the environment. *(Nurad, Inc. v. William E. Hooper & Sons Co., 966 F.2d 837 (4th Cir. 1992))*, shareholders of a corporation or limited partners to a partnership that exercised control over a site *(Redwing Carriers, Inc. v. Saraland Apartments, 94 F.3d 1489 (11th Cir. 1996))* and whether a parent corporation exercised sufficient control over a subsidiary facility to be deemed an operator *(Schiavone v. Pearce, 79 F.3d 248 (2nd Cir. 1996))*.

c. Generators- This category of PRP includes any person who arranges for the treatment or disposal of hazardous substances to a facility from which there is release or threatened release of hazardous substances. 42 U.S.C. 9607(a)(3). Generators will be liable even if a transporter takes waste to a site not previously approved by the generator. Hazardous substances sold as raw materials or finished products generally will not render a person liable as a generator since they did not arrange for "disposal" of a material *(U.S. v. Vertac Chemical, 966 F.Supp. 1491 (E.D. Ark. 1997))*. However, courts will look closely at these arrangements. For example, sales of spent batteries *(Gould, Inc. v. A & M Battery & Tire Service, 933 F.Supp. 431 (M.D. Pa. 1996))* and worn bearings *(Pneumo Abex Corp. v. Bessemer & Lake Erie Railroad, 921 F.Supp. 336 (E.D.Va. 1996))* have been ruled not to be the sale of useful products.

The Small Business Liability Relief and Brownfields Revitalization Act (the "2002 CERCLA Amendments"), Pub. L. No. 107-118, 115 Stat. 2356, created two exemptions from generator liability:

- **De Micromis Exemption**- The SBLPA adds a new de micromis PRP exemption

that essentially codifies EPA's settlement policy for de micromis PRPs (42 U.S.C. 9607(o). The new exemption apples to generators or transporters who arranged for the disposal or transport very small quantities of waste or low toxicity wastes. To be eligible for the exemption, a PRP must have generated or transported less than 110 gallons of liquid waste or 200 pounds of solid waste before April 1, 2001. These amounts are the same absolute volumetric cutoffs that were contained in EPA's de micromis policy though the policy also allowed for a volumetric percentage cutoff of 0.001% of the total hazardous substances at a site.

However, the exemption will not apply if EPA determines that the hazardous substances generated or transported by the de micromis PRP contributed significantly or could contribute significantly to the cost of the response action or natural resource damages, if the person has failed to respond to an information request or otherwise is impeding a response action, or the person has been convicted of a criminal violation for the conduct to which the exemption would apply. EPA's decision to withdraw the de micromis exemption will not be subject to judicial review. Plaintiffs seeking contribution will have the burden of establishing that these conditions do not apply.

- **Municipal Solid Waste Exemption**-The 2002 CERCLA Amendments also add a new exemption for certain generators of municipal solid waste ("MSW") that generated the MSW prior to April 1, 2001 (42 U.S.C. 9607(p)). The MSW exemption applies to an owner, operator, or lessee of residential property that generated municipal solid waste. Also exempt are businesses generating MSW that employed 100 or fewer workers during the three taxable years preceding receipt of a PRP notice and qualify as a small business concern under the Small Business Act. Finally, the MSW exemption also applies to 501(c)(3) non-profit organizations that employed fewer than 100 paid individuals during the taxable year preceding the PRP notice at the location that generated all of the MSW attributable to the organization. The exemption does not apply to transporters or municipalities that own or operate a MSW landfill.

  The exemption defines MSW as waste material generated by a household (including a single or multifamily residence) and commercial, industrial, or institutional entity that is essentially the same as waste normally generated by a household. The waste must be collected and disposed with other MSW as part of normal MSW collection service and contain a relative quantity of hazardous substances similar to that contained in waste generated by a typical single-family household. Waste materials that are not eligible for the MSW exemption include combustion ash generated by resource recovery facilities or municipal incinerators, or waste material from manufacturing or processing operations (including pollution control operations) that is not essentially the same as waste normally generated by households.

  The MSW exemption will not apply if EPA determines that the hazardous substances generated or transported by the PRP contributed significantly or could

contribute significantly to the cost of the response action or natural resource damages, if the person has failed to respond to an information request or otherwise is impeding a response action, or the person has been convicted of a criminal violation for the conduct to which the exemption would apply. EPA's decision to withdraw the municipal solid waste exemption will not be subject to judicial review.

Plaintiffs in a contribution action will have the burden of establishing that these conditions do not apply. Plaintiffs who are unable to establish that the exemption does not apply will be liable to the defendant for all reasonable costs of defending the action, including all reasonable attorney's fees and expert witness fees.

d. Transporters- The final category of PRPs are persons who transport hazardous substances to a treatment or disposal facility may be liable. 42 U.S.C. 9607(a)(4). However, transporters must select a site to be liable. *(B.F. Goodrich v. Betkoski, 99 F.3d 505 (2nd Cir. 1996))*.

7. Statutory Defenses to Liability - CERCLA contains three affirmative statutory defenses to liability: (i) act of God; (ii) act of war; and (iii) acts of a third party. (42 U.S.C. 9607(b)). The most common defense that may be raised by a CERCLA defendant is the third-party defense.42 U.S.C. 9607(b)(3)). To prevail under this defense, a defendant must establish by a preponderance of the evidence that the release or threatened release of the hazardous substance and the resulting damage was:

- SOLELY to the acts or omissions of a third party who was not an agent or employee of the defendant
- The defendant did not have a direct or indirect contractual relationship with the third party.
- Exercised Due Care- The defendant exercised due care in dealing with the hazardous substances and
- Precautions- The defendant took precautions against foreseeable acts or omissions of any third party and the foreseeable consequences of those acts or omissions.

a. The third-party defense has generally been unavailable to purchasers or occupiers of property or anyone in the chain of title because of the requirement that the person asserting the defense cannot be in contractual relationship with the third party (usually a prior landowner or tenant) who caused the release. CERCLA defines a "contractual relationship" to include "land contracts, deeds or other instruments transferring title or possession." The majority of courts have broadly construed the meaning of this term so that it encompasses nearly every contractual arrangement between potential defendants. Under this interpretation, a landowner could only invoke the defense if the release was a result of acts of trespassers, or adjacent landowners, and then only if the landowner exercised due care. Thus, very few landowner defendants have been able to assert the defense. For example, in *U.S. v. A & N Cleaners and Launderers, Inc.*, 842

F. Supp. 1543 (S.D.N.Y. 1994), the current owners did not had contractual relationship with subtenant dry cleaner during the time disposal took place but could not assert defense because the request by village authorities should have caused the owner to inquire. The owner's failure to inquire was lack of due care.

b. One exception to this trend was *New York V. Lashins Arcade, 91 F.3d 353 (2d Cir. 1996)* *where* the Second Court allowed the current owner/purchaser of a shopping center to invoke the third-party defense even though knew of contamination because current owner had no contractual relationship with former the dry cleaner tenant who had discharged hazardous substances into the ground 15 years prior to the current owner's acquisition. (Compare Lashins conduct to the purchaser/owner in *Idylwoods Associates v. Mader Capital Inc., 956 F.Supp. 410 (W.D.N.Y. 1997)).*

c. Assuming that a prospective purchaser or tenant could overcome the "contractual relationship" hurdle, it would still have to establish that it satisfied the third prong of the test to exercise due care in dealing with the hazardous substances and the fourth prong which requires taking precautions against the foreseeable actions of omissions of third parties. For example, one reason the defendant in the *Lashins* case was able to assert the defense was because it took steps such as maintaining water filter, sampling drinking water, instructed tenants to avoid discharging into septic, inserted use restrictions into lease and did periodic inspections.

d. These two last requirements can be problematic for properties where institutional controls have been implemented. If an institutional control such as an impervious cap is constructed on a property to prevent exposure to contaminated soils, a subsequent purchaser or lessor will probably be required to ensure that the institutional controls are properly maintained to be able to assert the third party defense even where the seller or lessor contractually agrees to maintain the institutional controls. This is because the failure of a seller or lessor to properly maintain the institutional controls could probably be construed as a foreseeable omission. Moreover, if the subsequent property owner or lessee fails to monitor the condition of the controls or fails to maintain the controls in the event the seller or lessor fails to do so, this omission could constitute failing to exercise due care regarding the contaminants at the site.

8. Innocent Purchaser's Defense- When a predecessor or tenant has caused the contamination, the third party defense as generally not been available to purchasers or landlords because a purchase agreement or lease would constitute a "contractual relationship" Likewise, a deed can serve as an indirect contractual relationship that can prevent a property owner from asserting the third party defense. (*US v. Occidental Chemical Corp., 965 F.Supp. 408 (W.D.N.Y. 1997)*). Because of this harsh impact on owners who did not cause the contamination, Congress enacted the "innocent purchaser's defense" in 1986. (42 U.S.C. 9601(35).

Prior to the 2002 CERCLA Amendments, an owner qualifying as an innocent purchaser had to comply with the due care and precautionary requirements of the third party defense. The 2002 CERCLA Amendments add the following new obligations that a

purchaser must comply with *after acquiring the property* to preserve its status as an innocent purchaser.

- Cooperate, assist, and provide access to persons that are authorized to conduct response actions or natural resource restoration at the property.
- Comply with any land use restrictions established or relied on in connection with the response action at a vessel or facility and must not impede the effectiveness or integrity of any institutional control employed at the vessel or facility in connection with a response action, and.
- Provide access to persons authorized to conduct response actions at the facility to operate, maintain or otherwise ensure the integrity of land use controls that may be a part of a response action.

c. Bona Fide Prospective Purchaser Defense- The 2002 CERCLA Amendments added the Bona Fide Prospective Purchaser defense ("BFP").42 U.S.C. 9607(r) for property acquired or leased after January 11, 2002. Landowners or tenants who qualify as a BFP may knowingly acquire or lease contaminated property without incurring liability as a CERCLA owner or operator if they establish the following conditions by a preponderance of the evidence that:

- All disposal of hazardous substances occurred before the purchaser acquired the facility.
- The purchaser conducted an "appropriate inquiry" (see above)
- The purchaser complied with all release reporting requirements.
- The purchaser took "*appropriate care*" by taking 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.
- The purchaser cooperates, assists, and provides access to persons that are authorized to conduct response actions or natural resource restoration at the property.
- The purchaser complies with any land use restrictions established as part of response action and does not impede the effectiveness or integrity of any institutional control used at the site.
- The purchaser must also provide access to persons authorized to conduct response actions to operate, maintain or otherwise ensure the integrity of land use controls at the site.
- The purchaser complies with any EPA request for information or administrative subpoena issued under CERCLA.
- The purchaser must establish that it is not a PRP or affiliated with any other PRP for the property through any direct or indirect familial relationship, any contractual or corporate relationship, or as a result of a reorganization of a business entity that was a PRP.

The BFP defense does not apply to EPA actions brought under RCRA 7003, citizen suits brought under RCRA 7002, RCRA corrective action orders and state

enforcement actions. Owners and occupants will need to have thorough Phase I ESAs so that they will be in a position to exercise their post-closing or occupancy "appropriate care" requirements.

d. Contiguous Property Owner Defense- The 2002 CERCLA

Amendments add a Contiguous Property Owner defense. 42 U.S.C. 9607(q). This defense provides that a person owning property that is contiguous to or otherwise similarly situated to a contaminated site and that is or may be contaminated by a release or threatened release of a hazardous substance from that contaminated site shall not be considered to be a CERCLA owner or operator solely by reason of the contamination if it can satisfy the following conditions by a preponderance of the evidence:

- The owner has not caused, contributed, or consented to the release or threatened release;
- The owner it is not a PRP or affiliated with any other PRP for the property through any direct or indirect familial relationship, a contractual or corporate relationship, or the result of a reorganization of a business entity that was a PRP.
- The owner takes reasonable steps to stop any continuing release, prevent any threatened future release, and prevent or limit human, environmental, or natural resource exposure to any hazardous substance released on or from property owned by that person;
- The owner cooperates, assists, and provides access to persons that are authorized to conduct response actions or natural resource restoration at the property;
- The owner complies with any land use restrictions established as part of response action at the site and does not impede the effectiveness or integrity of any such institutional control. In addition, the owner must provides access that is necessary to allow persons authorized to conduct response actions to operate, maintain or otherwise ensure the integrity of land use controls.
- The owner must comply with all release reporting requirements and other required notices regarding the discovery or release of any hazardous substances at the facility;
- The owner has complied with any EPA request for information or administrative subpoena issued under CERCLA; and
- The owner conducted an "appropriate inquiry" at the time the person acquired title to the property and did not know or have no reason to know that the property was or could be contaminated by a release or threatened release of 1 or more hazardous substances from other real property not owned or operated by the person.

A person qualifying as a contiguous property owner shall not be required to conduct ground water investigations or to install ground water remediation systems unless it would otherwise be required to conduct such activity under the EPA 1995 policy Final Policy Toward Owners of Property With Contaminated Aquifers. 60 FR 34790

(July 3, 1995). It is possible that a contiguous owner will now have to allow access to PRPs to conduct response actions in order to be deemed to have exercised "appropriate care" and no longer be able to demand compensation as a condition for access to the property.

EPA is also authorized to issue assurance to a contiguous property owner that no enforcement action will be initiated under CERCLA and to provide protection against claims for contribution or cost recovery. The defense does will not protect a Contiguous Property Owner from EPA actions brought under RCRA 7003, citizen suits brought under RCRA 7002, RCRA corrective action orders and state enforcement actions. If an owner cannot qualify for the contiguous property owner defense because for example it did not conduct an appropriate inquiry, it may still be able to qualify for the BFP defense. The contiguous property owner may also assert any other defense to liability that may be available under any other law.

Many owners and occupants do not focus on environmental conditions at nearby properties during due diligence. They will now need to have to perform thorough Phase I ESAs so that they will be in a position to exercise their post-closing or occupancy "appropriate care" requirements.

9. Innocent Seller's Defense- Innocent Purchaser who then becomes seller can assert defense if does not know or discloses existence of hazardous substances and exercises due care and takes precautions not liable for subsequent releases caused by buyer. *(Westwood Pharmaceuticals v. National Fuel Gas Distributors, 964 F.2d 85 (2nd Cir. 1992)).*

10.Contractual and Equitable Defenses- While the statutory defenses are the only ones available to defendants in government cost recovery actions, traditional equitable defenses are available to defendants in private party cost recovery actions or contribution actions such as latches, release, waiver, or unclean hands to reduce liability in private cost recovery actions. Defendants may also raise procedural defenses to Government cost recovery actions such as the response costs were not consistent with the NCP; the remedy was not the most cost-effective, etc.

11. Contribution Actions- Often times, the government only brings an enforcement action against a handful of PRPs at a site. In such a case or when a PRP incurs cleanup costs on its own, section 113 authorizes PRPs it may file a contribution action to recover those portion of the cleanup costs that are beyond their fair share of the cleanup. In allocating liability among PRPs, courts have used the following equitable factors.

* The ability of a PRP to distinguish their contribution to the discharge, release, or disposal of contaminants at a site;
* The amount of the Hazardous Waste generated by the PRP;
* The degree of toxicity of the Hazardous Wastes generated by the PRP;
* The degree of involvement by the PRP in the generation, transportation, treatment, storage or disposal of Hazardous Wastes at the site;

* The degree of care exercised by the PRP with respect to the Hazardous Wastes, taking into account the characteristics of the waste; and
* The extent that the PRP has cooperated with federal, state or local officials to prevent any harm to the public health or the environment.

In allocating liability between landlords and tenants, courts have used additional factors such as the benefits received by landlord from having the activity at the site (e.g. rent), landlord's knowledge or acquiesce to the polluting activities, enhanced property value to the landlord as a result of the cleanup and how the parties contractually allocated liability. In most cases, landlords are allocated some liability even when they did not contribute to the problem. *(e.g., Bedford Affiliates v. Sills, N0. 97-9245, 97-9267 (2nd Cir. Aug. 1997)(landlord 5% liable for contamination caused by dry cleaner tenant because landlord's inaction).*

12. "As Is" Contracts- Most courts have held that section 107(e) (42 U.S.C. 9607(e)) allows parties to a transaction to contractually transfer or release each other from financial responsibility under CERCLA and to rely on such releases or indemnities as a defense in private cost recovery or contribution actions. (*Purolator Products Corp. v. Allied Signal, Inc., 772 F.Supp. 124 (W.D.N.Y. 1991*)). However, such provisions are only effective between parties and cannot be asserted as a defense to liability in a government cost recovery. The provisions should clearly refer to CERCLA-like liability and agreements executed prior to the enactment of CERCLA may be construed to apply to CERCLA liability if the language of the release or indemnity is sufficiently broad. Id. Most courts have essentially eliminated the doctrine of caveat emptor as a defense to liability even in an "as is" contract. Such clauses have been interpreted as simply barring breach of warranty action. *(Westwood Pharmaceuticals v. National Fuel Gas Distribution Corp., 964 F.2d 85 (2d Cir. 1992)).*

13. De Minimis Settlements - Purchasers who are not eligible to take advantage of the innocent purchase of defense may still be able to negotiate a de minimis settlement with the government if (i) the property owner did not conduct or permit the generation, storage, transportation, treatment or disposal of hazardous substances at the facility; (ii) Had no actual or constructive knowledge that the property had been used for such activity; and (iii) Did not contribute to the release or threatened release by any action or omission.(42 U.S.C. 9622(g)).

14. **Liens-** CERCLA now provides EPA with two types of statutory liens. Section 107(l) authorizes EPA to impose a non-priority lien on property where it has performed response actions. 42 U.S.C. 9607(l). The lien becomes effective when EPA incurs response costs or notifies the owner of the property of its potential liability, whichever is later. The lien is subject to the rights of holders of previously perfected security interests

The 2002 CERCLA Amendments also established a windfall lien. in favor of EPA for property owned by BFPPs. To impose a windfall lien, EPA must establish that it has performed a response action, has not recovered its response costs and that the response action increased the fair market value of the property above the fair market value of the

facility that existed before the response action was initiated. The windfall lien is to be measured by the increase in fair market value of the property attributable to the response action at the time of a sale or other disposition of the property. The lien will arise at the time EPA incurs its costs and shall continue until the lien is satisfied by sale or other means, or EPA recovers all of its response costs incurred at the property. In lieu of EPA imposing a windfall lien on the property, the BFP may agree to grant EPA a lien on any other property that the BFP owns or provide some other assurance of payment in the amount of the unrecovered response costs that is satisfactory to EPA.

15. CERCLA Cleanup Procedures- The process of responding to releases of hazardous substances is known as a "Response Action". The EPA has established the National Oil and Hazardous Substances Contingency Plan ("NCP") which contains procedures that must be followed in responding to oil spills and releases of hazardous substances. (40 CFR Part 300)).The NCP defines two types of response actions: removal actions and remedial actions.

a. Removal Actions- are interim or short-term measures that are designed to contain or stabilize releases of hazardous substances but not to eliminate all of the contamination at a site. Removal actions are intended to be used when a prompt response is necessary to minimize the immediate effects of a release of hazardous substances. (42 U.S.C. 9601(23)).

b. Remedial Action- consists of long-term work designed to permanently eliminate the risk posed by the release or threatened release of hazardous substances. Examples of remedial activities include soil excavation, groundwater treatment, offsite disposal of contaminated materials, and permanent relocation of residents and businesses affected by the hazardous substances. (42 U.S.C. 9601(24)).

16. Identification and Listing of Superfund Sites- The EPA has also compiled a list of those sites that it believes pose the greatest danger. These sites are placed on the National Priorities List (NPL), also known as the Superfund List, which is published as Appendix B to the NCP. (40 CFR Part 300, Appendix B). There are three ways that a site may be listed on the NPL. The principal method is by investigating and evaluating the danger posed by the release using the Hazardous Ranking System (HRS), which is attached to the NCP as Appendix A. (40 CFR Part 300, Appendix A). The HRS is a scoring system that is used to assess the relative threat associated with actual or potential releases of hazardous substances.

Sites that do not score high enough on the HRS may also be placed on the NPL if either a state where the site is located designates that site as the top priority site in that state presenting the greatest danger to the public health or the environment. Finally, a site may be added to the NPL if the Agency for Toxic Substances and Disease Registry ("ATSDR") issues a "public health advisory" recommending that individuals be isolated from the release of hazardous substances and the EPA determines that the release poses a significant threat to the public, and that a remedial action will be more cost effective than

removal action. (40 CFR 300.425(c)).

When EPA first learns that a release of hazardous substances may have occurred at a facility, the release and the facility may be recorded in the CERCLA Information System (CERCLIS), which is a database that EPA has developed to inventory and manage sites where releases of hazardous substances are known to have occurred. Inclusion of a site in CERCLIS does not represent a finding of liability or a determination that a response action is necessary. (40 CFR 300.5) Indeed, only between 2 and 7 percent of the sites listed in CERCLIS have eventually placed on the NPL.

a. Initial Investigation- To determine if a site should be placed on the NPL using the HRS, EPA will first take the site through a two-stage site assessment. The first step is a preliminary assessment (PA) which consists of a office review of the existing information on the site and possibly a visual observation of the site. The second step is a site investigation ("SI"), where more detailed information is collected, including soil and groundwater sampling. (40 CFR 300.420). Nearly half of the CERCLIS sites that are evaluated are eliminated from further consideration after the PA. It is also possible that the EPA may determine during the PA/SI that a removal action may be necessary.

If the EPA determines that a site does not require further investigation, a "No Further Response Action Planned" (NFRAP) designation will be placed in CERCLIS for that site which means that no additional actions will be taken by the federal government under CERCLA unless additional information becomes available which suggests more investigatory steps are warranted at the site. (40 CFR 300.5) It is important to understand that NFRAP designation does not necessarily mean a hazard does not exist but simply that EPA does not plan to take any action based on the available information. A NFRAP determination does not preclude a state from initiating enforcement action under its own environmental laws. Indeed, a small percentage of NFA sites do eventually become active CERCLIS sites after EPA notifies states of an NFRAP decision.

If a site receives a HRS score of 28.5 or more out, EPA will place the site on the NPL using the process required under the Administrative Procedures Act for promulgating regulations. The NPL must be revised annually. The procedure that EPA usually follows is that it will first propose placing a group of sites on the NPL. This notice of proposed inclusion on the NPL will be published in the federal register. Then, after a public comment period, EPA will issue a final rule in the federal register formally adding sites to the NPL. Listing of a site on the NPL may be challenged only in the Court of Appeals for the District of Columbia. Petitions challenging the listing of a site must be filed within 90 days of the final notice to list the site on the NPL. (42 U.S.C. 9613(a)). Approximately 1,300 sites that have been included or proposed for inclusion on the NPL. The EPA will defer listing a site on the NPL or may delete from that list a site that may be remediated under the RCRA corrective action program. However, EPA may decline to defer a site if the RCRA corrective action may not apply to all of the contamination at a site.

An NPL listing is not, by itself, a determination of CERCLA liability nor does it require site owners or operators to undertake response actions. Moreover, the EPA may undertake a removal action and pursue enforcement actions against PRPs even when the site is not on the NPL. However, Superfund-financed remedial actions may not be undertaken unless the site is on the NPL. (40 CFR 300.66(c)(2)). Although the NPL sites are listed according to their HRS scores, response actions do not have to be implemented in the same order as a site's ranking. Private parties may pursue cost recovery and contribution actions even for non-NPL sites

b. Site Remediation Process-The remedial action selection process has several phases. It begins with a "Remedial Investigation" (RI) which involves a complete technical assessment of the site, including characterizing the hydrology, identifying the source and extent of the contamination, and identifying the pathways the contamination may follow. The RI also evaluates the health risks posed by the site and identifies the "applicable or relevant and appropriate requirements" ("ARARs") which are state and federal laws or regulations that must be used to establish cleanup levels for the site. (40 CFR 300.430(d))

Once the RI is completed, the next phase is the "Feasibility Study" (FS) which identifies and evaluates where alternatives for decontaminating the site. Often, because of the site complexities, the RI and/or FS will address only a portion of the site contamination, such as groundwater, or a geographic area of the site. These distinct areas are known as operable units. A study evaluating the remedy for an operable unit is an Operable Unit Feasibility Study ("OUFS"). (40 CFR 300.430(e)).

The FS must develop at least four types of remedial alternatives: an alternative that that attains ARARs, an alternative that exceeds those standards, a "no-action" alternative, and an alternative that does not meet ARARs but reduces the threat and adequately protects public health and the environment. Often, the FS will contain a dozen cleanup options. The list of remedial alternatives is then narrowed or screened by evaluating the following nine statutory criteria: (1) degree of protection of human health and the environment; (2) compliance with ARARs; (3) long-term effectiveness; (4) permanence; (5) reduction of toxicity, mobility, or volume through treatment; (6) short-term effectiveness; (7) implementability; (8) cost; and (9) state and community acceptance. Id.

The nine statutory criteria are not equally weighted. Instead, they are categorized into three groups: threshold, primary balancing and modifying. The first two criteria are the minimum threshold requirements that a remedy must meet. Criteria 3-8 above are the balancing criteria where the EPA (or state agency if the state has been given the authority to make a particular remedy selection) evaluates these factors and balances the tradeoffs. Finally, state and community acceptance is factored into the remedy selection process. Id.

After the RI/FS is completed, the EPA will propose the selected remedy for the entire site or just an operable unit in the draft Record of Decision (ROD). The ROD must

summarize the site conditions, the threat posed, and the remedy selected. In addition, it must describe the relative weaknesses and strengths of the remedial alternatives and offer a clear justification for the final remedy that is selected. In particular, the EPA must demonstrate that the selected remedy is cost-effective, protective of human health and the environment, attains the specified cleanup levels, and utilizes permanent solutions to the maximum extent practicable. If the selected remedy does not satisfy the preference for permanent solutions, the agency must explain why an alternative that would have reduced the toxicity, mobility, or volume of waste was not selected. The EPA must identify the ARARs for the site, or the health-based standards that must be met in the absence of ARARs. Furthermore, the ROD must detail which ARARs will not be met and justify waivers for ARARs. (40 CFR 300.430(f)).

The ROD is only released to the state where the site is located. To inform the public and the PRPs about the proposed remedy, the EPA will issue a proposed remedial action plan ("PRAP") in the federal register. The EPA will hold public meetings where the affected community can respond to the proposed cleanup. The EPA will review the public comments and issue a final ROD that responds to the public comments and selects one of the remedial alternatives. A state may ask EPA to enhance or expand a remedy and EPA may agree to incorporate the changes in the remedy if it finds the changes are necessary and appropriate.

After the approval of the ROD, the EPA will authorize the preparation of a detailed engineering plan for the cleanup known as the Remedial Design ("RD"). After publication and approval of the RD, the actual cleanup known as the remedial action ("RA") will be implemented. Once the RA is completed, the EPA may propose to remove or "de-list" the site from the NPL even if the contaminant levels have not yet reached the ARARs. EPA will propose to de-list a site by publishing a notice of intent to de-list in the federal register followed by a final de-listing notice in the same publication. (40 CFR 300.435(e)). After the RA has been completed, it may be necessary for continued operation and maintenance (O & M) such as groundwater monitoring or treatment to continue for a period of time. (40 CFR 300.435(f)).

16. New Brownfield Funding Program- In addition to providing liability relief to purchasers of contaminated property, the 2002 CERCLA Amendments established a statutory brownfield funding program. The law increases the funding for assessment and cleanup of brownfield sites from approximately $96 million to $250 million a year for fiscal years 2002 through 2006. Of this amount, $150 million will be allocated to localities, states and tribes to support site assessment and cleanup. Another $50 million will be used to establish and enhance state and tribal cleanup programs. Finally, $50 million will be available to clean up sites contaminated with petroleum.

a. Eligible Brownfield Sites- To be eligible for funding, the property must fall within the new CERCLA definition of a "brownfield site". The term refers to real property where the expansion, redevelopment, or reuse may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant. The definition of a brownfield site excludes property that is:

- Subject to a planned or ongoing removal action under CERCLA;
- Listed or proposed for inclusion on the National Priorities List ("NPL");
- Subject to a CERCLA section 106 unilateral order, a court order, an administrative order on consent or judicial consent decree;
- Operating under a permit issued pursuant to RCRA, the CWA, TSCA or the SDWA;
- Subject to corrective action under RCRA section 3004(u) or 3008(h), and a corrective action permit or order has been issued or modified to require the implementation of corrective measures;
- Undergoing RCRA closure for a land disposal unit, a closure notification for a land disposal unit has been submitted or where closure requirements have been specified in a closure plan or permit;
- There has been a release of polychlorinated biphenyls ("PCBs") on a portion of the property that is subject to remediation under TSCA;
- Subject to the jurisdiction, custody, or control of a department, agency, or instrumentality of the United States, except for land held in trust by the United States for an Indian tribe; or
- A response action at the site has received financial assistance from the federal Leaking Underground Storage Tank Trust Fund.

EPA is authorized to provide financial assistance to sites that are statutorily excluded from the definition of a brownfield site if EPA determines on a site-by-site basis that financial assistance will protect human health and the environment, and either promote economic development or enable the creation, preservation, or addition to parks, greenways, undeveloped property, other recreational property, or other property used for nonprofit purposes.

One of the limitations of EPA administrative brownfield program had been that sites contaminated with petroleum were not eligible for funding because petroleum was excluded from the CERCLA definition of hazardous substances. As a result, EPA recently launched its USTfields program but has only issued 10 grants for $100,000. The 2002 CERCLA Amendments fill this gap by allowing petroleum-contaminated sites to be eligible for brownfield financial assistance if they meet certain conditions. The site must either fall within the definition of a brownfield site or be administratively included within that definition, EPA or a state must determine that the site poses a relatively low risk compared with other petroleum-contaminated sites in the state, there is no viable responsible party to assess, investigate, or cleanup a site, and the site is not subject to a corrective action order. In addition to petroleum-contaminated sites, mine-scarred land and property contaminated with controlled substances under the Controlled Substances Act land may also be eligible for funding. Sites that qualify as a brownfield site are not precluded from qualifying for assistance under any other provision of Federal law**.**

2. Entities Eligible for Brownfield Grants- The 2002 CERCLA Amendments add a new section 128 to CERCLA that creates a class of entities who may receive

grants to inventory, characterize and remediate brownfield sites. Eligible entities include the following:

- A general purpose unit of local government;
- A land clearance authority or other quasi-governmental entity that operates under the supervision and control of or as an agent of a general purpose unit of local government;
- A government entity created by a State legislature;
- A regional council or group of general purpose units of local government;
- A redevelopment agency that is chartered or otherwise sanctioned by a State;
- A State; or
- An Indian Tribe.

3. Uses of Brownfield Funds- Under the EPA administrative brownfield program, parties interested in remediating brownfield sites could only obtain loans through the BCRLF program. The legislative history for the 2002 CERCLA Amendments recognized that brownfield sites redeveloped for recreational property, open space or other non-economic uses would not generate sufficient revenue streams to repay the BCRLF and that it was difficult to obtain private financing for these properties. In addition, the legislative history acknowledged that disadvantaged communities might lack the resources to repay BCRLF awards.

As a result, new CERCLA section 128 directs EPA to establish a program to provide grants to inventory, characterize, assess, and conduct planning related to brownfield sites under paragraph, and to perform targeted site assessments at brownfield sites. Site assessments performed using funds authorized by section 128 must be conducted in accordance with the ASTM E1527 standard for Phase I Environmental Site Assessments until EPA promulgates standards for what constitutes an appropriate inquiry.

The grants for characterization, assessment and planning shall not exceed $200,000 per site though EPA may waive the $200,000 limitation and permit an eligible entity to receive a grant of up to $350,000 for a brownfield site, depending on the anticipated level of contamination, size, or status of ownership of the site. The grants may be awarded to an eligible entity on a community-wide or individual site basis.

EPA is also authorized to provide direct grants of up to $200,000 to eligible entities or non-profit organizations to remediate one or more brownfield sites owned by the eligible entity or non-profit organization. In determining whether to make direct remediation grants, EPA is required to take the following factors into account:

- The extent a grant will facilitate the creation, preservation, or addition to a park, a greenway, undeveloped property, recreational property, or other property used for nonprofit purposes;
- The extent a grant will meet the needs of a community that has an inability to draw on other sources of funding for environmental remediation and

subsequent redevelopment of the area in which a brownfield site is located because of the small population or low income of the community;
- The extent a grant will facilitate the use or reuse of existing infrastructure;
- The benefit of promoting the long-term availability of funds from a revolving loan fund for brownfield remediation; and
- Other similar factors EPA considers appropriate to consider for the purposes of this section.

The eligible entities may receive up to $1 million for remediation grants to capitalize their own brownfield revolving loan programs. These funds may be used to remediate brownfield sites in the form of 1 or more loans to an eligible entity, a site owner, a site developer, or another person selected by the eligible entity. EPA may award additional grants to an eligible entity in subsequent years after the year the initial grant is made after taking the following factors into account:

- The number of sites and number of communities that are addressed by the revolving loan fund;
- The demand for funding by eligible entities that have not previously received a grant;
- The demonstrated ability of the eligible entity to use the revolving loan fund to enhance remediation and provide funds on a continuing basis; and
- Other similar factors the Administrator considers appropriate to carry out this section.

By substantially increasing the amount of money available for brownfield grants, the 2002 CERCLA Amendments will allow more sites to receive money for assessment and cleanup. However, by limiting the remediation grants to $200,000 ($350,000 in special cases) and the maximum grant of $ 1 million for capitalizing a brownfield cleanup revolving loan fund, Congress did not seem to learn from EPA's early mistakes with the brownfield. Initially, the EPA BCRLF grants ranged from $200,000 to $400,000 per site. However, it soon became clear that grants of this size were inadequate incentives for all but the smallest contaminated sites. As a result, EPA has been increasing the size of its BCRLF grants. Indeed, the 46 BCRLF grants EPA awarded in 2001 ranged from $500,000 to $2 million, with the average grant at $1 million. Indeed, the majority of the 26 revolving loan grants awarded during the last round of 2001 were for the maximum $1 million allowed under the BCRLF. Thus, in this respect the brownfield grants authorized by the 2002 CERCLA Amendments represent a step backwards and are not likely to provide sufficient incentives for brownfield redevelopment.

4. NCP Compliance- Another drawback of the current administrative brownfield program was that the response actions had to comply with the national contingency plan ("NCP"). This requirement discouraged brownfield redevelopment because it made cleanups more costly and also slowed down the cleanup process. To simply

the application process and expedite funding of response actions, section 128 provides that applicants will not have to comply with the NCP. However, if EPA determines that a particular NCP requirement is relevant and appropriate (e.g., public participation), the agency may include this requirement as a condition of the application process.

5. NPL Deferral Of Brownfield Sites- Because of concern the property may become stigmatized, many states are increasingly reluctant to have contaminated sites added to the National Priority List ("NPL"). The 2002 CERCLA Amendments authorize EPA defer final listing of an eligible response site on the NPL at the requested of a state if EPA determines that:

- The state or a private party acting pursuant to a state order or agreement is conducting a response action at the eligible response site in compliance with a state response program that is protective of human health and the environment, and provides long-term protection of human health and the environment; or
- The state is actively pursuing an agreement to perform a response action at the site with a person that the state has reason to believe is capable of conducting a response action.

EPA may defer the listing for one year from the time the eligible response site is proposed for listing on the NPL. EPA may defer the listing for an additional six months if the agency determines that reasonable progress is being made toward completing the response action, deferring the listing would be appropriate based on the complexity of the site, substantial progress has been made in negotiations and other appropriate factors that EPA may identify.

EPA may decline to defer, or elect to discontinue a deferral of a listing of an eligible response site if the state is as an owner, operator or a significant contributor of hazardous substances at the facility. EPA may also decline or discontinue deferral if the agency determines the NCP criteria for issuance of a health advisory have been met or the other conditions for deferral are no longer being met.

6. Funding for State Response Programs- Under its administrative brownfield program, EPA has been providing financial assistance to states to help them establish and administer state brownfield programs. The $50 million authorized by the 2002 CERCLA Amendments for establishing or supporting state cleanup programs is considerably more than EPA has been providing the states under its administrative brownfield program. To be eligible for this money, a state must have either executed a Memorandum of Agreement ("MOA") with EPA or established a response program with the following minimum elements:

- Timely survey and inventory of brownfield sites in the State;
- Oversight and enforcement authorities or other mechanisms, and resources

that are adequate to ensure that a response action will protect human health and the environment; be conducted in accordance with applicable Federal and State law**;**

- Oversight and enforcement authorities or other mechanisms, and resources that are adequate to ensure that if a person conducting the response action fails to complete the necessary response activities, including operation and maintenance or long-term monitoring activities, the necessary response activities are completed;
- Mechanisms and resources to provide meaningful opportunities for public participation;
- Mechanisms for approval of a cleanup plan, and a requirement for verification by and certification or similar documentation from the State, an Indian tribe, or a licensed site professional to the person conducting a response action indicating that the response is complete**.**

A potentially important and problematic provision is the requirement that a state response program must also establish a mechanism where a person who may be affected by a release or threatened release of a hazardous substance, pollutant or contaminant from a brownfield site located in the community works or resides may request that a site assessment be performed. This provision has the potential for creating much uncertainty for owners of contaminated property and their lenders. Because of limited resources, most states have established a system for prioritizing site investigations. During due diligence, property owners and their lenders can normally gain some comfort by determining where a site is ranked on a state list of contaminated sites. However, this provision may require a site to be investigated that might not normally draw the attention of state regulators. It is not clear if the assessment that is to be performed is simply a Phase I ESA or a risk assessment. It is also unclear who must pay for this assessment.

Moreover, because this provision applies to pollutants or contaminants, it can apply to sites that might not be covered by a state superfund program such as those contaminated with petroleum, asbestos or lead-based paint. In addition, the trigger for requiring a site investigation is a “threatened release” which is a very low threshold such as the mere presence of abandoned drums in the backyard of a facility or where an institutional control may no longer be operating properly. It is possible that community groups may try to use this provision to apply pressure on state regulatory agencies to closely monitor an ongoing remedial action or operating and maintenance program.
As a result, property owners may not only have to pay greater attention to neighboring properties during due diligence to determine if their may be sensitive populations but may feel constrained to perform more extensive cleanups than required under state risk-based cleanup standards.

7. Environmental Insurance- The 2002 CERCLA Amendments provide that a state

may also use a portion of its grant to pay for premiums to purchase environmental insurance premiums, develop a risk sharing pool, an indemnity pool, or insurance mechanism to provide financing for response actions under a State response program.

Secured creditor policy underwriting requirements has tightened considerably and premiums have increased significantly. As a result, some brownfield sites may no longer be eligible for these policies or the costs of the policies may no longer make economic sense for the transaction. By enabling states to provide premium subsidizations and increased capacity, the 2002 CERCLA Amendments may help make affordable environmental insurance available to more brownfield sites.

8. Federal Enforcement Bar- Approximately 47 states have enacted brownfield or voluntary cleanup programs that use risk-based cleanups. Purchasers of brownfield sites and their lenders have been concerned that EPA might determine that a site cleanup performed under a state program was inadequate. This fear of federal enforcement is probably more theoretical than real since brownfield sites are not as seriously contaminated as NPL sites and are therefore usually not on the federal enforcement radar screen. However, to address these concerns, approximately a dozen states have entered into a memorandum or agreement where EPA has agreed not to require additional cleanup except under certain circumstances.

The 2002 CERCLA Amendments added a new section 129 to CERCLA that bars EPA from bringing enforcement actions under CERCLA when a cleanup is performed at an "eligible response site" and the state response program meets the minimum standards established in this section. An "eligible response site" under section 129 includes sites that fall within the definition of a brownfield site and those sites that EPA determines are eligible for brownfield financial assistance on a case-by-case basis. Sites specifically excluded from this definition are NPL sites as well as sites where EPA has conducted or is conducting a preliminary assessment and site inspection, and determines after consulting with the state that the preliminary score of the site makes it eligible for inclusion on the NPL. However, if EPA determines not to take any further action, the property may be classified as an eligible response site. In addition, sites that pose a threat to a sole-source drinking water aquifer or a sensitive ecosystem may not be considered an "eligible response site.

Congress did not provide for any extensive standards for state response programs in order for the federal enforcement bar to apply at eligible response sites. The only state program requirement is that a state maintain an inventory of sites where response actions have been completed in the previous year and that are planned in the upcoming year. The inventory must be updated at least annually and be made available to the public. Each site should be identified by name and location. The inventory must indicate if a site will be remediated unrestricted use or if institutional controls will be used. The specific land use controls that will be used must also be identified in inventory.

A significant limitation of the federal enforcement bar is that it does not apply to petroleum-contaminated sites. The legislative history indicated that EPA has estimated that petroleum is the primary contaminant at approximately 200,000 of the 450,000 brownfield sites. Indeed, the vast majority of contaminated sites in New York have been impacted with petroleum.

The federal enforcement bar is more limited than the BFP, contiguous property owner or innocent purchaser's defense. It is limited to actions involving eligible response sites in states with response programs that meet the minimum statutory standards. In addition, it only applies to CERCLA section 106 unilateral orders to compel a cleanup or a section 107 to recover response costs. In contrast, a BFP, contiguous property owner or innocent purchaser will be immune from CERCLA liability brought by government and private parties at any site. EPA may bring an enforcement action if one of the following conditions occurs:

- The State requests EPA assistance in the performance of a response action;
- EPA determines that contamination has migrated or will migrate across a state line and further response actions are necessary to protect human health or the environment;
- EPA determines that contamination has migrated or is likely to migrate onto property subject to the jurisdiction, custody, or control of a department, agency, or instrumentality of the United States and may impact the authorized purposes of the Federal property;
- EPA determines after taking into consideration the response activities already taken that a release or threatened release may present an imminent and substantial endangerment to public health or welfare or the environment, and that additional response actions are likely to be necessary to mitigate the release or threatened release; or
- EPA determines after consulting with a state that new information that was not known by the state when the response action was approved or completed has been discovered that indicates further remediation is necessary to protect public health or welfare or the environment.

The extent of contamination is usually not fully understood when a state approves a cleanup plan. Likewise, it is not uncommon for contamination to migrate at a site and courts have broadly construed what constitutes a threatened release. As a result, these re-openers may vitiate much of the protection offered by the federal enforcement bar.
If EPA decides to take a response action at an eligible response site, the agency must notify the state of the proposed action at least 48 hours before taking the action. The state has 48 hours to notify EPA if the eligible response site is or has been subject to a cleanup conducted under a state program or if the state is planning to abate the release or threatened release, identify the actions that are planned. If the state fails to respond within the 48-hour period, EPA may take immediate action. However, if EPA determines that more than one of the exceptions to its enforcement bar applies, the agency may take immediate action after notifying the state.

E. TOXIC SUBSTANCE CONTROL ACT (15 U.S.C. 2601 et seq.)(TSCA)- This law addresses the manufacture, processing, distribution in commerce and use of certain kinds of toxic substances. TSCA is most frequently encountered in real estate and commercial transactions when PCBs or lead-based paints are present.

1. PCBs- EPA has prohibited the manufacture, processing, distribution and use of PCBs. However, certain uses have been exempted from the PCB ban. Electrical equipment containing fluids with PCBs can continue to be used for the useful life of the equipment. The EPA PCB Rules are published at 40 CFR Part 761.

a. Electrical Equipment- is classified according to the concentrations of PCB in the fluid. If the fluid contains less than 50 parts per million ("ppm"), it is considered non-PCB equipment. If it contains between 50-499 ppm, it is considered PCB Contaminated and electrical equipment with dielectric equipment containing more than 500 ppm is classified as PCB Equipment)

b. Repair and servicing- PCB-Contaminated can be serviced and rebuilt if new fluid contains <500 ppm. PCB Electrical Equipment may not be rebuilt unless reclassified to a lower category using fluid containing the limit for that category. (40 CFR 761.30(a).

c. **Marking and Storage Requirements** – PCB Equipment must be marked with labels that comply with 40 CFR 761.40. Transformers without markings should be considered as PCB Transformers unless testing confirms that the dielectric fluids contain less than 50 ppm of PCBs. (44 FR 31517 (May 31, 1979)). Equipment containing more than 50 ppm of PCBs may be stored for up to one year prior to disposal provided certain storage standards are met. Storing the equipment for reuse for spare parts is not allow beyond 1 year. (40 CFR 761.65).

d. Disposal- In general, any PCBs in concentrations that exceed 50 ppm must be incinerated. However, certain kinds of electrical equipment or items such as contaminated rags, sludges, dredged materials with PCB concentrations between 50-500 OK may be disposed in RCRA Subtitle C facilities. Drained hydraulic equipment and some small white goods (capacitors in appliances, light fixtures) may be placed in RCRA Subtitle D facilities. EPA has adopted a manifesting system for PCB disposal which is like the RCRA waste tracking system. (40 CFR 761.60).

e. Spill Policy- EPA has established a policy for cleaning up spills of PCBs that exceed 50 ppm or more. Cleanup procedures will depend on the quantity of the spill and the location where the spill occurred. (40 CFR 761.120).

Note: Common transactional issues that prospective purchasers need to address include identifying category for unmarked transformers, determining where old equipment was disposed and evaluating if there were any old PCB spills.

2. **Lead-Based Paint**- EPA lead-based paint regulations requires sellers, lessors and/or agents of target housing to provide written disclosure to purchasers and lessees about the known presence of lead-based paints (LBP). The regulations do not impose affirmative obligations on sellers/lessors to investigate the presence of lead-based paint nor remove LBP. The LBP rule also does not apply to informal tenancies (no written lease) or to renewals of existing leases where the tenant previously received the required disclosure. (40 CFR 745.101).

a. Target Housing includes residential dwellings built prior to 1978 but excludes residences where living areas are not separated from living area such as studio apts. unless children are present. (40 CFR 745.103).

b. Sellers include partnerships, entities that transfer shares in co-ops or transfer leasehold interests. It is unclear if in the case of an individual transfer if both the shareholder and CO-OP board must comply. Id.

c. Agents are parties who enter into a contract to represent a seller or lessor for the purpose of selling or leasing target housing. They have own independent obligations to comply or ensure that their principals comply. Agents representing lessee/purchaser and who are paid exclusively by those parties are not required to comply. (40 CFR 745.115).

d. Foreclosure sales are not covered but a party who acquires title will be required to comply for any subsequent transfer or lease. (40 CFR 745.101)

e. If the dwelling is in a multi-family building, similar disclosure must be made for common areas. (40 CFR 745.107(a)(4)).

f. Contract Provisions- In addition to disclosure, the contract/lease must contain lead warning statement, certification by seller of the known information, certification by agent that seller/lessor complying with rule and acknowledgment by purchaser that it has read, understood statement and received certifications. Sellers/lessors are not required to maintain acknowledgment forms for any period of time. (40 CFR 745.113).

g. Inspection Period- Purchasers but NOT LESSEES must be given a 10 day inspection period. However, the rule allows for the parties to shorten or waive this requirement. The rule did not address whether the inspection should be conducted prior to execution or if it should operate as a post-execution cancellation right. (40 CFR 745.110).

h. Violations- Civil penalties of up to $10,000 per day and criminal penalties of up to $10,000 plus up to one year of jail. (40 CFR 745.118). Failure to comply with the LBP rule does not create a defect in title nor will not render contract unenforceable or permit termination of lease. (61 FR 9078, March 6, 1996).

I. NYC LBP Requirements- The NYC Health Code prohibited the use of LBP since

1960 (24 RCNY § 173.13). Because over half of the housing stock continues to have LBP, Local Law 1 was enacted in 1982 to address the concerns raised by the presence of LBP (Administrative Code § 27-2012). The law requires owner of multiple dwelling buildings to remove or cover in a manner approved by the health department LBP in any dwelling where a child or six years or younger resides. The law defines LBP as paint that has 0.7 milligrams of lead per square centimeter or contains more than 0.5% of metallic lead.

The law also creates a rebuttable presumption that if a child of six or less lives in multiple dwellings built before 1960, the paint peeling paint will be considered to be LBP and must be abated with 24 hours. (Administrative Code § 27-2115[c]).

In New York, landlords may be liable for injury caused by a defective or dangerous condition if the landlord is under a statutory or contractual duty to maintain the premises and reserves the right to enter for inspection and repair. The Multiple Dwelling Law requires every part of the building to be kept in good repair and NYC landlords are under a duty to maintaining their buildings (NYC Administrative Code § 27-127).

Local Law 1 does not establish a statutory cause of action for civil remedies but imposes a specific duty to abate hazardous levels of lead that is considered part of a landlord's general duty to repair. A breach of this duty does not impose strict liability but instead a plaintiff must establish the rest of the elements of common law negligence. (Juarez v. Wavecrest Management, 88 N.Y.2d 628 (1996)). Thus, where a landlord has shown that it has exercised reasonable care with respect to the LBP, it will not be liable. Local law 1 does not specify how to abate LBP but confers the power to establish such standards to the Department of Housing Preservation and Development ("DHPD"). These standards are promulgated at 28 RCNY 11-04.

To be held liable for injuries from a defective condition on the premises, the landlord must have actual or constructive notice of the condition for a period of time where the condition could have been corrected using reasonable care. Local Law 1 did not eliminate the notice requirement and the Court of Appeals has ruled that it does not charge landlords with the responsibility of determining if young children reside at the premises. However, a building owner may be charged with constructive notice of defects in its building. (Juarez v. Wavecrest Management, 88 N.Y.2d 628 (1996)).

3. Asbestos- In 1989, EPA implemented a phased ban on the manufacture, importation, processing and commercial distribution of most asbestos-containing products (the "Asbestos Ban") under TSCA (40 CFR 763.160) . However, in 1991, the United States Court of Appeal for the Fifth Circuit vacated and remanded most of the Asbestos Ban. In November 1993, EPA re-issued the Asbestos Ban (58 FR 58964, 11/5/93). The revised rule reinstated the ban for six categories of products including corrugated paper, roll board, commercial paper, specialty paper, flooring felt, and new uses of asbestos. However, the following asbestos-containing products were no longer subject to the Asbestos Ban: vinyl-asbestos tile, roofing felt, roofing coatings, caulking putties, construction mastics, textured coatings, asbestos-cement shingle, corrugated sheet, asbestos-cement flat sheet, pipeline wrap, millboard, asbestos-cement pipe, and asbestos-cement.

a. Asbestos in Schools- The Asbestos Hazard Emergency Response Act

("AHERA")(15 U.S.C. 2641) amended TSCA in 1987 and imposed asbestos inspection, abatement and management obligations for buildings owned, leased or otherwise used by a Local Education Agency ("LEA"). AHERA requires LEAs to conduct response actions for damaged or friable asbestos but does not require that ACM be removed. The decision how to address manage asbestos is left to the LEA. For abatement actions exceeding the ACM thresholds established under the CAA, the LEA must demonstrate that indoor air concentrations of asbestos do not exceed outdoor ambient air concentrations. For projects involving less than the thresholds, the OSHA PEL will apply.

The Asbestos School Hazard Abatement Reauthorization Act ("ASHARA") amended AHERA. It requires that any person performing asbestos inspections and abatement activities in public or commercial buildings must be accredited.

b. ASTM and Asbestos- The ASTM E1527-00 standard for Phase I ESAs identifies asbestos as a non-scope item. This means that a consultant will not look for the presence of asbestos during a Phase I unless a client specifically requests that asbestos be included within the scope of the ESA. Many clients mistakenly believe that asbestos was banned from buildings in 1972 and thus do not request that asbestos be included in ESAs for newer construction.

Thus, while it is true that many products used in the construction of buildings no longer contain asbestos, there are still building materials can still contain asbestos. As a result, it is still important for purchasers of buildings and their lenders who are financing acquisitions or providing refinancings to request that consultants note the presence and condition of suspect ACM. If known ACM is present, the building owner should develop an asbestos O & M Plan. If there is just suspect ACM and the building was constructed after the asbestos ban went into effect in 1993, it would still advisable for an owner to take samples of suspect ACM prior disturbing the material unless the building owner can establish that the building was constructed of asbestos-free materials. Owners should also consider inserting requirements in their construction contracts requiring contractors and architects to use asbestos-free materials.

C. Summary of EPA Asbestos Actions-

- March 31, 1971 (36 FR 3031) Asbestos Identified as Hazardous Air Pollutant
- April 6, 1973 (38 FR 8820):EPA Issues its NESHAP Banning spray-on insulation and establishing demolition standards
- October 14, 1975 (40 FR 48299): Demolition Standards Revised
- June 19, 1978 (43 FR 48299)- Revised workpractices for demolitions and renovations
- 1983- EPA Issues "Guidance for Controlling Friable Asbestos-Containing Materials in Buildings"
- 1983 "Friable Asbestos-Containing Materials in Schools; Identification and

Notification Rule".

- April 5, 1984 (49 FR 13658)- Revised workpractices for demolitions and renovations
- June 1985 EPA Revises "Guidance for Controlling Friable Asbestos-Containing Materials in Buildings"
- July 12, 1989 (54 FR 29460)- Asbestos Ban Rule Issued
- November 20, 1990 (55 FR 48406)- Major Revision of Asbestos NESHAP
- November 5, 1993 (58 FR 58964)- EPA Issues Asbestos Ban Phase-Out Rule
- July 28, 1995 (60 FR 38725)- Clarification of Residential Building Exemption

F. Safe Drinking Water Act(42 U.S.C. §300f-j-26.)(SDWA)- The law requires EPA to establish standards for contaminants in public drinking water supplies. Public water drinking systems are required to prepare Consumer Confidence Reports. These reports identify the source of the drinking water, summarize the system's susceptibility to contamination, describe the level of any contaminant found in local drinking water, identify the likely source and potential health effects of the contaminant and describe how the contaminant was reduced back to safe levels.

A common source of lead contamination in drinking water comes from lead that may be present in plumbing systems of homes or apartments. When water rests in pipes and faucets for several hours or longer, the lead can leach into the water. The SDWA prohibited the use of any pipe, plumbing fittings or fixtures, solder or flux containing lead to repair or install a public water system or any plumbing in any residential or non-residential facility providing water for human consumption after June 19, 1986. In addition, the SDWA prohibited businesses selling plumbing supplies to sell solder or flux that is lead free after August 6, 1996. Moreover, after that date the SDWA prohibited any person from introducing into commerce any solder or flux containing lead unless a label was attached to the solder or flux stating that it is illegal to use the solder or flux to install or repair plumbing providing water for human consumption. HUD was also prohibited from insuring or guaranteeing any mortgages for newly constructed residential property containing a potable water supply unless the water system contains lead-free pipe, solder and flux.

Purchasers of homes built before 1986 should not rely on drinking water sampling results from public water supply providers but also have water samples taken from the faucets in the homes to ensure that the water supply in the
particular home does not have elevated levels of lead.

Lenders do not have consistent due diligence standards for testing drinking water on property that is to serve as collateral for a loan. Most lenders require the consultant to verify that the public water supplier is in compliance with the EPA Lead and Copper Rule requirements. Some go beyond this step and require varying amounts of samples to be collected from individual residences. Nearly all require samples for residential property that uses on-site wells while others require testing for lead in drinking water for residential properties, hotels and commercial sites with food establishments even where those properties are connected to the public water system.

G. <u>Endangered Species Act (16 U.S.C. 1531 et seq.)(ESA)</u> - This ESA authorizes the federal government identify species whose continued existence law is threatened or endangered. Once a species is listed, the ESA to develop plans to promote the recovery of the species, including protecting and acquiring critical habitat. The ESA also prohibits the killing, harming or otherwise "taking" a listed species. Under section 9, a "taking" is defined broadly and includes any activity that "harms" endangered species. "Harm" can include habitat modification or destruction which actually kills or injures wildlife by impairing essential behavioral patterns such as breeding, feeding and sheltering

At first glance, the ESA would not seem to have any impact on real estate development. However, the law has begun to be used aggressively by development opponents not only to halt projects located in critical habitats for listed species but also projects outside a critical habitat that may result in a modification or degradation of that habitat such as stormwater runoff.

Under section 7 of the ESA, if a federal agency permits, authorizes or funds an activity it must consult with the FWS or the National Marine Fisheries Service ("NMFS") to ensure that the federal action will not jeopardize the continued existence of an endangered species or result in the destruction or modification of a habitat critical to the species existence. The consultation can be informal or formal such as requiring a biological assessment to determine if construction activity may "affect" the endangered species. If the FWS concludes that the construction action would jeopardize the continued existence of the species or cause adverse modifications of the critical habitat of the endangered species, the FWS must suggest "reasonable and prudent alternatives" to the proposed activity. If EPA accepts the proposed alternatives, the FWS could then issue a statement authorizing EPA to allow "incidental takings" under section 10 of the ESA provided the permittee prepare a Habitat Conservation Plan ("HCP") which will describe the mitigation measures that will be used to protect the endangered species. .

Some citizen groups are using the ESA to contest issuances of wetlands and NPDES permits. Usually, EPA will issue a draft permit, evaluate comments and then make a permit decision. CWA permits usually allow certain amount of pollutants to be discharged. However, if the citizen group can show that a proposed discharge could affect an endangered species, EPA would then have to engage in a consultation process with other agencies that could bring the permit process to a grinding halt.

Section 7(a)(1) also required federal agencies to "conserve" listed species which can include promoting their recovery. Thus, a federal agency may be able to limit or deny a project that will not result in a "taking" of an endangered species but will restrict the ability of the endangered species from becoming more plentiful.

In addition, the geographic scope of the section 7 consultation can exceed the area that is subject to the federal permit which triggered the consultation process. For example, if a developer has obtained a wetlands permit, the section certification may require

assessment of habitats that go beyond the area to be filled.

H. Common Law Actions- Prior to the enactment of CERCLA, RCRA and the state mini-Superfund laws, parties had to resort to common law causes of action such as trespass and nuisance to force the cleanup of contaminated properties. These common law actions are difficult to bring because plaintiffs in common law actions have to establish some connection between the defendant and the harm alleged to have been caused. CERCLA , in particular, creates a much lower threshold for plaintiffs because plaintiffs need only establish that a defendant falls within one of the categories of PRPs and does not require proof of fault or causation.. Nevertheless, because neither CERCLA nor RCRA creates a federal cause of action for personal injury or property damage, the common law actions are often the only recourse for plaintiffs who have been injured by exposure to hazardous wastes. These actions can be used to enjoin a defendant's activity. Bringing an order to show cause seeking injunctive relief can prove to be a useful device to bring an otherwise recalcitrant opponent to the negotiating table. Finally, common law actions may be joined as state pendant claims to a complaint alleging CERCLA violations since CERCLA does not preempt state claims.

Part III
NEW YORK SPILL RESPONSE AND HAZARDOUS WASTE REMEDIAL PROGRAMS

The New York Department of Environmental Conservation ("NYDEC") is responsible for administering the following four remedial programs: the State Superfund Program for hazardous wastes, the Spill Response Program for petroleum contamination, the Environmental Restoration Program for municipal brownfields and the Voluntary Cleanup Program (“VCP”). The Department of Health ("DOH") and State Attorney General also have a role for ensuring the cleanup of inactive hazardous waste disposal sites across the state.

Traditionally, the NYDEC staff for the various programs have adopted their own procedures and standards for investigating and remediating sites under their jurisdiction. Moreover, the nine NYDEC regional offices often have used different cleanup standards and procedures for similar sites. In an attempt to establish better uniformity across its remedial programs, the NYDEC’s Division of Environmental Remediation (“DER”) developed a draft "*Technical Guidance for Site Investigation and Remediation*" (“DER 10”) in December 2002. The DER-10 effectively serves the same role as the NJDEP “*Technical Regulations for Site Remediation*” (“*NJDEP Tech Regs*”)(N.J.A.C. 7:26E) and helps to promote better consistency across the NYDEC remedial programs and among the regional offices.[1] DER-10 establishes the minimum steps that must be followed in each remedial program. These steps include Site Characterization, Remedial Investigation, Remedy Selection, Remedial Design/Remedial Action, and Operation, Maintenance and Monitoring (“OM&M”).

Because the remedial programs have different statutory goals, individual cleanup projects may not be required to complete each of the investigative and remedial steps. For

example, when there is a known spill event or the contamination is associated with an underground storage tank, a responsible party may skip certain portions of the Site Characterization process (i.e., records review). In addition, the individual remedial programs continue to use different types of oversight documents used to implement response actions.

The NYDEC has not promulgated regulations procedures for remediating contaminated sites. Instead, the agency has issued a series of guidance documents that establish cleanup goals and objectives. The principal guidance for determining soil cleanup objectives and cleanup levels for VOCs, SVOCs, heavy metals, pesticides and PCBs is the Technical and Administrative Memorandum ("TAGM") 4046. The recommended soil cleanup objectives apply to in-situ (non-excavated) soil and excavated soil that will be placed back into the original excavation or consolidated elsewhere on a site. Since December 2000, TAGM 4046 is also used to develop soil cleanup objectives for gasoline and fuel oil contaminated soils that will be remediated in-situ.
The Spill Technology and Remediation Series (STARS) Memo #1 provides guidance on the handling, disposal and/or reuse of ex-situ (excavated) non-hazardous petroleum-contaminated soil. STARS Memo #1 also provides guidance on sampling soil from tank pits and stockpiles. Excavated petroleum-contaminated soil must meet the guidance values listed in STARS Memo #1 before it can be reused off-site. The principal guidance document for establishing groundwater cleanup goals is the Technical and Operational Guidance Series ("TOGS") # 1.1.1

A. Hazardous Waste Remediation Program-

The New York Inactive Hazardous Waste Disposal Site Law is the New York Superfund law (ECL §27-1301 et seq.). DEC has promulgated regulations implementing the state superfund program at 6 NYCRR 375.

1. DEC Site Listing Authority- Under §27-1305 of the New York Inactive Hazardous Waste Disposal Site law, the Department of Environmental Conservation ("DEC") is required to identify and establish a registry of sites that are contaminated with hazardous wastes. The sites are to be classified as follows:

* Class 1- Poses an imminent danger of causing irreversible or irreparable damage to the public health and the environment. Immediate actions is required.

* Class 2- poses significant threat to public health or the environment. Action is required.

* Class 3- Does not present a significant threat to public health or the environment. Action may be deferred.

* Class 4-Site properly closes but continued management is required;
* Class 5- Site is properly closed and there is no evidence of present or adverse

impact so no further action is required.

§27-1305(4)(d) requires the DEC to notify owners of sites that are proposed to be placed on the registry. Owners or operators of sites that are listed on the registry may petition the DEC to have the site de-listed or to have the classification changed. The DEC is required to convene an adjudicatory hearing within 90 days of receiving a de-listing petition and provide at least 30 days notice of a scheduled hearing. The DEC is required to issue a ruling within 30 days after the hearing.

NYDEC will de-list a site if no "consequential" quantity of hazardous wastes are present. This can occur when one of two conditions exist:

- A consequential quantity of hazardous waste was never present at the site. Upon investigation, it is often found that no hazardous waste was ever disposed of at a site. If other environmental problems exist at the site, DER refers the site to the appropriate agency division for further tracking - Division of Solid and Hazardous Materials, Division of Water; or;
- An inconsequential amount of hazardous waste is all that remains at the site as a result of remediation.

Most municipal landfills are not formally listed as hazardous waste sites because the definition of hazardous waste law excludes household hazardous waste. (6 NYCRR Part 371). For a municipal waste landfill to be considered a hazardous waste site, it must be determined that hazardous waste present at the site was commercial or industrial in origin. As a result, municipal landfills are usually handled by the Division of Solid and Hazardous Materials under closure provisions of 6 NYCRR Part 360. Co-disposal municipal landfills that are also hazardous waste sites are also usually closed under Part 360.

2. DEC Information Gathering Authority- Under §27-1309, DEC is allowed access to and has the right to copy all books, papers, documents and records related to current and past generation, transportation and disposal of hazardous waste. The DEC may issue subpoenas requiring the production of such records as well as to take testimony by deposition of persons regarding current and past hazardous waste activities. The subpoenas and depositions are subject to the CPLR.

In addition, DEC is authorized to enter any inactive hazardous waste site and areas near such sites to inspect and take samples of wastes, soil, air, surface water and groundwater. Under §27-1309(4), DEC shall not take any samples that involve substantial disturbance of the ground unless if has first made a reasonable effort to identify the owner of the property and provide the notify the owner with at least ten days notice of the intent to collect the samples. Any such inspection shall be conducted at reasonable times and be completed with reasonable promptness. The owner may request split samples. The costs of the sampling may be recovered by the DEC pursuant to the statute or common law.

3. DEC Remedial Authority- When the NYDEC determines that a site poses a

"*significant threat"* to the environment, it may order the owner of the site and/or any other person responsible for the disposal of the hazardous wastes to develop a remedial program acceptable to the NYDEC and to implement the remedial program (ECL §27-1313.3.a).

Significant threat is not defined by the statute. However, 6 NYCRR 375-1.4 sets forth conditions that would satisfy a significant threat. It is important to note that the mere presence of hazardous waste at a site is not sufficient to constitute a "significant threat."

The NYDEC may develop and implement the remedial plan if the agency determines that:

* the hazardous wastes constitute a "*significant threat*";
* the "*significant threat*" is causing or presents an imminent danger of causing irreversible or irreparable damage to the environment, and;
* Delaying responding to the threat to allow a hearing on the order would be prejudicial to the public interest.

In developing a remedial plan, the NYDEC is required to develop a cost-effective plan whose goal will be the complete cleanup of the contamination by the elimination of the "*significant threat***"** or the imminent danger of irreversible and irreparable harm.. (ECL §27-1313.5.d) Factors that the NYDEC is to consider include:

* the ability to determine through scientific means that the imminent danger of irreversible or irreparable harm may be achieved through limited actions;
* the ability of the NYDEC to identify responsible parties with sufficient financial resources to develop and implement the plan;
* the nature of the danger, and;
* the extent to which the actions shall reduce the danger. (ECL §27.1313.5.a)

Unlike CERCLA or the New Jersey Spill Act, the NYDEC cannot issue a cleanup order until after the alleged responsible party is provided with a hearing. Moreover, a party who has been issued an order after an administrative hearing may seek judicial review of that decision. (ECL §27-1313.4)The inability to order a PRP to cleanup a site without first conducting an administrative hearing has substantially limited the usefulness of the state superfund program.[2]

The NYDEC may also develop and implement a remedial plan if a person who has been ordered to eliminate the threat fails to do so within the time period set forth in the order. The reasonable expenses of developing and implementing the remedial program are recoverable from the responsible persons. If a site constitutes a "*significant threat*" and the NYDEC cannot either identify or locate the responsible person after a reasonable attempt, the NYDEC shall also develop and implement a remedial program. However, the NYDEC is required to secure appropriate relief from any responsible persons who are

subsequently identified or located, including the recovery of reasonable expenses.(ECL §27-1313.5.b)

4. Responsible Parties-The categories of PRPs under this law are potentially broader than CERCLA since PRPs include anyone who might be liable under statutory or common law liability scheme. In addition, the law does not contain statutory defenses, an innocent purchaser's defense, secured creditor's exemption or any statutory right of contribution or cost recovery. The law does not expressly provide for strict and joint liability but this kind of liability may be imposed under common law.

Under §27-1321, persons who voluntarily provide assistance or advice to help mitigate the effects of an accidental or threatened discharge without expectation of compensation shall not be liable for penalties or civil liability for damages or injuries alleged to have been sustained by any person as a result of an act or omission in the course of providing such advice or assistance.

In addition, persons who by training or experience are qualified to analyze and interpret matters pertaining to the transportation, treatment, disposal and storage of hazardous materials are also not liable.

None of the foregoing are relieved from liability for gross negligence, reckless, wanton or intentional misconduct, are under a duty to respond to the incident or receive compensation other than for out-of-pocket expenses.

5. Use Restrictions- §27-1317 provides that no person may substantially change the use of a site that has been placed on the registry without first notifying the DEC at least 60 days before the physical alteration or change in use is to commence. Substantial changes includes but is not limited to the following:

* constructing a building or other structure;
* the paving of the site for use as a roadway or parking lot;
* the creation of a park or other private or public recreational facility

B. Oil Spill Response Program-

The oil spills response program in New York is authorized by the Oil Spill Prevention, Control and Compensation Law (Navigation Law §12-170 et seq.) and the Control of the Bulk Storage of Petroleum Act (ECL §17-0101)

1. Liability Framework of Navigation Law-

Like the New Jersey Spill Act, the Navigation Law was enacted in the mid-1970s to establish a mechanism to respond to the possibility of oil spills from off-shore oil drilling that was being considered in response to the energy crisis. However, while the New Jersey Spill Act was subsequently amended to cover hazardous substances, the Navigation Law continues to be limited to petroleum spills.

The Navigation law prohibits the unpermitted discharge of petroleum into the waters of the state or onto land from which the petroleum might drain into state waters. (Navigation Law §173) Dischargers of petroleum are strictly liable without regard to fault for all cleanup and removal costs as well as direct and indirect damages. (Navigation Law § 181) Cleanup liability extends to discharges that occurred prior to the 1977 enactment date of the statute.

The statute does not expressly define who qualifies as a discharger. The term has been construed to include operators of a facility where a release has occurred, the owner of tanks that leaked, suppliers of heating oil, installers of oil tanks and even oil brokers. Until 2001, it was unclear if landowners who did not actively operate the source of contamination may be liable. In *State v. Green*, the New York Court of Appeals ruled that while the Navigation Law does not impose liability based solely on ownership of contaminated land, a landowner that can control activities occurring on its property and has reason to believe that petroleum products will be stored there, could be liable as a discharger for the cleanup costs. (96 N.Y.2d 403; 754 N.E.2d 179;729 N.Y.S.2d 420 (July 2, 2001)

Owner or operators of a "major facility" may assert defenses to liability based on act or omissions solely caused by an act of war, sabotage, or government negligence. (Navigation Law §181) However, it appears that these defenses may not be asserted by owners or operators of smaller facilities. There are also limited defenses for certain kinds of persons such as responders (Navigation Law §178-a) good Samaritans and contractors unless the injury is a result of negligence or gross negligence. (Navigation Law §176(7))

The Navigation Law also authorized the creation of the Environmental Protection and Spill Compensation Fund ("Oil Spill Fund") which is strictly liable for all cleanup and removal costs as well as direct and indirect damages. (Navigation Law §176).[3]The NYDEC is authorized to use the Oil Spill Fund to pay for cleanups of discharges from underground storage tanks as well as vessels, vehicles, pipelines and aboveground tanks that impair or threaten surface and ground waters when a responsible person refuses to

perform the cleanup, where the responsible party is unknown or the responsible party is unable to pay for a cleanup that NYDEC considers necessary to prevent risking public health or the environment. Cleanups should be performed in accordance with the NCP.

While parties damaged by oil spills may seek reimbursement from the Oil Spill Fund, dischargers may not obtain reimbursement from the Oil Spill Fund even if they paid more than their fair share of the cleanup costs. (Navigation Law §182) Claims for reimbursement must be made within three years after discovery of the damage and no later than ten years after the incident.

The state comptroller is the administrator of the Oil Spill Fund. The state attorney general is authorized to seek reimbursement of any dispersed funds from dischargers. (Navigation Law §187) The Navigation Law also authorizes the state to file a lien against the land where the discharge took place when the Oil Spill Fund incurs costs to cleanup or remove a discharge or makes payment to satisfy claims asserted by injured parties and a landowner fails to make payment within 90 days of a demand. The lien is a non-priority lien that does not subordinate previously perfected security interests. (Navigation Law §181-a)

In 1991, the Navigation Law was amended to expressly include a right of contribution. Under section Navigation Law § 181(5) private parties who have been injured by oil spills to recover their costs and damages may recover directly from the discharger. The Court of Appeals has ruled that a faultless landowner who is liable as a discharger may seek contribution under the Navigation Law. (State v. Green, ***supra***) The amendment has been construed to apply retroactively so that property owners who were considered dischargers has may seek recovery against prior owners/dischargers. (Snyder v. Newcomb, 194 A.D. 2d 53, 603 N.Y.S.2d 1010(4th Dept. 1993)) Navigation Law § 190 authorizes the NYDEC and injured parties to file claims directly against the insurance carriers of the discharger.

Dischargers are required to report any unauthorized spills of petroleum within two hours of discovery to the NYS Spill Hotline (1-800-457-7362). The reporting requirement does not apply to spills that meet all of the following criteria:

- The quantity is known to be less than 5 gallons;
- The spill is contained and under the control of the spiller;
- The spill has not and will not reach the State's water or any land; and
- The spill is cleaned up within 2 hours of discovery. (Navigation Law §175)

A spill is considered to have not impacted land if it occurs on a paved surface such as asphalt or concrete. A spill in a dirt or gravel parking lot is considered to have impacted land and is reportable.

The NYDEC spill reporting regulations also impose reporting obligations on the owner or operator of the facility where the spill occurred as well as the person who was in actual or

constructive control of the petroleum. (17 NYCRR Part 32.3)

2. Liability Framework of Bulk Storage of Petroleum Act ("PBSA")-

This law regulates facilities that store petroleum in USTs or ASTs with a combined capacity of between 1100 and 400,000 gallons of petroleum. Facilities that store more than 400,000 gallons of petroleum are considered "major facilities" and regulated by the Navigation Law. The definition of facility does not include heating oil tanks used for on-site consumption that are less than 1100 gallons.

Like the federal UST program, owners and operators of petroleum bulk storage facilities must comply with design and construction standards as well as closure requirements. (6 NYCRR Parts 613 and 614). Owners are defined as anyone who has legal title and operators

a. Reporting Obligations

The PBSA imposes reporting obligations on "any person with knowledge of a spill leak or discharge" of petroleum that exceeds 25 gallons or creates sheen on nearby surface water. (6 NYCRR Part 613.8). Most authorities interpret this reporting obligation to only apply to parties who own or operate facilities that store more than 1100 gallons of petroleum.

However, in an appeal of an administrative law decision, the NYDEC Commissioner recently ruled that this reporting obligation could extend to environmental consultants. *In re Middletown Kontokosta Associates, Ltd, NYSDEC Case No. R1-6039* Reporting obligations for smaller facilities are governed by the Navigation Law.

If the NYDEC suspects or believes that a UST is leaking, it may order the owner to perform a tightness test. If the owner fails to conduct the test within ten days, the NYDEC may conduct the test and seek reimbursement of its reasonable expenses. (ECL §17-1007(2)).

b. Oil Spill Cleanup Procedures

Cleanups of oil spills that are expected to completed over an extended period of time will usually accomplished pursuant to a Stipulation Agreement ("STIP"). The STIP is designed as fast track procedure with predetermined non-negotiable discharge limits. The terms of the STIP are non-negotiable except for the corrective action plan and schedule.

For complex remediation, the NYDEC may require the responsible party to enter into a long-form consent order. The long-form order is drafted to address site-specific issues, and its terms are subject to negotiation. While the STIP will address only the cleanup portion of a spill site, the long-form order may address other aspects of the situation, including possible fines and/or penalties

Anyone willing to accept responsibility for cleaning up a petroleum release may enter into a STIP. This includes the responsible party or a volunteer not responsible for the discharge. A responsible party can also request to negotiate a long-form order.

Within a short time after a spill has occurred, a responsible party will receive a STIP Guidance Package, including a "Letter of Responsibility," a Stipulation Agreement, and discharge limits, from the NYDEC Regional Director.

The letter informs the recipient that the NYDEC believes that the party is responsible for a spill. The recipient will be asked to sign the STIP. Work can and usually will begin prior to the STIP being signed. Any milestone already completed will be identified in the schedule. The responsible PRP can discuss a proposed schedule and include the schedule with the signed STIP.

The schedule may identify any or all of the following milestone activities: initiation of the investigation, completion/submittal of the investigation report, submission of the remediation plan, and project start date. For more complex sites, the remediation schedule may be adjusted to reflect site conditions subject to approval of the Regional Spill Engineer. If a recipient refuses to sign a STIP, the NYDEC will hire its own contractor, conduct the spill cleanup, and bill the responsible party.

C. Environmental Restoration ("Brownfield Program")

The Clean Water/Clean Air Bond Act of 1996 authorized the $200 million Environmental Restoration Project Fund program to cleanup contaminated properties are owned by municipal governments. (ECL § 56.0101 et seq.) NYDEC refers to this program as the "Brownfield Program". The program may be used to remediate sites contaminated with hazardous substances and petroleum.(ECL § 56-0101.11) This program not only provides funding to local governments but also liability protection. The NYDEC regulations are codified at 6 Part NYCRR 375-4 et seq.

1. Eligibility Requirements

A municipality is eligible for a brownfield grant if it is the owner of a property that may be contaminated with hazardous substances or petroleum.[4] The municipality does not have to own the property at the time of the application but must hold title before funds can be disbursed. If city-owned property has a privately owned parcel in the middle, the municipality would have to exclude the private parcel from its project's application or not be eligible for the grant unless the private entity is a non-profit organization. Thus, private developers who would not ordinarily be able to obtain financing for remediating the site could enter into an agreement with a local government where the local government performs the cleanup and then sells the property to the developer who would reimburse the local government for its share of the cleanup costs. Moreover, while a property can be subdivided prior to the completion of remediation, contaminated parcels may not be used either by the municipality or a successor until the NYDEC approved

cleanup as be completed for that parcel.

There are two important eligibility limitations. First, a municipality is not eligible if it was responsible for the hazardous substance or petroleum contamination. Thus, if a municipality applies for a grant and during the investigation finds that the petroleum contamination was from city-owned vehicles or tanks, the municipality would lose its grant and its liability limitation in this situation. However, if hazardous substances disposed of by a municipality are distinct from and not intermixed with other hazardous substances found at a property, the municipality could be eligible for funding if it completely removes its hazardous substances from the site before applying for State assistance**.** This exclusion may not apply when the government's liability is based solely on its status as an owner of the property but it did not operate the site.

Second, a municipality is not eligible if the property is listed as Class 1 or 2 on Registry. If the site is listed as a Class 2 site after the investigation is carried out under the grant but before a grant for remediation is made, the municipality would not be eligible for the grant. However, the municipality would still receive the liability limitation by virtue of completing the investigation and would not be obligated to remediate the property as long as the property was not used for any new purpose until the remediation is implemented to the satisfaction of the NYDEC.

If the municipality takes title, then applies for an investigation grant, and NYDEC subsequently determines that the site should be listed as a Class 2 site, the NYDEC will ensure that the grant is awarded before the property becomes a Class 2 site. However, if a municipality takes title and the property becomes a Class 2 before the municipality applies for a grant, the municipality will not be eligible for this program.

2. Liability Limitation

A municipality that is accepted into the program will receive a release for any common law or statutory liability and indemnity from the NYDEC for all claims filed by third parties as a result of hazardous substances that were on the property prior to the grant. The rights of this indemnification are assignable to a subsequent landowner, lessees, and lenders of the municipality. The State will indemnify these same persons for any liability associated with the hazardous substances that were on the property prior to the grant. (ECL § 56-0509) The liability relief will take effect when the application is approved.

However**,** if the municipality fails to complete the work to the satisfaction of the NYDEC, liability relief will be suspended until the work is completed. In addition, the property cannot be used for any new purpose until the remediation of the property is completed to the satisfaction of the NYDEC.

3. Funding and Eligible Costs

Under the Brownfield Program**,** a local government may receive up 75% of the funds necessary to remediate a site but will be required to supply the remaining 25%. The 25%

cost share may not be provided by private funds. Any money received from a private source will be subtracted from the eligible costs before State assistance is calculated**.**

However, a municipality may use low-interest loans from the Clean Water State Revolving Fund ("CWSRF") to satisfy the 25% cost share as well as pre-finance design and construction costs incurred prior to reimbursement of the State share, and costs that are ineligible for the Brownfields Program .[5]

There are two types of grants available under the Brownfield Program: Investigation grants and remediation grants. A municipality may apply for as many grants as it has brownfield sites.

Investigation grants are used to determine the nature and extent of contamination and then determine the appropriate remedy using the same process followed in the superfund program (e.g., RI/FS and ROD). Complete applications for investigations which satisfy the four eligibility criteria will be approved on a first-come, first-served basis.

Remediation grants may be used to fund the Design and Construction of the cleanup remedy selected in the ROD. Generally, completed applications for remediation will be evaluated in groups based on when they are received. The NYDEC will score each application according to the Environmental Restoration Project prioritization criteria. If the project's score meets or exceeds the minimum score required for eligibility, and there are sufficient funds, then the project will be approved. If available funds are insufficient, the NYDEC will approve the complete applications in accordance with their rank. Once funds become available, complete applications will be reconsidered for funding.

A municipality has to disclose all other funding sources available for remediation of the property including but not limited to enforcement actions against responsible parties and the existence of private parties willing to remediate the property using private funding sources.

If a municipality receives proceeds from the sale of property remediated under a SAC, a cost recovery action or the federal government, the shares of the state and the municipality shall be recalculated and any excess payments received by the municipality from the state shall be repaid. Any sales by a municipality to a PRP must be at least equal to the costs associated with the SAC as well as transaction expenses and interest.

Similarly, if the property is leased, the benefits to the municipality will be calculated using the higher of the present worth of the stream of rent over a thirty year period or the present worth of the fair market value of the property. Once those SAC expenses have been paid, the municipality's expenses may be paid. Any additional revenue must be equally shared by the state and municipality. (ECL §56.0503)

A municipality ay not be eligible for funding if it indemnifies other PRPs for remediation of the site. Indeed, the local government is required to assist the state in seeking reimbursement of response costs.

Eligible costs include the costs of appraisal, surveying, engineering and architectural services, plans and specifications, consultant, and legal services which are necessary for conducting the approved project, and which are reasonable and properly documented, as determined by NYDEC. Generally, costs to acquire or redevelop the property are not eligible costs**.** Thus, all costs associated with the approval, preparation, issuance and sale of bonds issued by the municipality in support of the project, together with the interest on such bonds or other form of indebtedness are not eligible for State assistance. However, it is possible that a municipality could recover its redevelopment costs upon recovery of money from federal payments, responsible or private party payments, or the sale or lease of the property if the total recoveries exceed the environmental restoration project cost.

Costs incurred prior to NYDEC approval of an investigation application are also not eligible. However, pre-application costs associated with storage tank registration, closure, and disposal activities are eligible for reimbursement if those costs are incurred on or after June 6, 1996.

Costs of indoor asbestos abatement and demolition of structures will usually be reimbursed at 50%. However, if the costs are almost exclusively for demolition, indoor asbestos abatement or lead-paint abatement, those costs will not be eligible for reimbursement. In addition, costs incurred prior to the approval of the SAC are also not reimbursable. Legal services that are necessary to implement the project are reimbursable for up to 5% of the investigation costs. (6 NYCRR Part 375-4.7)

4. Clean Up Procedures Standards

The Brownfield Program basically follows the Superfund cleanup procedures with some limited exceptions. Cleanups under the Brownfield Program must meet the same standard for protection of public health and the environment that applies to remedial actions performed under the state superfund program. (ECL § 56-0505.3) The Brownfield program does not differentiate between petroleum and hazardous substances for purposes of cleanup. As a result, a petroleum cleanup funded under the Brownfield Program must follow the requirements of the superfund program. If it is not feasible to cleanup to that level, then deed restrictions could be required and a higher cleanup level may be allowed based on feasibility. (6 NYCRR Part 375-1.10) Any land use controls that are required as part of the remedy selected by NYDEC must be recorded in the local land records along with a copy of the SAC within 45 days of receipt of an executed SAC. (TAGM 4058)

The oversight document for the Brownfield Program is the State Assistance Contract ("SAC"). As part of the application, the municipality must identify the environmental benefit to be derived from the project and either the economic benefit also to be derived or the public recreational use to which the property will be placed once it is remediated. The municipality must complete the application form and include a Site Investigation ("SI") workplan if applying for an investigation grant. If the municipality is applying for a remediation grant, it must include workplans for the SI and the Remedial Alternatives Report ("RAR").

Projects will be prioritized based on the benefit to the environment, the economic benefit to the State, the opportunity for the property to be used for public or recreational purposes, and the opportunity for other funding sources to remediate such property.(ECL § 56-0505).

A municipality is required to submit a site investigation ("SI") workplan as part of the application process. The SI workplan may be submitted independently or combined with the Remedial Alternatives Report (discussed below).The NYDEC must approve any workplan prior to the start of any work for the costs to be eligible for reimbursement. If the SI workplan is unacceptable, the application will be rejected and the municipality will notified of the SI workplan deficiencies. (6 NYCRR Part 375-4.5)

The SI will provide sufficient information to:

- Fulfill the work plan objectives;
- Make a preliminary identification of potential remedial alternatives;
- Further define the study area of the SI/RAR;
- Identify probable Standards, Criteria, and Guidance ("SCG") and determine the extent to which they have been exceeded or contravened;
- Perform a Health and Environmental Risk Assessment as necessary.

A municipality must prepare a Remedial Alternatives Report ("RAR") or a combined SI/RAR instead of a FS. The RAR phase may begin concurrently with or shortly after commencement of the SI. For example, SI data will be used to develop and screen alternatives, and the alternatives under consideration may serve as a guide for additional characterization work.

The RAR does not provides the same detailed analysis as a FS but simply provides sufficient information to develop potential remedial action alternatives that may be used to clean up the property and to mitigate any off-site impacts from the property. The minimum information may be:

- Identifying potential general response actions;
- Evaluating general response actions for effectiveness, reliability; implementability and cost, and;
- Assembling suitable general response actions into alternative remedial actions. [6]

NYDEC will prepare a PRAP which summarizes the proposed remedy for the property based on the findings of the SI/RAR Report. A summary of Remedial Goals and whether they will be attained by a specific alternative will be presented in the SI/RAR and PRAP. Once the SI/RAR and PRAP are ready for public release, the municipality must notify the public and allow a 45-day comment period to receive written comments.

After the 45 day comment period, public comments must be addressed through a Responsiveness Summary ("RS"). The municipality will assist the NYDEC with the preparation of the RS. The NYDEC will determine if the PRAP needs to be modified or if a public hearing is necessary because substantive issues were raised by the affected community.

Once the NYDEC issues a final ROD, the municipality will be notified in writing that it may proceed with the implementation of the remedy and that it has satisfactorily completed the project.

The municipality is responsible for designing and implementing the remedy selected by NYDEC. Workplans for the RD and RA must be prepared and submitted to NYDEC for approval. (6 NYCRR Part 375-4.9(b)) The end product of the detailed Remedial Design is a set of plans, specifications, and detailed construction cost estimates which are suitable for bidding and construction. The municipality must submit a final OM&M plan to the NYDEC just before the completion of construction of the RD. (6 NYCRR Part 375-4.9(c))

5. Application of the State Environmental Quality Review Act (SEQRA)

If a municipality is applying for a grant to undertake an investigation, SEQRA will not apply since data collection and research of properties are Type II actions that are not subject SEQRA. (6 NYCRR Part 617.5(c)(18)) However, NYDEC must comply with SEQRA prior to approving any remediation grants. Since the issues involving brownfield cleanup and redevelopment are primarily local in nature, it is strongly recommended that the municipality assume lead agency status on an action and coordinate review of the action with all involved agencies (including NYDEC). It is also strongly recommended that coordinated review of an action be conducted and a determination of significance made prior to submitting an application for a grant.

Before the NYDEC can issue a grant for remediation, the SEQRA process must be completed. This means that an environmental assessment must be conducted of the "whole action" (i.e., the remediation and redevelopment) by the lead agency. If the environmental assessment results in a negative declaration, SEQRA will be satisfied. However, if a positive declaration is issued by the lead agency, then a Final Environmental Impact Statement and Findings Statements must be prepared before the action can go forward and before NYDEC can issue the grant. SEQRA determinations must be submitted as part of a complete application.

D. Voluntary Cleanup Program ("VCP")

The NYDEC has established an administrative VCP to allow landowners, prospective purchasers and other volunteers to investigate and/or remediate sites that are contaminated with hazardous substances and petroleum. The work is performed under the oversight of the NYDEC and the DOH and the volunteer pays the State's oversight costs. When the volunteer completes work, it will receive a release from liability from the NYDEC.

The VCP has evolved considerably since it was established in 1994. Initially, individual VCP agreements were negotiated on an individual basis. Now, NYDEC uses a standardized form that is essentially non-negotiable.

While the NYDEC has not promulgated regulations governing the VCP, DEC prepared a "*Voluntary Cleanup Program Guide*" in May 2002 that details the program requirements.[7]

As discussed above, the Oil Spill Fund Administrator and the Attorney General also have authority over petroleum spills. Since a VCP liability release is only binding on the NYDEC, volunteers should request that the Attorney General execute especially when the volunteer is not required to remediate off-site petroleum contamination. Otherwise, the Oil Spill Administrator would not be precluded from seeking reimbursement from volunteers for off-site petroleum migration.

1. Eligibility Requirements

The volunteer must enter into a VCP agreement ("VCA") that obligates the volunteer to perform a site investigation and/or a remedial action. A volunteer can commit to only performing an investigation or perhaps implement a cleanup in a phased approach. Some of the earlier commitment documents were in the form of consent orders but are now generally in the form of voluntary agreements. Investigation or Remedial Workplans will be attached to the VCA.

The NYDEC will use the VCP application to determine an eligibility for participation in the VCP. The application also serves as an initial summary of site conditions. DER will attempt to notify applicants within 45 days of receipt of a completed application. If an application is deemed incomplete, the applicant will be notified of the deficiency and may submit the additional information.

All sites over which the NYDEC has enforcement jurisdiction are eligible for the VCP except the following:

- Sites listed as Class 1 in the Registry;
- Sites on NPL other than Onondaga Lake NPL Sub-sites;
- Sites regulated under the state counterpart to RCRA[8];
- Sites that are currently subject to a NYDEC or EPA enforcement action may be deemed ineligible by the NYDEC Project Attorney.

The program is available to non-PRPs and property owners who would be PRPs simply because of their status as current landowners. PRPs may also be eligible for the program if the site is not listed as a Class 1 or 2 sites on the Registry. The following parties are not eligible to participate in the VCP:

- A “discharger” under the Navigation Law at a petroleum site unless the “discharger” qualifies as an “innocent owner” because it acquired title to the site after the cessation of petroleum discharge;
- A PRP at a Class 2 site unless it is an "innocent owner", or;
- A PRP subject to any "enforcement action" requiring the PRP to remove or remediate at the site a hazardous substance.

If the site has distinct zones of contamination of petroleum and hazardous substances, a party that is considered a “discharger” for the petroleum contamination may still be eligible to participate in the VCP for non-petroleum portion of the site. The petroleum contamination would be managed separately under a STIP.

For purposes of VCP eligibility, an enforcement action will be deemed to have commenced under state law upon issuance of a notice of violation, commencement of an enforcement action under the ECL or issuance of an accusatory instrument under the state Criminal Proceedings law. For actions brought by EPA, an enforcement action will be considered to have been initiated when the party receives a notice that commences an administrative or judicial proceeding requiring the removal or remediation of hazardous substances.

2. Liability Release

Upon satisfactory completion of the response program, the NYDEC will issue an Assignable Release that contains a covenant not to sue for “Covered Contamination” and releases the volunteer from future liability for the Covered Contamination subject to re-openers. [9] This release will run with the land so that it would apply to future landowners as well as the volunteer's successors and assigns. Non-PRP volunteers also receive a release that covers natural resource damages. If use restrictions are required, the release will not be issued until the NYDEC has received a copy of the recorded Declaration of Covenants and Restrictions.

The release is from the NYDEC and is not binding on the Attorney General’s office which has jurisdiction over releases of hazardous substances and petroleum. While the NYDEC will not generally require volunteers to “chase” plumes of oil contamination migrating off-site, the state Oil Spill Fund is strictly liable for responding to all oil spills. Therefore, volunteers with property that has a petroleum plume migrating off-site would be well advised to address seek concurrence or a release from the Attorney General’s office.

The Assignable Release will contain the following re-openers:

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- Off-site migration of petroleum (and other contamination causing significant impacts if the Volunteer is a PRP);
- Environmental conditions or information related to the Site that were unknown when the Release was issued and that indicate that site conditions under the Contemplated Use are not sufficiently protective of human health and the environment;
- Failure to comply with the VCA (e.g., not completing OM&M, not paying State costs, not maintaining use restrictions, etc.);
- Fraud committed by the Volunteer in entering into or implementing the VCA;
- A release, discharge or threat thereof after the effective date of the VCA; or
- A change of use where the new use requires a lower level of residual contamination.

If a volunteer is an asset purchaser who would be considered a successor corporation to a PRP who caused the off-site contamination, the volunteer will probably be required to remediate the off-site contamination. If a VCP agreement does not require an asset purchaser to remediate off-site contamination, the volunteer should consider obtaining the concurrence of the state attorney general's office since it has adopted the "continuity of enterprise" theory for determining successor liability which may be broader than the test used by the NYDEC.

For cleanups of sites contaminated with hazardous substances, the VCA will contain contribution protection under CERCLA section 113. However, the VCA will not provide contribution protection for petroleum-contaminated sites.

It is important to note that a volunteer must perform substantive work under a VCA to obtain a release. A volunteer will not be able to obtain a release for work that was done prior to participating in the VCP or without NYDEC oversight.

3. VCP Cleanup Procedures

The VCP generally uses a streamlined approach to site cleanups. The volunteer will develop and develop an Investigation Workplan to evaluate on-site conditions. Innocent parties are not required to investigate off-site contamination of hazardous wastes. PRP volunteers and volunteers at petroleum sites are required to complete both on-site and off-site investigations.

At the conclusion of the investigation, the volunteer will submit a VCP investigation report. If NYDEC determines that remediation is necessary, the project manager will issue an investigation approval letter requesting the volunteer to submit a Remedial Action Workplan. If the volunteer declines to proceed with a cleanup, the NYDEC will approve the investigation but will not issue a release.

If NYDEC concludes determines that no remediation is required after the investigation report is reviewed, the volunteer will be able to receive a release.

One of the principal advantages of the VCP is that a volunteer is generally not required to prepare an FS. Instead, the volunteer must submit a Remedial Action Selection ("RAS") report that demonstrates through an engineering analysis that the remedy can achieve the cleanup goals for the Contemplated Use. While the RAS must generally address the superfund criteria, the volunteer is not required to evaluate cost effectiveness or community acceptance. The RAS can be incorporated into the Remedial Action Workplan or submitted separately. It is not necessary to submit an RAS for underground storage tanks that will be closed in accordance with the NYDEC requirements. For more complex sites, the volunteer may be required to submit a RAR which is similar to a focused FS.

If hazardous wastes have been disposed at the site and the investigation indicates that the site presents a significant threat, the NYDEC would normally place the site on the Registry. However, if the volunteer agrees to satisfactorily remediate the site, the agency will defer listing the site. If the volunteer declines to remediate the site, terminates the VCA or the project otherwise does not adequately address the significant threat in a timely manner, the NYDEC will lift the deferral and the place the site on the Registry.

Innocent volunteers are not required to investigate or remediate hazardous substances that have migrated off-site. If the off-site contamination poses a "significant threat", the NYDEC will place the site on the Registry and perform the off-site work.

In most cases, a volunteer will not be required to prepare a full-scale remedial design but simply submit a Remedial Action Workplan. However, the project manager may determine that the complexity or sensitivity of the site may warrant a full-scale Remedial Design.

If the approved Remedial Workplan is based on a restricted use, the volunteer must prepare a Declaration of Covenants and Restrictions within 30 days of its approval of the workplan and then file the instrument within 30 days of the agency's approval.

Within 90 days of completing the remedy, the volunteer must submit a final engineering report and any OM&M plan that is required. When OM&M is necessary, the NYDEC will issue a release when construction of the OM&M is completed and is shown to be working effectively even though the cleanup goals have not yet been achieved.

5. Cleanup Standards-

The VCP allows sites to be remediated to a level that is protective of public health and the environment for the present or intended use of the property. In the VCP application, the volunteer is to identify the contemplated use. The VCA shall specify one of the following four use categories"

- **Unrestricted-** For this category, site must be remediated without engineering and/or institutional controls.
- **Restricted Residential-** The site may be used for residential purposes but must have engineering and/or institutional controls to be protective.
- **Restricted Commercial-** Residential uses are not allowed but commercial uses are allowed with engineering and/or institutional controls that make the site protective. Commercial operations that could include residential-like uses such as day care and health care facilities are prohibited.
- **Restricted Industrial-** The site may be used for industrial purposes but requires the use of engineering and/or institutional controls.

E. New York City Superfund Law

The New York City Hazardous Substance Emergency Response Law (§24-600 et seq. of the New York City Administrative Code), the New York City Department of Environmental Protection (DEP) is authorized to respond to actual or threatened releases of hazardous substances and to impose a lien on the property subject to the cleanup.

1. Responsible Parties- Each responsible party is jointly and severally liable without regard to fault for all response costs incurred by the DEP. Includes any owner, operator, lessee, occupant or tenant other than a residential lessee, occupant or tenant of property at the time there is a release, or a substantial threat of a release, of a hazardous substance from such property into the environment.

An owner of an owner-occupied residential property consisting of six or fewer dwelling units used exclusively for residential purposes will not be deemed to be a responsible person unless that person committed a willful, knowing, reckless or negligent act or omission which caused or substantially contributed to the threat or threatened release of hazardous substances. The invitee or licensee of a person using the property as a residence will not be liable as a responsible person unless that person willfully, knowingly, recklessly or negligently caused or substantially contributed to the release or threatened release.

Regulated financial institutions chartered under state or federal law which received title to the contaminated property through abandonment, foreclosure, a deed in lieu of foreclosure or through a judicial or bankruptcy order will not be deemed to be a responsible party unless (i) the institution willfully, knowingly, recklessly, or negligently caused or substantially contributed to the release or threatened release of hazardous substances, or (ii) the financial institution received title in order to secure the underlying credit extension for the purpose of allowing the responsible party from avoiding the provisions of the law.

2. Defenses- The New York City Superfund law contains the same statutory affirmative defenses as provided in CERCLA but there is no innocent purchaser's defense.

3. Non-Priority Lien-Any cost incurred by the DEP under this law shall constitute a "debt" recoverable from each responsible party and a lien may be placed upon the real property of the responsible party or which was subject to the response measures. The lien becomes effective when either (i) a statement of account of costs is filed in the office of the City Collector and a notice of potential liability is filed, or (ii) three days after a notice has been mailed by certified and registered mail to the owner of the real property that was a subject of the cleanup action. The amount set forth in the statement of accounts continues to be a lien on the property until it is paid but is subordinated to the rights of any mortgagee.

PART IV.

LIABILITY OF PARENT AND SUCCESSOR CORPORATIONS AND LENDERS

A. LIABILITY OF SUCCESSOR CORPORATIONS UNDER CERCLA-

The general rule in most American jurisdictions is that a corporation which acquires the assets of another company is not liable for the actions of its predecessor. *(New York v. Storonske Cooperage Co., 164 B.R. 366 (Bankr.N.D.N.Y. 1994))* Over the years, the courts have developed four exceptions to the general rule of non-liability for asset purchasers. The purpose of these exceptions is to make sure that corporations do not evade their liabilities or to prevent corporate evasion of liability or debt through the use of corporate formalities.

1. Because successor corporations are not specifically referred to in CERCLA, some courts initially ruled CERCLA did not apply to those successor corporations. However, it is now generally agreed that Congress intended successor corporations to be liable under CERCLA. *(B.F. Goodrich Co. v. Betkoski, 99 F.3d 505 (2nd Cir. 1996); New York v. Panex Industries, 1996 WL 378172 (W.D.N.Y. June 24, 1996)).* In defining what exactly constitutes a successor corporation, many courts will look to state law with its four traditional exceptions since corporations are creatures of state corporate law. *(Anspec Co. v. Johnson Controls, Inc., 922 F.2d 1240 (6th Cir. 1990)).*

2. Under this traditional approach, asset purchasers will be considered corporate successors if one of the following applies:

* **Assumption**- The purchaser expressly or impliedly assumes the liabilities of the seller;
* ***De Facto* Merger**- The transaction amounts to a *de facto* merger or consolidation so that the surviving corporation assumes the liability of its predecessor. The important concept in this exception is not the continuation of the business operation but the continuation of the corporate entity;
* **Mere Continuation**- Under this exception, a corporation will be held to be a successor if there is are the same shareholders, directors and officers); and
* **Fraud**- The transaction was fraudulently entered into to escape liability.

Courts tend to strictly construe these exceptions. As a result, plaintiffs have had a difficult prevailing against asset purchasers particularly under the "*de facto*" and "Mere Continuity" tests where courts have required a high degree of continuity in management, personnel and stockholders. *(Louisana-Pacific Corp. v. Asarco, Inc. 909 F.2d 1260 (9th Cir. 1990))*

3. Because of the difficulties encountered by plaintiffs seeking to impose liability on

successor corporations under traditional corporate law, some jurisdictions have adopted two additional exceptions for imposing liability upon successor corporations.

* **Product Line Exception-** Under this doctrine, a successor corporation can be held liable for the acts of its predecessor if it continues to manufacture the same product even if there is no continuity in ownership. Only four states have adopted this exception and none of those state courts have employed it to impose CERCLA liability.

* **Continuity of Enterprise or Substantial Continuity Test-** The other non-traditional exception that courts have used to impose successor liability on asset purchaser's is the "Continuity of Enterprise" or "Substantial Continuity" doctrine. It is essentially a more relaxed version of the "mere continuation" exception. However, instead of focusing on the corporate entity, the Continuity of Enterprise exception analyzes whether the business operation has continued. Under this theory, a successor corporation may be found liable if it continues the same business or manufacturing operation as it predecessor even if there is no continuity of ownership. Courts will examine the following factors to determine if a successor corporation should be held liable *(B.F. Goodrich v. Betkoski, 99 F.3d 505 (2nd Cir. 1995))*:

- retention of the same employees;
- retention of the same supervisory personnel;
- retention of the same production facilities in the same location;
- production of the same product;
- retention of the same name;
- continuity of assets;
- continuity of general business operations; and
- does successor hold itself out as a continuation of the previous enterprise.

B. LIABILITY OF PARENT CORPORATIONS- A basic tenet of traditional corporate law is that a corporation is a separate entity from its shareholders who are shrouded under a corporate veil from the liabilities of the corporate enterprise. Under this concept of limited shareholder's liability, the shareholder's responsibility for the debts or obligations of a corporation is limited to the amount of the investment in the corporation. In the traditional state corporate veil piercing analysis, courts are extremely reluctant to disregard the corporate form but will use the equitable doctrine of "piercing this corporate veil" to hold either corporate shareholders or specific individuals liable for corporate actions. A court will pierce the corporate veil when (1) the court determines that the shareholder and the corporate entity are not distinct entities and (2) when upholding the corporate form will cause injustice. Some states, like New York, impose a more stringent test for the second element and require fraud before the corporate form may be disregarded *(New York v. Shore Realty, 759 F.2d 1032 (2nd Cir. 1085))*.

1.The essence of the first part of the test is that the shareholder is using the corporation to further its own purposes. This may be established by showing that the corporation was

controlled by an alter ego who completely dominated the policy and business practices of the corporation so that it had no separate will, mind, or existence of its own. The second element for piercing the corporate veil, which requires injustice or fraud to justify disregarding the corporate form, can be satisfied when there is inadequate capitalization for the debts normally associated with business or where the corporate form has been used to misrepresent or defraud creditors.

2. In considering whether to disregard the corporate form, a court will examine the following:

- Inadequate capitalization in light of the purpose of the subsidiary;
- Extensive or pervasive control by the parent shareholders;
- Intermingling of the subsidiary properties or accounts with the parent such as parent pays the salaries and expenses of the subsidiary or all business of the subsidiary is funneled through the parent;
- Subsidiary fails to observe corporate formalities and separateness such as keeping separate books and records, and holding shareholder or director meetings;
- Siphoning of subsidiary funds;
- The companies share common shareholders, directors, and officers;
- The companies have common business departments;
- The daily operations of the two companies are not kept separate;
- The companies file consolidated financial statements and tax returns; and
- Non-functioning officers or directors.

3. A number of courts have held parent corporations liable under CERCLA for the activities of their subsidiaries under either an “owner” or “operator” theory. Under the "owner" liability theory, courts focus on the relationship of the parent corporation to its subsidiary. (Mobay Corp. v. Allied- Signal, Inc., 761 F.Supp. 345 (D.N.J. 1991);*City of New York v. Exxon Corp., 112 B.R. 540 (S.D.N.Y. 1990)).*These cases tend to use a traditional corporate veil piercing analysis to determine if CERCLA liability should be imposed on parent corporations.

4. Under the “operator” liability cases, courts will bypass the corporate veil piercing analysis and assess if a parent corporation was pervasively involved in the operations of a particular facility owned by a subsidiary. Under this line of cases, a parent may be liable under CERCLA as an operator in the absence of facts that would justify piercing the

corporate veil. *(Schiavone v. Pearce, 79 F.3d 248 (2nd Cir. 1996);Lansford-Coaldale Joint Water Authority v. Tonolli, 4 F.3d 1209 (3rd Cir. 1993);U.S. v. Kayser-Roth, 910 F.2d 24 (1st Cir. 1990).* With limited exceptions, these cases require active involvement by the parent corporation and not merely ownership or ability to control that is necessarily inherent with ownership. Thus, in jurisdictions adopting the operator theory of liability, unexercised power to control generally will not be sufficient to impose operator liability on a parent corporation.

However, In *United States vs. Best Foods, 118 S. Ct. 1876 (1998)* the United States Supreme Court ruled that a parent corporation may not be liable as an operator for the environmental liabilities of its subsidiary based on its relationship with the subsidiary if such relationship would not warrant piercing the corporate veil. Instead, the court said that the key the question is not whether a parent operates the subsidiary but whether the parent operates the facility. If the parent corporation exercises actual control over the facility, then it may be liable as an operator. However, as in this case, the mere fact that the parent had placed its own key officials on the subsidiary's board of directors, that parent officers' occupied the president and chief executive positions and that these officials exercised day-to-day management of the facility would not expose the parent to operator liability. The court noted that there was a well-established principle of corporate law that directors and officers holding dual positions with a parent and subsidiary can and do "change hats" and that courts presume that directors are wearing their "subsidiary hats" and not their "parent hats" when acting on behalf of the subsidiary. It is up to the government, the court went on, to rebut this presumption and establish that a particular officer may have been acting as an agent of the parent and not the subsidiary.

Because there was some evidence that the parent's environmental and regulatory affairs director may have exerted control over the environmental operations of the subsidiary's plant, the court remanded the case to the district court with instructions to evaluate the role of the parent's environmental officer and any of the parent's other employees who might be said to have played a role in operating the subsidiary's facility.

C. Liability of Lenders

Both RCRA and CERCLA contained a rather short secured creditor exemption when they were originally enacted. There is scant legislative history on the scope of the exemption. The history of the exemption indicates that it was added to the definition of "owner or operator" out of a concern that persons who held mortgages for security of loans or other obligations in so-called "title-theory" states would be treated as CERCLA owners or operators while a mortgage is in effect. In those states where the common law of mortgages applies, mortgagees actually holds title to t[1]he property.[10] The legislative history does not provide any guidance on the types of permissible activities that would be considered to be consistent with the exemption.

The secured creditor exemptions received little attention until the late 1980s when a series of conflicting decisions created much uncertainty in the financial community on the scope of their protection and what actions they could take without losing their immunity to liability. This uncertainty took on particular importance for the Federal Deposit Insurance Corporation ("FDIC") and the Resolution Trust Corporation ("RTC") that were acting as conservators and receivers of failed insured depository institutions under the Federal Institutions Reform, Recovery and Enforcement Act ("FIRREA").[11] The FDIC and RTC became concerned that when they were appointed as receivers or conservators of insolvent financial institutions, they could take title or have security interest in contaminated properties that were in the portfolios of those failed lenders. The exemption also posed a risk to other governmental agencies such as the Small Business Administration who could acquire interests or possession of a diverse range of businesses, properties and assets that might contain contaminated properties.[12]

As a result, EPA promulgated a CERCLA Lender Liability Rule in 1992[13] and a RCRA Lender Liability Rule in 1995.[14] Finally, in 1996, Congress enacted the Asset Conservation, Lender Liability and Deposit Insurance Protection Act ("1996 Lender Liability Amendments") that substantially amended the secured creditor exemptions of CERCLA and RCRA.[15]

The 1996 Lender Liability Amendments added new defined terms and identified the kinds of actions lenders could take without being considered to be participating in the management of a facility as well as the steps that lenders had to follow to foreclose on property and still be considered simply protecting their security interest. Congress made it clear that the 1996 Lender Liability Amendments did not create any liability but instead merely limited liability that might otherwise be present.[16]

The CERCLA secured creditor's exclusion operates to exclude from the definition of "owner or operator" any person who " holds indicia of ownership primarily to protect the security interest" in a vessel or facility will not be liable as an owner or operator if that person does not "participate in the management" of the facility or vessel.[17] This exemption can insulate a secured creditor from liability during the administration of a loan including workouts so long as the lender's actions during the life of a loan do not constitute exercising managerial control over the operations of its borrower.

The exemption also provides limited protection to lenders during foreclosure.[18] However, this memorandum will focus on the pre-foreclosure activities that are permissible under the secured creditor exemption and not discuss what a lender has to do to comply with the foreclosure requirements of the secured creditor exemption.

The RCRA secured creditor's exemption is similar to the CERCLA provision but it is limited to underground storage tanks ("USTs"). The RCRA secured creditor's exemption provides that a lender who has indicia of ownership in a UST system (i.e., one or more USTs) or property containing a UST system will not be liable as an owner or operator of the UST system if: (i) the indicia of ownership is held primarily to protect a security

interest; (ii) the lender does not participate in the management of the UST system, and; (iii) the lender is not engaged in petroleum production, refining or marketing.[19]

The RCRA secured creditor exemption specifically incorporates the definitions and other requirements contain in the CERCLA secured creditor exemption establishing when a lender will not be considered an owner or operator of a facility except that to the extent they only apply to a lender's potential liability as an owner or operator of an underground storage tank. The RCRA secured creditor exemption will not insulate a lender from liability as an owner or operator of a RCRA TSDF or at a generator-only facility.[20]

In addition, the RCRA secured creditor exemption provides that to the extent it is inconsistent with any provisions of the RCRA Underground Storage Tanks ("USTs") Lender Liability Rule, the provisions of that rule will prevail.[21] Our preliminary information is that there are not any material liabilities associated with RCRA-regulated USTs. Accordingly, the RCRA Lender Liability is not addressed in this memorandum. If material liabilities associated with USTs are uncovered during the due diligence period, this memorandum will be updated to discuss the RCRA Lender Liability Rule

It should be noted that the 1996 Lender Liability Amendments only protect financial institutions for liability under CERCLA or RCRA. The secured creditor exemptions do not insulate lenders from liability under other federal laws such as for the cleanup of polychlorinated biphenyls ("PCBs") under the Toxic Substance Control Act.[22] The exemptions also do not claims brought under state environmental laws.

1. Key Definitions of the Secured Creditor Exemption

Before analyzing the scope of the secured creditor exemption, it is important to review some of the key definitions. These terms apply to both the RCRA and CERCLA secured creditor exemptions.

Lender- The secured creditor exemption applies to a broad range of traditional lending institutions[23] as well as any person who:

- Makes a bona fide extension of credit to or takes a security interest from a person not affiliated with the lender;
- Insures or guarantees against a default in the repayment of an extension of credit or who acts as a surety for an extension of credit to a person not affiliated with the lender; or
- Provides title insurance and acquires a vessel or facility as a result of an assignment or conveyance in the course of underwriting claims and claim settlements.[24]

Indicia of Ownership- The legislative history indicated that the purpose of the exemption was to protect lien holders in states where mortgages were considered to have title in the property subject to the security interest. However, in its CERCLA Lender Liability Rule, EPA defined this term more broadly so that it would apply to all lenders regardless if they were located in a "title-theory" or "lien-theory"

jurisdiction. Under the EPA definition, it was not necessary for a person to actually hold title in order to maintain "indicia of ownership. Instead, the term was defined as evidence of a security interest or evidence of an interest in real or personal property securing a loan or other obligation including equitable or legal title in real or personal property acquired incidental to foreclosure or its equivalents. Examples of indicia of ownership set forth in the regulation included mortgages, deeds of trusts, surety bonds, guarantees of obligations, title held pursuant to a lease financing transaction, assignments, pledges and other forms of encumbrances against property that are held primarily to protect a security interest.[25]

The 1996 Lender Liability Amendments did not contain a definition of indicia of ownership. While this term remains undefined in CERCLA and RCRA, EPA has reinstated its CERCLA Lender Liability Rule as an enforcement policy. Thus, for purposes of federal enforcement, the EPA definition would apply. Presumably, a court in a private contribution or cost recovery action might find the EPA interpretation of this term persuasive though EPA's definition would not be binding on a court.

Security Interest- This term includes a right under a mortgage, deeds of trust, assignment, judgment lien, pledge, security agreement factoring agreements, or lease and any other right accruing to a person to secure the repayment of money, performance of a duty, or any other obligations by a non-affiliated person. [26]

Participation in Management- A lender holding indicia of ownership primarily to protect a security interest in a facility or vessel will not be liable as a CERCLA owner or operator during the term of a loan if it does not participate in the management of that facility. The 1996 Lender Liability Amendments added a list of permissible activities commonly taken by lenders that are considered consistent with the exemption and therefore do not constituent "participation in management".

CERCLA specifically provides that a lender who holds indicia of ownership primarily to protect a security interest shall be considered to participate in management if a lender does the following while the borrower is in possession of the property encumbered by the security interest:

- Exercises decision-making control over the borrower's environmental compliance, such that the holder has undertaken responsibility for the borrower's hazardous substance handling or disposal practices; or
- Exercises control at a level comparable to that of a manager of the facility or vessel so that the lender has assumed or manifested responsibility for the overall management of the day-to-day decision-making at the facility with respect to environmental compliance, or overall or substantially all of the operational aspects functions of the facility or vessel. [27]

If the lender meets the two-prong test for not participating in management, the CERCLA secured exemption provides that the lender may take the following nine actions and not be deemed to have participated in management:

- Holding, releasing or abandoning a security interest;
- Including environmental compliance covenants, warranties or other environmental conditions in an security agreement or extension of credit[28];
- Monitoring or enforcing any terms or conditions of a security agreement or extension of credit;
- Monitoring or undertaking any inspections of the collateral;
- Requiring the borrower to take response actions to address releases of hazardous substances;
- Providing financial or other advice or counseling to mitigate, prevent or cure default or diminution of the value of the collateral;
- Restructuring, renegotiating or otherwise agreeing to altering terms and conditions of a security agreement or extension of credit,
- Exercising forbearance of any rights;
- Exercising any remedies that may be available under applicable law for breaches of security agreements or extensions of credit; and
- Conducting a response action under CERCLA in accordance with the National Contingency Plan or under the direction of an on-scene coordinator.[29]

Financial or Administrative Functions- A lender may engage in financial and administrative actions during the life of a loan without being deemed to be an owner or operator under CERCLA. Examples of financial or administrative functions set forth in the secured creditor exemption include actions performed by a credit manager, accounts payable officer, accounts receivable officer, personnel manager, comptroller, or a chief financial office. [30]

Primarily To Protect the Security Interest- This term was undefined in the original versions of RCRA and CERCLA. EPA did provide its own interpretation of that phrase when it proposed the CERCLA Lender Liability Rule in 1991. The agency said the primary purpose of the security interest must be to secure repayment of money, the performance of a duty or some other obligation and does not include interests in the nature of an investment in the facility or an ownership interest held for any other reasons other than to protect a security interest.[31] Nevertheless, EPA did recognize that lending institutions have revenue interests in their loans so the mere fact that a secured creditor derives some profit or income from the transaction will not cause the lender to forfeit its immunity so long as the security interest is primarily to secure repayment of a loan or performance of some obligation. [32] The agency said the protection of a security interest does not necessarily have to be the sole reason for the transaction.

When a person holds indicia of ownership in a facility primarily for investments purposes as opposed for assuring repayment of a loan or as security for some other obligation, EPA said the exemption would not apply.[33]

The final CERCLA Lender Liability Rule promulgated in 1992 indicated that the lender's motivation was irrelevant for purposes of determining whether it "participated in the management of a facility" but was relevant in determining why the lender held its indicia of ownership.[34] EPA went on to say that the fact that a lender has a secondary reason for holding the security interest (e.g., investment purpose) would not void the exemption.[35] Thus, a secured creditor can still generate profits such as interest and fees without forfeiting its immunity from liability so long as the lenders primary purpose was to protect its security interest.

The 1996 Lender Liability Amendments did not contain a definition of primarily to protect a security interest. Again, while this term remains undefined in CERCLA and RCRA, EPA has reinstated its CERCLA Lender Liability Rule as an enforcement policy. Thus, for purposes of federal enforcement, the EPA definition would apply. Presumably, a court in a private contribution or cost recovery action might find the EPA interpretation of this term persuasive though EPA's definition would not be binding on a court.

PART V
ENVIRONMENTAL DISCLOSURE AND DUE DILIGENCE

A. OVERVIEW OF DISCLOSURE REQUIREMENTS

The Securities Act of 1933 requires regulated companies to register their securities prior to offering them to the public. The Securities Exchange Act of 1934 requires registrants to file periodic reports disclosing information that would be material to investment decisions. The principal purpose of the 1933 Act is to protect offerees of publicly traded securities while the 1934 Act is primarily oriented towards protecting secondary market trading. The United States Security and Exchange Commission (SEC) is empowered to promulgate rules to implement the provisions of these laws. For much of the first 50 years following the enactment of the two securities acts, the SEC took the position that differing objectives of the two laws made it difficult to implement common disclosure requirements. However, the SEC eventually adopted an integrated disclosure system, which is contained in Regulation S-K. These regulations set forth non-financial disclosure guidelines for annual reports (Form 10-K); quarterly reports (Form 10-Q); and episodic reports (8-K).

Additional environmental reporting obligations may also exist under the Williams Act for tender offers and the Financial Accounting Standards Board (FASB), which has established standards for disclosing "loss contingencies" Finally, section 10(b) of the 1934 Securities Act and Rule 10b-5 prohibit the making of false statements or omissions in connection with the purchase or sale of securities. Registrants who fail to make the required disclosures or fail to make amendments to prevent prior disclosures from becoming misleading can be subject to civil or criminal enforcement actions. Moreover, shareholders and investors may bring private actions against registrants for losses caused

by misleading statements or omissions of material information.

1. SEC Disclosure Requirements

The SEC environmental reporting requirements are set forth in three sections of Regulation S-K in Items 101, 103 and 303. In 1989, the SEC clarified the environmental disclosure requirements in Securities Act Release ("SAR") 6835*(Release No. 33-6835, 54 FR 22427 (May 24, 1989))* . In addition, Staff Accounting Bulletin No. 92 (SAB 92)*(58 FR 32843 (June 14, 1993))* provides further guidance on identifying and reporting contingent environmental losses.

a. Item 101

The first SEC environmental reporting obligation appears in Item 101 *(17 CFR 229.101).* This section requires the registrant to describe the "material" effects that compliance with federal, state and local environmental laws regulating the discharge of materials into the environment will have on earnings, capital expenditures and the competitive position of the company and its subsidiaries.

Courts have generally interpreted the "materiality" requirement to mean that a company must disclose information if there is a substantial likelihood that a reasonable investor would have found the omitted information important or that the missing facts would have altered the "total mix" of information available to the investor.

Normally, capital expenditures estimates need only be made for two years. However, the SEC has indicated that estimates for additional years should be made if necessary to prevent the disclosed information from being misleading or if the registrant reasonably believes those future costs would be materially higher than the disclosed costs. *SAR 6130 (Sept. 27, 1979)* In *Levine v. N.L. Industries, 926 F.2d 199 (2d Cir. 1991)* the Second Circuit ruled that Item 101 not only required disclosing estimates of compliance costs but also potential fines for non-compliance if such fines were material.

Item 101 can pose particular difficulty to registrants as environmental statutes are enacted or amended to create new or expanded future obligations. For example, a registrant may know that it will have to incur compliance costs in the future under the Clean Air Act to comply with more stringent air emissions standards. However, it may be difficult to determine the effect future expenditures will have on the capital expenditures, earnings and competitive position of the company because the regulations establishing the particular emissions standards will not be developed for a few more years.

b. Item 103

Item 103 requires registrants to describe any material concerning pending legal proceedings unless the legal proceedings involve ordinary routine litigation incidental

to the business. (*17 CFR 229.103.)* The scope of the disclosure obligation under this section is somewhat vague because some of the elements of this requirement have not been fully articulated by either the SEC or the courts.

For example, the term "legal proceeding" is undefined. In 1979, the SEC took the position that the term included administrative orders involving environmental matters even if the orders are not a result of formal proceedings. However, it is uncertain from this interpretative release if there is a duty to disclose notices of violations of PRP notices. At least one court, however, has disagreed with the SEC and suggested that the issuance of a notice of violation does not automatically constitute a disclosable "proceeding" since such notices often lead to negotiated settlements.

In SAR 6835, the SEC indicated that a PRP notice does not automatically qualify as a "proceeding" that must be disclosed. However, the SEC went on to say that the particular circumstances of the registrant coupled with the PRP status might give knowledge to the registrant that the government was contemplating a proceeding so that disclosure would be required.

In Instruction 5 to Item 103, the SEC adopted the position that an administrative or judicial proceeding commenced or that is "known to be contemplated" by the government under environmental laws regulating the discharge of materials into the environment will not qualify for the "ordinary routine litigation incidental to the business" exception and must be disclosed if one of the three following conditions are met:

- The proceeding is material to the business or financial condition of the company, or
- The proceeding involves a claim or potential monetary sanctions, capital expenditures, deferred charges or charges to income that will exceed 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis, or
- A government body is a party to the proceeding and the proceeding involves potential monetary sanctions, unless the registrant reasonably believes that the sanctions will be less than $100,000.

In calculating the costs for the criteria identified in Instruction 5, the SEC has indicated that remedial costs incurred pursuant to a remediation agreement are considered either charges to income or capital and not monetary sanctions. Thus, remediation costs do not have to be included in the estimate required for subsection 5(C). Furthermore, the availability of insurance, contribution or indemnity is relevant in determining if the disclosure criteria for 5(A) and (B) have been met.

c. Item 303

The third principal source for environmental disclosures is Item 303 *(17 CFR 229.303)*, which is also known as Management Discussion and Analysis (MD&A).

Under this section, management is required to prepare a narrative report discussing liquidity, capital resources, results of company operations and any other information necessary to provide investors with an understanding of the registrant's financial condition. The aim of the MD&A is to give investors an opportunity "to look at the registrant through the eyes of management by providing a historical and prospective analysis of the registrant's financial condition and results of operation . . ." *(SAR 6835, 54 FR at 22, 436)*

The principal difference between Items 101 and 303 is that the MD&A has a discussion on the registrant's future prospects. Management is required to disclose any "known trends . . . events or uncertainties" known to management "reasonably likely" to have a material effect on the registrant's financial condition or operating results. The requirements under Item 303 are intertwined with the kinds of information contained in the registrant's financial statements.

For a number of years, the SEC has been concerned that the narrative descriptions in the MD&A have not adequately disclosed the extent of environmental liabilities. As a result, in the late 1980s, the SEC conducted a comprehensive review of MD&A disclosures that had been submitted by registrants in selected industries. Based on this review, the SEC issued SAR 6835 in 1989, in which the SEC set forth its interpretation on the kinds of information required to be reported under Item 303.

Instruction 3 to Item 303 states that in preparing the MD&A, management should focus on material events or contingencies that would cause reported financial information not to be necessarily indicative of future operations or of future financial conditions. *(17 CFR 229.303, Instruction 3).* SAR 6835 says that in determining whether to disclose a known trend, event or contingency, management must use the following two-prong test:

- Is the known trend, etc. reasonably likely to occur? If management determines that it is NOT reasonably likely to occur, no disclosure is required.
- If management cannot make the determination that the uncertainty is not reasonably likely to occur, management must objectively determine if it will have a material effect on the registrant's financial conditions or operating results.

In determining if an uncertainty is "material" the standard followed by the courts is that for a matter to be material, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available." *(TSC Industries v. Northway, Inc., 426 U.S. 438 (1976).*

Because of the uncertainties involving environmental liabilities, management may encounter difficulty if a known uncertainty is not reasonably likely to occur. To assist management, the SEC provided two illustrations of the MD&A requirements for environmental issues in SAR 6835.

The first example involved anticipated environmental compliance costs where legislation or regulations are proposed. The Company had no firm cash commitments as of December 31, 1987 for capital expenditures. However, in 1987, legislation was enacted which may require that certain vehicles used in the Company's business be equipped with specified safety equipment by the end of 1991, Pursuant to this legislation, regulations have, been proposed which, if promulgated, would require the expenditure by the Company of approximately $30 million over a three year period. Under this example, registrants are required to disclose environmental compliance costs associated with proposed regulations. *(54 FR 22,430)*

Another difficult question is how to handle potential cleanup costs under CERCLA when the registrant receives a PRP notice. Under the two-prong test contained in SAR 6835, if management cannot determine that the liability is not reasonably likely to occur, the potential liability must be disclosed unless management can establish that the liability will not be material. However, since liability is both joint and several, management has struggled over how to determine if there is material liability. May management include in its materiality evaluation, for example, the possibility of insurance or contribution from other PRPs?

In the second example contained in SAR 6835, a registrant received PRP notices for three sites where there were multiple PRPs but the ability to obtain contribution or insurance coverage was unknown. Furthermore, the extent of the cleanup was not known so management could not determine at the time if this liability would have a material effect on the company's financial condition or operating results. Under this scenario, the SEC said that disclosure would be required under Item 303 although it might not be required under Items 101 or 103. (*Id. at n.30)*

However, the SEC went on to say that the availability of insurance or contribution may be factors that could be used to determine if the event would have a material effect on the financial condition of the registrant. The SEC has said both in SAR 6835 and SAB 92 that in assessing joint and several liability, registrants should consider such facts as the periods in which contribution or indemnification claims will be realized, the likelihood that such claims will be contested and the financial condition of the third parties from whom recovery will be sought.

d. Quantifying Contingent Liabilities

A related issue to the SEC disclosure requirements is when must a company recognize environmental liabilities as a contingent loss and how are they to be calculated in the company's financial statement or balance sheets. The SEC Commissioner said in 1993 that the failure of publicly owned companies to accrue environmental liability on their financial statements was of great concern to the SEC.

Under Financial Accounting Standards Board Statement No. 5 ("SFAS 5"), which was published in 1975, estimated losses from loss contingencies must be charged to income on the balance sheet if it is probable that a liability has been incurred and it is

reasonably estimated. SFAS 5 defines a loss contingency as:

an existing condition, situation, or set of circumstances involving uncertainty as to possible ... loss ... to an enterprise that will ultimately be resolved when one or more future events occurs or fails to occur. Resolution of the uncertainty may confirm the ... impairment of an asset or incurrence of a liability.

Paragraph 8 of SFAS 5 requires companies to recognize or accrue an estimated loss from a loss contingency by a charge to income on their balance sheets when both of the following conditions are met:

- Information available prior to the issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements; and
- The amount of the loss can be reasonably estimated.
-

After the development of SFAS 5, there was some confusion regarding probable losses that could not be precisely estimated. Some companies provided a range of losses while others took the more aggressive posture that the losses were not reasonably estimable and, therefore, did not have to be accrued because they did not fit the second prong of SFAS 5.

As a result, the Financial Accounting Standards Board issued Interpretation No. 14 (FIN 14) in 1976. FIN 14 indicated that it was inappropriate to delay accrual of a loss until only a single amount can be reasonably estimated. If the particular loss contingency and the reasonable estimate of the loss fell within a range, FIN 14 said that a company should recognize the number within the range that represents the better estimate. When no amount within the range is a better estimate than any other amount, FIN 14 stated that the minimum amount should be accrued. SAB 92 specifically endorsed this interpretation.

SFAS 5 does not resolve the dilemma, however. Because of differing legal and accounting standards, there often may be a tension between lawyers and accountants in transactions involving publicly owned registration statements on the duty of reporting of environmental liabilities in registration statements and financial statements. Lawyers performing environmental due diligence may come to develop estimates of potential environmental liabilities based on statutory liability and practical experience that can far exceed the kinds of loss contingencies accountants believe are required to be accrued and disclosed. Furthermore, when a multi-plant company sells a business, which will be vacating a leased facility that it previously operated, SFAS 5 may not require the accountants to include the liability associated with the facility since that asset is not being transferred. However, the business being transferred might have CERCLA liability as an operator of the facility so the environmental attorney performing due diligence will want to include liabilities associated with that facility.

Another important issue is whether contingent environmental liability can be offset in financial statements and the MD&A to take into account claims for recovery from insurance policies and other parties. Some registrants have historically offset environmental liabilities with potential claims. Some registrants have used this tool to reasonably estimate their potential exposure but then presume the maximum possible recovery without considering the viability of the third party or the validity of its insurance coverage. Registrants have also used the offsets to mask their management estimates of liability to discourage lawsuits from third parties or to assist in settlement negotiations.

In SAB 92, the SEC Division of Corporation Finance and the Office of the Chief Accountant (the SEC Staff) agreed that while potential sources of recovery, such as insurance, contribution and indemnification, may be factored into the determination of whether there is a material event that is reasonably likely to occur, a different standard applies for reporting loss contingencies. SAB 92 indicated that pursuant to FIN 39, losses arising from recognized environmental liabilities ordinarily may not be offset or reduced by potential claims for recovery but instead should be listed separately as a gross liability. However, if the claim is probable of realization or likely to occur so that it effectively amounts to a right or setoff, then the environmental claim could be reduced by the amount of the potential claim. SAB 92 cautioned that registrants who offset liabilities with a claim for recovery will be expected to report an increase in total reported assets.

When the registrant is a PRP at a site and there is a reasonable basis for apportioning the costs among the other PRPs, SAB 92 took the position that it is not necessary to include the costs apportionable to other PRPs. However, if it is probable that other PRPs may not fully pay their apportioned costs because they are insolvent or liability is disputed, the registrant must include an estimate of those additional costs of the orphan shares it may have to pay before considering potential recoveries from third parties. In estimating such liability, the registrant should use not only use site-specific information, but also rely on past experience with other sites and data compiled by the EPA. Where a specific remedy has not yet been selected, the registrant should use estimates for the kinds of remedies that may be available.

A major theme of SAB 92 was to ensure that registrants provide investors with meaningful disclosures. SAB 92 indicated that the disclosures must enable a reader to fully understand the scope of the contingencies affecting the registrant. For example, when discussing historical and anticipated environmental expenditures, SAB 92 indicated that registrants should discuss the following to the extent they are material: (1) recurring costs associated with managing hazardous substance and pollution in ongoing operations; (2) capital expenditures to limit or monitor hazardous substances or pollutants; (3) mandated expenditures to remediate previously contaminated sites; and (4) other infrequent or non-recurring cleanup expenditures that can be anticipated but are not presently required. The SEC Staff also said that disaggregated disclosures describing accrued and reasonably likely

losses for particular sites may be necessary for a full understanding of the contingency if the site is individually material.

To prevent financial statements from being misleading, SAB 92 said that for both recorded and unrecorded environmental liabilities, the registrant should provide detailed disclosures regarding the judgments and assumptions that were used to evaluate the underlying environmental liability. SAB 92 outlined the kinds of assumptions that need to be disclosed:

- Circumstances affecting the reliability and accuracy of loss estimates;
- The extent that unasserted claims are reflected in accruals or may affect the magnitude of the contingency;
- Uncertainties regarding joint and several liability that may affect the magnitude of the contingency. The aggregate remedial costs for sites that are individually material should be disclosed if the likelihood of contribution cannot be established;
- Nature and terms of any PRP cost-sharing arrangements;
- The extent that disclosed but unrecognized contingent losses may be offset through insurance, indemnification or other sources and any material limitations on those recoveries;
- Uncertainties regarding sufficiency of insurance coverage or solvency of insurance carriers;
- Time frames for the payment of accrued or presently recognized losses;
- Material components of any accruals and significant assumptions for the underlying estimates. These disclosures should be specific enough to enable a reader to completely understand the scope of the contingencies that may effect the registrants.

SAB 92 cautioned that a statement that the contingency is not is expected to be material does not satisfy the requirements of SFAS 5 if there is a reasonable possibility that a loss exceeding amounts already recognized may have been incurred and the additional loss would be material. In such a case, the registrant must either (1) disclose the additional loss or (2) state that the estimate cannot be made.

SAB 92 also contained specific disclosure requirements for certain kinds of environmental liabilities. For example, SAB 92 stated that closure and post-closure costs, as well as other site restoration expenses that may be required upon the sale or abandonment of property, should be disclosed in financial notes. These disclosures should include the nature of the costs, total anticipated costs, total accrued costs to date, balance sheet classification of accrued costs and range of or amount of reasonably possible additional costs. Furthermore, if an asset must undergo remediation upon its sale or prior to development, the registrant must make a disclosure indicating how these costs were considered in evaluating the asset's net realizable value.

In addition, SAB 92 stated that registrants should also disclose liabilities associated with assets or businesses previously disposed of unless there is only a remote

likelihood of an unfavorable material outcome.

Finally, the SEC has apparently cautioned management that good faith judgments regarding liability estimates for purposes of determining disclosure obligations will provide no defense to SEC violations if the judgment is deemed to be unreasonable by the SEC. Management's disclosures will be judged objectively under the circumstances existing at the time. However, a good faith judgment will not be a defense if the SEC subsequently determines that the registrant's determination was unreasonable. Furthermore, when making a first-time disclosure, SEC may look backwards to prior filings and determine that sufficient information existed at an earlier time to warrant disclosure under Item 303 and, therefore, find that a disclosure violation occurred.

2. Disclosure Obligations under Rule 10b-5

Registrants may be liable to stockholders and investors under Rule 10b-5 for material misstatements or omissions made in connection with the purchase or sale of a security. Rule 10b-5 provides as follows:

It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national exchange,
(a) To employ any device, scheme, or artifice to defraud,
(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. (17 CFR 240.10b-5)

Liability may be imposed on a registrant even where mandatory disclosure is not required under Regulation S-K. Since Rule 10b-5 creates another layer of disclosure obligations, management must consider the scope of this rule when evaluating the extent of its environmental disclosure.

The basic elements of a Rule 10b-5 cause of action are that the defendant must knowingly fail to disclose or misstate material facts that the plaintiff has relied upon and that have caused the damage or loss suffered by the plaintiff in connection with the purchase or sale of securities. However, the key factor leading to a duty to disclose under Rule 10b-5 is that the omitted or misleading information be material. Courts will employ the "probability/magnitude test" for determining materiality under Rule 10b-5, which requires a "balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in the light of the company activity."

Unlike Regulation S-K, there are no interpretative release or other agency guidance to

help management determine what is an adequate disclosure under Rule 10b-5. Because of this uncertainty and the potential liability under Rule 10b-5, management is often prompted to make environmental disclosures that go beyond those imposed by Regulation S-K.

3. Case Law Involving Environmental Reporting Requirements

There have been only a handful of judicial or administrative cases interpreting the SEC environmental reporting obligations. None of the cases involving the SEC reporting requirements have involved interpretations of SAR 6835 or SAB 92 so it is unclear what precedential value the existing case law will have on future registrants or what weight courts will attach to the recent SEC interpretations of the environmental reporting obligations. These documents have tightened the reporting obligations for environmental liability.

In *In re United States Steel Corp.(1979-80 Transfer Binder, Fed. Dec.L.Rep. (CCH), 82,319),* the SEC brought an administrative action because the company had failed to disclose estimates of future material expenditures ranging from $1 billion in Form 10-K that were necessary to meet environmental compliance. The company also failed to disclose certain environmental proceedings and the risks of its policy in order to delay as much as possible capital expenditures for environmental compliance.

In *In re Occidental Petroleum Corporation(1980 Transfer Binder, Fed. Dec.L.Rep. (CCH), 82,622),* the SEC claimed that Occidental failed to adequately disclose the liabilities its subsidiary faced at Love Canal. The disclosure stated that "there can be no assurance that Occidental will not incur material liabilities in the future as a consequence of the impact of its operations upon the environment."

The most significant case to date regarding the scope of SEC environmental reporting obligations was *Levine v. NL Industries(926 F.2d 199 (2nd Cir. 1991)).* Although the case was decided in 1991, it did not involve the most recent SEC interpretation reflected in the 1989 SAR 6835 since the case involved filings that had been made prior to the issuance of the SAR.

In that case, a shareholder brought a Rule 10b-5 class action suit alleging, inter alia, that NL had failed to disclose that its subsidiary, NLO, Inc., had operated a Department of Energy (DOE) uranium processing plant in violation of environmental laws. NLO had been operating a DOE plant located in Fernald, Ohio from the early 1950s to December 31, 1985. The DOE contract with NLO provided that NLO was entitled to be reimbursed for all costs, losses and expenses arising out of its management of the Fernald facility that did not result from willful misconduct or lack of good faith by the directors, officers or the supervising representatives of NLO. NL itself never operated the facility but guaranteed NLO's performance to the DOE.

During the class period (January 27, 1982 to December 10, 1984), NLO's share of NL's gross revenue never exceeded 0.2 percent. For each of the 10-K reports filed

during the class period, NL stated that "NL's wholly-owned subsidiary, NLO, Inc., is the contract operator for the U.S. Department of Energy of the uranium ore concentration plant at Fernald, Ohio."

In addition, five general statements appeared in each of the 10-K reports filed during the class period. Under the heading "Properties," NL said that "its plants are all in good operating condition. . . ." Under the heading "Legal Proceedings," there were four statements involving environmental matters. The first indicated that NL had continued to implement environmental control programs designed to ensure compliance with governmental workplace and environmental standards. The second statement indicated that the major environmental issues facing the company were addressed below. The third statement noted that one or more NL plants were subject to environmental enforcement from time to time, that the issues raised in these matters were usually resolved in discussions with environmental authorities, that these meetings occasionally resulted in the establishment of compliance programs and the payment of penalties and that the penalties did not have a material effect on NL's sales and profits. The fourth statement indicated that the company could not predict the precise nature of future regulations and the costs associated with such compliance and the environmental problems that might arise in the future. However, NL said that it did not believe there would be any significant curtailment or interruption of any of its important operations as a result of any failure to comply with present or future environmental laws.

On the last day of the class period (December 10, 1984), it was announced that there had been an accidental emission of uranium dust at the plant. Lawsuits were subsequently filed in 1985 by a group of adjacent landowners and by the State of Ohio in 1986. The plaintiff argued that NL had a duty to disclose under Item 101 because NLO was operating in violation of environmental law and also because the company's prior statements in its 10-K forms had been misleading. The plaintiff also alleged that NL had failed to disclose under Item 103 the filing of a notice to sue under its water discharge permit.

The district court found that NL did not have a duty to disclose under Item 101 because any non-compliance would not have a material effect on NL due to the DOE indemnity. Likewise, the court found that NL had complied with Item 103 because it had revealed the class action suit in the 1984 10-K and that NL had no information that Ohio was contemplating an enforcement action under NLO's clean water permit.

The court also held that none of the general environmental statements were misleading. The court said that a misleading statement is one that conveys a false impression and the test was whether a reasonable investor would get the impression based on the statements that NLO was operating the Fernald facility in compliance with law. The court said that it was clear that the statement regarding the compliance of the plants referred to NL plants, and not the NLO facility. Furthermore, the court felt that a reasonable investor would not have interpreted the statements in the "Legal Proceedings" section to include Fernald since it was clear there were no legal

proceedings filed or contemplated against the Fernald facility during the class period.

On appeal, the Second Circuit did not address the lower court's interpretation of Item 103 and only tangentially touched on the Item 101 analysis when it rejected that court's finding that costs of violations did not have to be included in the capital expenditures disclosure. The appellate court also did not reach the plaintiff's allegation that the general environmental statements in the 10-K filings had been misleading.

Instead, the Second Circuit simply focused on whether NL had a duty to disclose the environmental violations at Ferndale and whether such undisclosed information was material. Relying on the materiality requirement of Rule 10b-5, the court found that the failure to disclose environmental violations was immaterial because DOE had agreed to indemnify NLO. The court noted that the DOE, in a 1987 report, had found no basis for not honoring the indemnity. Since, in the court's view, there was no plausible way that NL shareholders could suffer financially from the consequences of the environmental violations, a "reasonable investor would not consider NL's asserted violations of environmental law important information significantly altering the total mix of information made available to the investor."

Two cases involving tender offers are also illustrative of how courts may view failures to disclose environmental liabilities. In *Grumman Corp. v. LTV Corp., 527 F. Supp 86 (E.D. N.Y. 1981)* the plaintiff obtained an injunction because LTV had failed to include projected environmental expenditures in its offer to purchase even though the estimated costs had been included in the financial statements filed with the SEC. The financial statements had indicated that LTV would probably have to expend between $185-240 million. The court found that these amounts were substantial and would have been important information to shareholders in determining whether to accept the tender offer. As a result, the court held that the failure to discuss these liabilities in the offer to purchase was an omission of material facts.

In *Crouse-Hinds v. InterNorth, Inc., (518 F.Supp. 416 (1981))*a target company seeking to enjoin a takeover argued, inter alia, that the defendant's tender offer failed to disclose potential material environmental liabilities and contemplated governmental proceedings as required by the SEC reporting requirements. The environmental liabilities that the plaintiff alleged should have been disclosed were $55 million in remediation costs for a gypsum pond and some notices of violation issued by the EPA and the Illinois EPA. Although the court ruled that the particular SEC requirements did not apply to this case because they were not applicable to tender offers, its analysis of those matters was illustrative. The court found notices of violations are typically settled and that settled environmental litigation had little significance to the typical investor. Furthermore, the court found no evidence that there was presently any liability for the gypsum pond that would result in material damages, fines or penalties that had not been disclosed.

B. PRESERVING CONFIDENTIALITY OF ENVIRONMENTAL AUDITS

Regulatory authorities and neighboring parties who have filed a toxic tort action may seek to use environmental audits as evidence of the existence of contamination or unlawful practices. In some cases, the information contained in the audits could be used to establish knowing violations that could lead to criminal liability. Since government prosecutors and private plaintiffs may seek disclosure of environmental reports during discovery, parties performing environmental due diligence should consider taking steps to protect the confidentiality of these environmental reports

1. Common Law Privileges

There are essentially three privileges that an attorney could try to invoke to protect the confidentiality of environmental reports. Each of these privileges must be affirmatively asserted or it may be waived. Furthermore, because they are exceptions to the rules of evidence favoring full disclosure, courts will narrowly construe the privileges.

A. Attorney-Client Privilege-This privilege protects confidential communications between an attorney and the client. The intent of the privilege is to encourage a client to fully and freely communicate with the attorney. The privilege extends to communications rendering legal advice that are made at the request of the client. Generally, the underlying facts in a report are not privileged although an attorney can try to extend the privilege to the facts by carefully interweaving the facts into the legal analysis.

However, merely labeling a document as privileged will not necessarily create the privilege. Courts often take a functional approach to a document and try to determine if the primary purpose of the report was to obtain legal advice. For example, in U.S. v. Chevron, periodic environmental status reports were found not to be privileged even though an attorney had been part of the three-member team that had conducted the audits. The court ruled that the primary purpose of the reports were not to enable the attorney to provide legal advice to the client but to evaluate compliance with the Clean Air Act.

The limitations of the attorney-client privilege for in-house counsel were also illustrated in Georgia-Pacific Corp. v. GAF Roofing Manufacturing Corp. In this case, an in-house lawyer for the defendant negotiated the environmental provisions of a contract to sell certain assets to the plaintiff. When the parties could not agree on the environmental liabilities to be assumed by the purchaser, the defendant terminated the agreement. Plaintiff filed a breach of contract action and sought to depose the in-house environmental counsel about certain recommendations the attorney had made to the defendant's management. The defendant asserted the attorney-client privilege but the court ruled that the privilege did not extend to lawyers acting as negotiators of business transactions nor to the communications with management about the contract negotiations. The court said the plaintiff was entitled to know what environmental

matters the in-house environmental counsel believed were covered and the exposure faced by the defendant as a result of the negotiations in order to evaluate if the defendant as a matter of business judgment had agreed to assume certain environmental risks. As a result, the court ordered the in-house counsel to testify.

b. Work-Product Privilege-This rule applies to materials collected or prepared by an attorney in anticipation of litigation. In some respects, this privilege is broader then the attorney-client privilege because it extends beyond oral or written communications to such things as memorandum, photographs, drawings, and even computer-generated data. Like attorney-client communications, opinion work product (mental impressions, opinions, reasoning, and conclusions of the attorney) are given absolute protection from disclosure. However, "ordinary" work product is only a qualified privilege and may be subject to disclosure if a court finds that another party may suffer undue hardship.
The requirement that the material is prepared in anticipation of litigation does not require that the litigation must actually have been commenced or that it is imminent. However, it should be more than a remote possibility. Furthermore, the litigation is not limited to judicial proceedings but may also extend to administrative proceedings.
Finally, the privilege does not extend to materials prepared in the "ordinary course of business." This limitation may make it more difficult to cloak periodic and voluntary audit reports under the attorney-work product privilege. Thus, it is important for an attorney to become involved early in a matter to demonstrate that litigation was anticipated and that the reports were prepared in preparation for litigation.

c. Self-Evaluation Privilege-This is a recent judicially-created privilege designed to encourage companies to evaluate and correct noncompliance with laws by subjecting the information collected to a privilege. However, many courts have refused to apply the privilege if nondisclosure will impede enforcement of environmental laws, especially where Congress has imposed extensive reporting requirements.

In Reichold Chemicals, Inc. v. Textron *(No. 92-30393-RV(N.D. Fla. 1994)*, in which this author was involved, a federal court extended the doctrine of self-critical analysis for the first time to environmental reports. In that case, the plaintiff sought recovery of remediation costs from prior owners and operators of its facility. The defendants sought discovery of the groundwater investigation conducted by the plaintiff in the hope that the groundwater reports would show that the contamination was at least partially the fault of the plaintiff. The court ruled that the doctrine of self-critical analysis could be applied to studies involving past conditions but would not extend to studies designed to uncover possible future problems. This case was important as a precedent but its usefulness will hinge on the particular facts of a case since the party advocating the privilege will have to show that the reports were intended to study the past effects of pollution. At many sites, it may be difficult to distinguish retrospective studies from prospective studies. In addition, since this case involved private parties, it is unclear if another court will extend the privilege to situations where the government is seeking the documents.

2. EPA Environmental Audit Policy

As the use of environmental compliance audits has grown, the regulated community has become increasingly concerned over how the information contained in these reports will be used by the governmental regulatory agencies, environmental organizations, citizen groups, and other private litigants. Environmental compliance audits can serve many useful purposes. They can help companies identify health and safety risks, assess the effectiveness of corporate environmental programs, improve personnel training and environmental awareness, and prioritize corporate resources available for environmental compliance or implementation of pollution prevention programs. However, the possibility that this information could be used by regulatory agencies or private citizen groups can discourage companies from implementing environmental auditing programs.

To encourage the regulated community to voluntarily discover, disclose, and correct environmental violations, the EPA has issued a series of environmental auditing policies while encouraging the use of self-policing environmental audits. The first EPA Environmental Policy was issued in 1986 *(51 FR 25004, July 9, 1986)* and essentially defined what constituted an acceptable environmental audit as well as stating that the agency would not routinely request audit reports. However, the agency expressly reserved its rights to view any information that it would otherwise be able to obtain under the various reporting requirements of other environmental statutes when the agency determined that this information was necessary to accomplish its statutory mission. The agency did state that it would take into account a company's auditing program when calculating an appropriate penalty for violations.

Following the 1986 Environmental Auditing Policy Statement, the Department of Justice published a guidance document of its auditing policy in 1991. In this document, the DOJ said the existence of self-auditing procedures and voluntary disclosure would be viewed as a mitigating factor in criminal enforcement matters. The policy also stated that environmental audits could not be relied upon to create a right or otherwise limit the litigative prerogatives of the DOJ or EPA. Indeed, when some states began enacting environmental privilege statutes, the DOJ suggested it might challenge those statutes.

Two years later, the Final Draft Environmental Sentencing Guidelines were issued. These provided for mitigation of sentences when courts found that an environmental compliance program meeting certain criteria had been in effect. In 1994, the EPA's Director of Criminal Enforcement issued a guidance document stating that the agency would not refer for criminal enforcement violations voluntarily revealed and promptly corrected as part of a company's comprehensive environmental auditing program.

As states began enacting their own environmental auditing privilege statutes and as federal legislation began working its way through Congress, the EPA announced in 1994 that it would reevaluate its policies towards environmental auditing. Shortly

thereafter, the EPA issued its 1994 Restatement of Policies Related to Environmental Auditing *(59 FR 38455, July 28, 1994)*. This restatement was not intended to change any existing EPA policies, but was issued under the belief that there was widespread confusion in the regulated community as to the agency's policy towards environmental auditing and voluntary disclosure.

The EPA its final environmental auditing policy statement was issued in December 1995 *(60 FR 66706 Dec. 22, 1995)*. Under this policy, EPA said it would not seek gravity-based penalties for violations uncovered during the performance of an environmental audit or other acceptable environmental due diligence program if the company meets nine specified conditions. Gravity-based penalties are assessments based on the seriousness of the violation and not on the economic benefit gained from non-compliance. If the company can satisfy the second through the ninth conditions, EPA would reduce the penalty by 75%. To provide additional incentives for self-policing, the EPA stated that it reduced penalties by 75% for violations that are voluntarily discovered as well as promptly reported and corrected even where the company cannot document the existence of an acceptable due diligence program. The agency reserved its right to recover any economic benefits gained as a result of non-compliance.

The agency also indicated it will not recommend criminal prosecution for violations uncovered during environmental auditing or due diligence when the company satisfies all nine conditions of the policy. Since violations that cause serious harm or pose imminent and substantial endangerment to human health or the environment are not covered by the policy, EPA could recommend criminal prosecution for such violations. Moreover, the policy will not apply where corporate officials are consciously involved in or willfully blind to violations or conceal or condone non-compliance. The agency also clarified that when a company has satisfied the conditions for avoiding recommendation for criminal prosecution, the EPA will not levy any gravity-based penalties.

The policy does not apply to acts by individual managers or employees of a company. Thus, while a business owner or a plant manager who reports a violation may help to protect their employer, the disclosure could possibly expose the individual to criminal liability if the government could show that the individual was responsible for the violation. It is difficult to see how individuals will be motivated to report violations when they could face potential civil or criminal liability.

It should be emphasized that while the policy can operate to free a company from gravity-based penalties and from the fear of criminal prosecution, it will not relieve a company from the costs of correcting the violation.

EPA also reaffirmed its long-standing policy to refrain from routine requests for audits. However, the agency did indicate that if it has independent evidence of a violation, it may seek information contained in audits to establish the nature and

extent of the problem and the degree of culpability.

Following are the nine conditions that companies must satisfy to reduce or eliminate gravity-based penalties under the EPA auditing policy:

- Discovery of the Violation Through an Environmental Audit or Due Diligence. The information must be obtained through an environmental audit that satisfies the criteria set forth in the 1986 policy statement or a systematic procedure or practice that meets the definition of due diligence set forth in the policy. Where the violation is detected through a process that does not constitute an environmental audit under the 1986 policy, the company will have to establish that the process satisfied the criteria for due diligence. The EPA may also require as a condition of mitigation that a description of the due diligence process be made available for public review.

- Voluntary Discovery. The violation must be identified voluntarily and not through some monitoring process required by statute, such as effluent exceedances detected during DMRs and emissions violations discovered during continuous emissions monitoring. Likewise, violations detected as part of compliance auditing performed pursuant to a consent decree or settlement agreement will not be considered to have been voluntarily discovered.

- Prompt Disclosure. Violations voluntarily discovered must be reported to the EPA in writing within ten days of discovery. The requirement in the interim policy that disclosure also had to be made to state and local authorities was eliminated although EPA indicated it would work closely with local agencies to implement the policy.

- If an applicable statute or regulation requires a shorter reporting period, the disclosure should be made within the timeframe required by that statute or regulation. Where reporting within ten days is not practical because of the complexity of the violation, and compliance cannot be determined with that timeframe, EPA may accept later disclosure if the circumstances do not present a serious threat and the regulated entity establishes that greater time was needed to determine compliance status.

  It is important to note that the disclosure requirement pertains to actual violations as well as to suspected violations. If an entity has doubt whether a violation actually exists, the EPA recommended disclosure. Compliance agreements and descriptions of due diligence programs will generally be available to the public pursuant to the Freedom of Information Act ("FOIA"). It is unclear if information regarding particular violations could be subject to the Confidentiality Business Information provisions of that law. Thus, it is possible that the disclosed information could be available under FOIA to such parties as prospective corporate purchasers or investors, lenders, shareholders, labor unions, and communities where the facilities are located.

- Discovery and Disclosure Independent of Government or Third-Party Plaintiffs. To qualify as a voluntary violation, the infraction must be identified prior to the commencement of any government inspection, information request, enforcement action, notice of any citizen suit, or discovery by any whistleblower. If a regulated entity learns that the government is about to make an inspection or receives notice of a citizen suit and then initiates an audit that uncovers the particular violation, the EPA will not consider the violation to be voluntarily discovered or disclosed.

- Correction and Remediation. In order to qualify for penalty mitigation, the entity will also have to expeditiously correct the violation and remediate any harm caused by the violation. The policy requires that the violation be corrected within 60 days using measures approved by EPA, and that the entity provide written certification to the EPA when the violation has been corrected. If a longer period will be required, the entity must notify the EPA in writing prior to the expiration of the 60-day period. For complex or lengthy corrective actions, the EPA may require the entity to enter into an administrative order or other binding agreement.

- Prevent Recurrence. The regulated entity must agree in writing to take steps to prevent a recurrence of the violation, including improvements to its environmental auditing or due diligence procedures.

- No Repeat Violations. The specific violation or a closely related violation cannot have occurred during the previous three years or cannot be a part of a pattern of violations by the facility's parent during the preceding five years. For purposes of this condition, a violation includes any act or omission for which the entity received a penalty reduction in the past, such as minor violations that were settled informally.

- . Excluded Violations. Penalty reductions are not available for violations resulting in serious harm or that may have posed imminent and substantial endangerment to public health and the environment. The policy also precludes penalty reductions for violations of specific terms in consent decrees or other settlement agreements or orders.

- Cooperation. The regulated entity will provide information which EPA determines is necessary to evaluate the applicability of the policy and cooperate with EPA in its investigation. This could include providing requested documents, access to employees, and full disclosure of any non-compliance problems or environmental consequences associated with the violation. This condition suggests that once an investigation is underway, the government will use these audits as an enforcement tool. Thus, the environmental audits or due diligence reports could be potentially self-incriminating for both companies and individuals. Faced with that potential, it

would seem that individuals will likely be hesitant to be completely open during the audit process for fear of incriminating themselves or their employers.

3. PRACTICAL CONSIDERATIONS OF AUDIT POLICIES IN TRANSACTIONS

The existence of the federal auditing policy and the state immunity laws should provide significant financial incentives to prospective purchasers of businesses and lenders to require pre-loan or pre-transfer due diligence that go beyond the ASTM standards and address environmental compliance issues since a seller or borrower who voluntarily discloses violations discovered during this process could substantially reduce its potential environmental liability. Moreover, the corrective action requirements of the federal policy requiring violations to be addressed within 60 days or as expeditiously as possible could act as model for post-closing environmental remediation conditions. Purchasers and lenders could insist that the policy be followed as a condition of the sale or loan.

In order to maximize the possibility that environmental reports could fall within one of the foregoing privileges, the following steps should be followed:

- The audit should be performed by an outside counsel at the request of the client's attorney. The environmental firm should be retained by the attorney and not the client.

- The letter hiring the environmental consultant should specifically state that the audit is being requested to assist the attorney in rendering legal advice to the client. If the attorney work-product privilege will be relied upon, the letter should identify the litigation that is pending and indicate that the audit was to be prepared for that action. The letters should also state that the consultant will be acting under the supervision and direction of the attorney. In addition, the attorney's role should be clearly documented. For example, the consultant should be advised that all reports are to be submitted solely to the attorney and that the attorney is to participate in all meetings and site visits. Toward this end, it is advisable that the attorney be the person requesting such meetings and the attorney should indicate that such meetings are designed to help advise the client about actual or potential violations of law.

- In reviewing the report, the attorney should ensure that the consultant simply notes its observations without drawing any conclusions. Any evaluations or recommendations that may be desired by the client should be placed in a separate section from the factual observations so that if the underlying facts have to be disclosed, the conclusionary section could still possibly be cloaked under a privilege. To minimize the impact that statements may subsequently have, potential noncompliance should be expressed in terms of "areas of concern" rather than violations. If the attorney work-product privilege is being asserted, it may be preferable to have the factual sections integrated with legal analysis to try to get the entire document within the privilege. Of course, this strategy could backfire if a court finds that the facts are so interwoven with the legal analysis that the entire report will have to be disclosed.

- Distribution should be limited to those managers who have direct responsibility for the problems that may be identified in the report. The reports should not be routinely distributed to senior management. Such disclosure to non-attorneys could result in a waiver of a privilege.

There may be circumstances where a person who could assert a privilege may nevertheless decide against nondisclosure. For example, CERCLA and other environmental statutes contain notification provisions that require owners or operators of facilities to disclose the existence of spills or contamination above certain threshold concentrations. A financial institution in possession of information indicating that such a reporting threshold has been met will generally not be under an obligation to disclose such information to regulatory authorities so long as the lender is not an owner or operator of the site nor in possession of the facility. If the lender nevertheless wishes to foreclose and sell the property, it might consider furnishing the information to the regulatory authorities and attempt to negotiate an agreement that would allow the lender to sell the property and receive a covenant not to sue from the government in exchange for a de minimis payment.

Similarly, if a party otherwise qualifies for the CERCLA innocent purchaser's defense, acquires title, and then performs an environmental audit prior to selling the property that reveals previously unknown contamination, the party would be required to disclose the existence of the contamination to the prospective purchaser in order to preserve this defense.

Finally, companies may decide to disclose the results of environmental audits to establish a better relationship with a regulatory agency and to mitigate the possible amount of penalties that may be imposed. For example, the federal Department of Justice (DOJ) promulgated a policy statement in 1991 that indicated that in determining whether to bring criminal charges against a violator, the DOJ will consider if the violator made voluntary, timely, and complete disclosure of available information.

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C. PERFORMING DUE DILIGENCE INVESTIGATIONS

Environmental due diligence plays an important role in real estate, corporate and commercial financing transactions. Purchasers should conduct pre-closing environmental due diligence for defensive as well as pro-active reasons. First, environmental due diligence will be necessary if a purchaser hopes to be able to assert an innocent purchaser’s defense for contamination it did not cause. A purchaser can use the information to “draw a while line” around the facility to show what conditions existed prior to the closing. In this way, the purchaser could not only demonstrate in any future litigation what contamination it knew about but also what contamination was not attributable to its operations.

Second, the information can be useful to help a purchaser maintain its third party defense. The purchaser will find out what contamination exists at the property and will be able to

implement practices to make sure that it exercises due care regarding the contaminants.

Third, many industrial facilities that have been in existence for a long time have probably significantly changed their environmental practices. Areas of a facility that may not appear to pose any current environmental risk may have been used in the past as lagoons, landfills or disposal areas. If there are areas at a site where hazardous materials were handled or disposed, RCRA corrective action may be required in the future. Thus, it is important for the purchaser to review historical photographs of a facility, examine old records and try to interview former employees who may have knowledge about past practices.

Fourth, the environmental practices of the seller may differ from those of the purchaser. Pre-acquisition due diligence will help the purchaser identify the probable environmental costs of these changes and plan operational changes that may be necessary.

Fifth, a purchaser will evaluate the various facilities to be acquired in an effort to understand how the new business will fit into its current structure. The purchaser may find itself with excess production capacity and obsolete plants and will have to develop a plan for streamlining or restructuring operations and closing obsolete plants. Comprehensive pre-acquisition environmental due diligence will help the purchaser understand the environmental implications of these choices and help it avoid or minimize unnecessary environmental costs.

Sixth, Pre-acquisition environmental due diligence can help the purchaser negotiate and allocate the environmental liabilities associated with the transaction.

Environmental audits may also be used by lenders to evaluate the likelihood that a heavily leveraged borrower may be required to fund a cleanup that could render it insolvent. Finally, lenders or purchasers can use environmental audits to screen or exclude properties from the transaction or to identify properties that can be foreclosed.

1. Sources of Environmental Due Diligence Requirements

Despite their importance, there are no uniform federal due diligence standards. CERCLA provides only that purchasers use "appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice.'" In determining whether "all appropriate inquiry" was made, a court is required to examine "any specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property in an uncontaminated state, 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 to detect such contamination by appropriate inspection." Neither the CERCLA innocent purchaser's defense provision nor the EPA's Landowner Liability Guidance precisely describe what constitutes an adequate inquiry or investigation. Thus, the determination of whether "all appropriate inquiry" has been conducted is on a case-by-case basis but lenders and those involved in commercial transactions will be held to a higher standard than those involved

in private residential transactions. Indeed, the EPA has often taken the position that if an audit failed to detect contamination, it was not an appropriate inquiry.

Very few courts have interpreted the meaning of these statutory standards. It is clear that if an undeveloped parcel is sold for a price well below the market value of comparable parcels, the purchaser should inquire about its environmental condition. Likewise, metal drums or distressed vegetation might be deemed signs of the "likely presence of contamination" and failure to conduct a walking tour of the site might preclude a purchaser or lender from asserting the innocent purchaser's defense. It is also important that purchasers and lenders do not succumb to competitive pressures and accept inadequate audits as faulty audits may prevent them from invoking the innocent purchaser's defense. This was demonstrated in In BCW Associates Ltd. v. Occidental Chemical Corp., where the purchaser of a warehouse unsuccessfully raised the innocent purchaser's defense and was found liable for response costs to remove lead-contaminated dust even though it received an unqualified opinion that there were no hazardous substances on the property. The court found that the plaintiff had failed to exercise due care. The report had identified a possible area of environmental concern but declined to further investigate it due to the expense of additional testing. The court seemed to be persuaded that the discounted purchase price of the warehouse and the fact that the purchaser was aware it was buying an old, industrial warehouse should have put the purchaser on notice that a more extensive investigation was warranted.

a) 2002 CERCLA Amendments

The 2002 CERCLA Amendments added standards for performing due diligence

C**ommercial property acquired prior to May 31, 1997-** The 2002 CERCLA Amendments provide that courts should continue to examine the factors that were listed in the innocent purchaser defense prior to January 11, 2002 to determine if the purchaser conducted an appropriate inquiry:

- Defendant's specialized knowledge and experience;
- Relationship with the purchase price to the value of the property if uncontaminated (i.e. whether the property was acquired at a bargain price);
- Commonly known or reasonably ascertained information about the site;
- The obviousness of contamination at the site; and
- Detectability by appropriate inspection.

Commercial property acquired after May 31, 1997- The 2002 CERCLA Amendments provide that purchasers have to comply with the ASTM Phase I standards to satisfy the appropriate inquiry requirement.

Residential property- To qualify as an innocent purchaser or Bona fide prospective purchaser, a purchaser must conduct a site inspection and title search that reveal no basis for further investigation.

b). Fannie Mae

The Federal National Mortgage Association (Fannie Mae) has established environmental due diligence requirements for single family and multi-family properties that will serve as collateral for a Delegated Underwriting and Servicing ("DUS") mortgage (the "DUS Guide"). Lenders are responsible for complying with these requirements prior to obtaining a commitment from Fannie Mae.

1. Multi-Family Properties-

Part X of the Fannie Mae DUS Guide for multi-family properties (i.e., properties with five or more individual units) describes the procedures that lenders must follow to monitor and assess the environmental condition of each property pledged as security for a mortgage. The environmental assessments must be performed prior to the time that a lender makes a loan commitment. Fannie Mae can also require environmental assessments when a loan becomes non-performing.

Under the Part X Environmental Hazards Management Procedures, lenders are required to conduct a Phase I assessment and then complete a Phase I Assessment Form. The Phase I assessment is similar to the ASTM Phase I ESA since it will include a site inspection and a must review federal and state environmental databases for the subject property and all sites within a one-mile radius of the property. However, the lender is specifically required to address the following environmental hazards:

- asbestos,
- PCBs,
- radon,
- USTs,
- Waste Sites,
- Lead-Based Paint
- Urea Formaldehyde Foam Insulation Survey
- Interior Air Test Results
- Lead in Drinking Water Test Results
- Other environmental hazards that might be observed.

The Phase I Assessment Form must indicate if each of the hazards are either: Acceptable; Acceptable requiring O & M; Fail; Fail But Possible Remedy; or Phase II is required. The DUS Guide requires a phase II to be performed for any hazard that is identified as not being acceptable in the Phase I. There is no specific Phase II protocol but the lender will be required to complete a Phase II Assessment Form.

The following conditions will be considered to be “Unacceptable Environmental Conditions” that will render the property ineligible to serve as security for a mortgage to be purchased by Fannie Mae:

- The property is build over a landfill or waste disposal site;
- ACM is accessible to tenants or personnel and cannot be encapsulated or managed through an O & M Plan;
- Adjoining properties with soil or groundwater contamination;
- Soil or groundwater samples detect contaminants above specified concentrations
- PCB contamination that cannot be remediated because of technical or financial reasons as well as PCB-Contaminated transformer inside residential structures or that are located on the property and owned by the borrower;
- Radon gas in concentrations above 4 picocuries per liter that cannot be mitigated through capital improvements or an O & M Plan;
- Presence of lead-based paint in a condition that violates laws or that cannot be abated and managed in a reasonable manner to prevent exposure to sensitive populations;
- Material violations of environmental laws; and
- Property that is subject to enforcement actions or lawsuits because of environmental issues.

The lender may take a commitment on the property if a qualified environmental consultant issues an opinion indicating that the unacceptable environmental condition can be remedied within 90 days after loan delivery or a period not to exceed the time allowed for any repair or Moderate Rehabilitation. In addition, the borrower must have an contract with a qualified environmental consultant executed prior to the commitment and also execute a Completion/Repair Agreement along with a deposit of 150% of the contract amount.
Lenders are also responsible for ensuring that the borrower comply with environmental laws during the loan and maintain any required O & M programs.

2. Single-Family Property-

The Fannie Mae Environmental Hazard Assessment guidelines (the "Environmental Hazard Assessment Guidelines"), located in the Fannie Mae Selling Guide, Part 8 (Project Standards), apply to single-family properties (i.e., properties with one to four units). Fannie Mae requirements for single homes place the burden for reporting environmental problems on real estate appraisers who must consider environmental conditions of "common knowledge" when determining market value. This probably means all information contained in public records. This obligation may be shifted to lenders, as the appraisal industry has balked at these obligations.

c) Freddie Mac

The Federal Home Loan Mortgage Corporation (Freddie Mac) has circulated proposed rules for lenders whose mortgages they purchase. These requirements only pertain to residential properties but because of the lack of federal due diligence standards, lenders

have tended to adopt the environmental auditing requirements set forth by Fannie Mae.

d) Federal Reserve System

Division of Banking Supervision and Regulation- In SR 91-20 (FIS)(October 11, 1991) issued guidelines which covered environmental risks. These guidelines require member banks to have policies in place to safeguard against environmental liability. Member banks are required to develop loan policies that require and describe the level of environmental due diligence necessary for a credit transaction. In addition, member banks should develop procedures for evaluating environmental liabilities for loan portfolio analysis, credit monitoring, loan workouts, and pre-foreclosure. The Federal Reserve also warned its members not to participate in the day-to-day management of the borrower's business.

Office of the Comptroller of the Currency ("OCC")- has issued a variety of bank examiners' handbooks that contain environmental requirements. For example, section 213.1 of the "*Comptroller's Handbook For National Bank Examiners"* states that lenders should identify environmental risk prior to funding loans or offering a loan commitment. Lender are also required to monitor problems discovered on property already accepted as collateral and seek the advice of environmental experts particularly when the bank is considering foreclosing on the property. In addition, questions 28 and 29 in section 213.4, Real Estate Loans Internal Control Questionnaire specifically ask if the lender has established a procedures for reviewing environmental hazards.

Likewise, the November 1995 "*Comptroller's Handbook for Commercial Real Estate and Construction Lending*" states that banks should have policies in place to protect themselves from environmental hazards associated with real estate that they hold a collateral. The handbook says banks should ideally attempt to identify environmental risks before funding a loan or offering any loan commitments. If environmental problems are encountered, the handbook says that banks should seek the advice and assistance of environmental experts. For land development loans, the handbook states that the bank should require a feasibility plan that includes an environmental impact assessment. For construction loans, the handbook states the loan documentation file should include an architect certification of compliance that will address a number of issues including compliance with environmental protection regulations and should also include any environmental surveys deemed necessary because of the location and type of project.

The handbooks also provides that a loan can be assigned a more severe classification than "substandard" where the loan is collateralized by property with environmental hazards and the loss exposure cannot be reasonably ascertained. Moreover, the handbook states that a prior appraisal will not be valid if environmental contamination has been discovered since the appraisal was performed. The internal controls questionnaire requires examiners to determine if counsel and other experts have reviewed building and loan agreements for compliance with a number of issues including environmental protection. These internal control questionnaire also asks if ask if the lender has

established a procedures for reviewing environmental hazards, if the bank has established monitoring procedures for properties with known environmental hazards and for seeking advice of environmental professionals.

Office of Thrift Supervision- In 1989, the Federal Home Loan Bank Board ("FHLBB") issued Thrift Bulletin 16, "Environmental Risk and Liability" (February 6, 1989).The bulletin lists guidelines for the development of environmental risk policies for thrift organizations. The bulletin requires thrifts to develop environmental risk management policies. The policy should:

- Establish the level of due diligence in all real estate transactions,
- Establish a means for identifying excessive environmental risk in properties to be used for collateral or acquisition, properties to be foreclosed upon; or to meet standards for the secondary market
- Minimize environmental contamination on the borrower's property during the life of the loan by collateral monitoring and periodic property inspections,
- Establish guidelines for satisfying the CERCLA innocent purchaser's defense; and
- Support the institution's adherence to the principal of safety and soundness

The policy establish 12 components that must be included in an Environmental Risk Policy. These components are:

- A statement acknowledging the risk of potential environmental problems and that the institution's policy is to adopt due diligence to protect against such risks;
- Development of an environmental questionnaire to be prepared by loan applicants;
- A requirement that adequate due diligence be performed by the lead lender when purchasing or participating in a loan and that the environmental due diligence requirements of Freddie Mac or Fannie Mae be satisfied for all loans to be sold to those agencies;
- A Phase I be prepared for all loans where real property will serve as collateral. However, a Phase I will not be required for one-to-four family properties unless there is an indication that those properties have a high potential for environmental risk (e.g., historic use of land, presence of asbestos, etc);
- Designation of a employee as a "environmental risk analyst";
- Criteria for selecting qualified environmental consultants;
- Requirement that the loan officer has the responsibility for ordering Phase I reports as needed after consultation with the Environmental Risk Analyst;
- Requirement that appraisal reports take environmental risk factors into account;

- Any environmental problems identified in the environmental risk reports must be considered by the institution's required approval authority and senior management before the loan may be approved or the property purchased;
- Develop criteria for determining when loans may be declined for environmental factors. The bulletin lists a number of factors that should be included in the criteria;
- Establish procedures for reviewing collateral before completing foreclosure or accepting deeds in lieu of foreclosure; and
- Acknowledgement of the importance for coordination and cooperation among the institution's loan origination department, loan servicing department, environmental risk analyst, legal counsel and appraisers to carry out the environmental risk policy as well as to enlist the help of environmental specialists and applicable governmental agencies.

In addition, the bulletin states that institutions should revise their mortgages, indemnities, guarantees, and other loan documents to protect against environmental risks and maintain value of their loans and collateral.

FDIC- In 1993, the FDIC issued "Guidelines for Environmental Risk Programs" (FIL-14-93, February 14, 1993) which requires banks and thrifts to establish internal environmental risk management programs. The guidelines require that these programs be designed to identify and evaluate potential environmental concerns associated with lending practices and actions relating to real estate. The program must also include an environmental training component that will help employees understand and implement the program. Areas that should be addressed by the training program could include the sources of environmental liability, uses and limitations of environmental due diligence in defining and identifying environmental liabilities, as well as use of loan documentation to minimize exposure to environmental liability.

The FDIC acknowledged that the program should be tailored to the loan portfolio of a particular institution. Thus, an institution with a heavier concentration of industrial loans will have to have a more sophisticated environmental risk management program than a lender whose loans tend to be collateralized by one-to four-family residences.

The guidelines require that the institution's board of directors review and approve the environmental risk management program and that each institution designate a senior officer who is familiar with environmental matters to take responsibility for the institution's environmental risk management program.

Department of Housing and Urban Development (HUD)- Mortgage applications for one- to four-family dwellings in new subdivisions must be accompanied by an appraiser's statement that the property does not contain any toxic waste hazard and that the property is not located within 3,000 feet of a landfill, NPL, or state Superfund site.

2. Mechanics of Performing Environmental Due Diligence

The first step after a client has decided to perform environmental due diligence is to assemble and review the existing information on the facilities or properties involved in the transaction as well as any existing reports evaluating environmental conditions. There are also a number of databases that may be used to determine if any of the facilities have been subject to enforcement actions or have been listed on the NPL. During this review, the attorney should determine the number and location of current and formerly-owned and leased facilities and the kind of operations involved at each facility.

After gathering this information, the attorney must establish the scope of the environmental due diligence. The scope and detail of environmental due diligence will vary significantly from deal to deal because no two transactions are alike. There are a number of factors that can influence the scope of environmental due diligence and the attorney will have to identify these constraints in determining the scope of the investigation. Factors that must be considered will include:

- The number of facilities to be investigated;
- The value of the transaction;
- The time allotted for performing the investigation;
- The funds available for performing the investigation; and
- The level of risk that the parties are willing to accept in developing remediation or liability estimates.

While developing the scope of the environmental due diligence, it is important to remember that the objective of environmental due diligence investigations is not to uncover all the information that exists about a particular facility or company but simply to give purchasers or lenders an overview of the potential environmental liabilities at each facility so that the parties may contractually allocate those liabilities. The cost estimates will be expressed in a dollar range and the narrower the range that is desired, the more costly the investigation.

Although it will be preferable to conduct environmental due diligence examinations on each parcel that will be part of the transaction, parties in multi-parcel transactions may choose to restrict the investigations to a limited number of properties because of cost or time constraints. The sites that are selected will usually be those that are likely to have the worst problems, that have operations within certain SIC numbers, or that represent the most valuable properties. For example, on a multi-million dollar transaction, sites with $10,000 of liability may be ignored but several of those sites could pose severe problems for a one million dollar deal. However, because each site may pose its own unique environmental problems depending on its site history and because management practices may vary from plant to plant, extreme caution should be used during the site screening

process.

One way of screening the sites in a multi-parcel transaction is for the attorney or in-house environmental staff of the client to prepare an environmental due diligence questionnaire that will be completed by an engineer or the plant managers of each facility. This document will seek answers to general questions about the environmental practices and conditions operations of each of the facilities. The Transaction Screen proposed by the American Society for Testing and Material (discussed below) may also be used to identify the properties that should be investigated. This information gathered from the questionnaire will help to more narrowly focus the scope of work that will be prepared by the environmental consultant hired to perform the environmental due diligence and also cut down on some of the work that the consultant may have to do.

Another critical aspect of due diligence examinations is gaining access to the site and obtaining information from the facilities. Such cooperation will not be forthcoming in a "hostile" takeover. In a "friendly" takeover, the seller, target company, or borrower may be reluctant to share information that may cause a party to back out of a deal or renegotiate the price or that may make government aware of previously unknown operating conditions. This may be particularly so if the operator was engaged in negotiations with the government since the agency may use the pending transaction as leverage for additional concessions.
Another reason why operators may resist divulging information is that under the worst case scenario to the operator, the transaction may collapse but the operator may nevertheless be required to report the presence of contamination uncovered during the due diligence investigation. This resistance to divulging information can be softened, though, if the parties enter into a confidentiality agreement that outlines what information will be divulged and how it will be handled.

3. Retaining the Environmental Consultant

After the scope of the investigation has been determined, the client must determine if the environmental due diligence is to be performed internally or if an outside environmental consultant will be hired. If the decision is made to use an outside environmental consultant, a request for proposal (RFP) may be prepared and sent to a number of consulting firms, inviting them to bid on the project. If the transaction involves a limited number of facilities or the client has had significant experience performing environmental due diligence, a Scope of Work (SOW) may be prepared and forwarded to the bidders in lieu of an RFP.

The RFP will describe the objectives and limitations of the work to be performed and request that bids be submitted by a specific date. If there is inadequate time to solicit bids, the attorney or client may select consultants based on prior experience. If a national environmental consulting firm is being considered, it is important to remember that the level of competence may vary between offices and individuals within offices. Thus, if a consulting firm is being retained because of a previous work association, it is advisable to request the same individuals who worked on the prior transaction.

The consultant should not be directly hired by the client but, instead, retained by an attorney so that the opinions or conclusions contained in the consultant's report might be able to be cloaked under a legal privilege. The environmental consultant should be retained using a retention letter similar to the one appearing in Exhibit 13C.

4. Reviewing Environmental Consulting Agreements

Many consulting firms use standard contracts that should be carefully reviewed by the attorney prior to retention of the consultant. In addition to the standard contract terms, the contract should contain a description of the work to be performed, an estimate for the project, and a project schedule. The contract should also provide for an oral report following the physical investigation of the properties, which is to be followed by a draft report that is to be reviewed by the client's attorney. An updated draft report should be prepared to incorporate comments by the attorney, which would then be followed by a final report.
One of the most important issues involves ownership of all materials that are generated by the consultant. The consulting agreement should provide that all materials, including drafts, drawings, photographs, and field notes, are the property of the client and that the consultant will not release any information obtained in the investigation to any third party without the express written consent of the client. Furthermore, the consultant should agree to destroy any draft reports and field notes at the conclusion of the project.

Consulting agreements frequently request that the client indemnify the consultant for any injuries or losses resulting from site conditions. Since the client will usually not be the party that is in control of the site, the client should not agree to such a provision.

Clients are also often asked to be responsible for obtaining permits or to be responsible for disposal of any hazardous residues generated from laboratory analysis. The consultant should be responsible for obtaining permits, complying with the conditions of such permits, and for disposing of any sampling residues.

Another important issue is insurance. It is recommended that the consultant should be required to maintain GCL, professional liability, automobile, workers' compensation, and employer's liability insurance and to add the client as an additional insured under the GCL polity.

Many consulting agreements provide for accrual of interest after 30 days. If the client is a large corporation that cannot generate payments rapidly, it is advisable to request a longer accrual period of 60 to 90 days. The client should also seek the right to terminate the contract for any reason and have the consultant agree not to incur any further charges upon receipt of the termination notice. Many agreements normally provide that the consultant may finish the particular phase of the work following receipt of the termination notice.

5 Preparation and Review of the Scope of Work

Before commencing the project, the environmental consultant should prepare a scope of

work (SOW) unless the SOW was previously prepared by the client as part of the bid package. This document is probably the most critical document in the due diligence process because it determines how the investigation will be performed. The scope of work will be developed using the information that is already available from the existing company or regulatory records as well as the responses to the questionnaire.

The scope of work will describe the specific tasks to be performed, the schedule for each task, and a cost estimate for the project. Specifically, this document will indicate the number of facilities to be visited, the priority of the site inspections, the extent and nature of any sampling to be performed, the kinds of substances that will be analyzed, off-site disposal practices, and the kind of regulatory information that will be collected. If a buyer or lender is going to rely on environmental due diligence by a seller or borrower, it is imperative that the scope of work be reviewed to make sure that the investigation covered all of the areas that the buyer or the lender wanted to be examined. Without reviewing the scope of work, it may be hard to determine if a particular environmental issue was not discussed in a report because it simply was not examined.

Once the scope of work is approved, the consultant will have to determine its staffing needs. Generally, each site inspection could require two person-days and an additional two person-days will probably be needed for collection of regulatory information. Another couple of days will be required to prepare a draft report, and oversight by management will add another person-day to the project. As a result, a site inspection will typically cost between $5,000 to $7,000 per industrial facility without soil or groundwater sampling. If sampling is required, this could add $10,000 to $20,000 to the cost of each site depending on the number and depth of the wells that have to be installed, the number of soil samples, the kinds of parameters to be analyzed, and the time that the laboratory has to analyze the samples.

The scope of work should provide for a phased approach since this will be the most cost-effective methodology for performing environmental due diligence. Under this approach, each investigative phase is based on the information gathered in the preceding phase. Thus, it is extremely important that each phase be performed as thoroughly as possible. When the Phase I report is completed, the consultant should orally review the results of the investigation with the client and the attorney. If time is short, more frequent oral debriefings may take place at set intervals or after the investigation at certain key facilities have been completed.

Following the oral report, the consultant should prepare a draft report for review by the attorney. One of the most important tasks of the attorney is to make sure that the report is limited as much as possible to factual observations. Conclusions or opinions regarding status of regulatory compliance or speculations on the sources of potential contamination should be deleted. The reason for this is that many clients will not be prepared to address all of the noncompliance issues that may be raised in a report and the existence of such findings in a report could be used by a government agency in any subsequent civil or criminal enforcement action as evidence of willful or deliberate noncompliance with environmental laws. If the attorney makes substantive changes to the draft Phase I report,

a revised draft should be forwarded to the attorney and a final Phase I report should not be issued until the attorney approves the revised draft. The final Phase I report should be issued to the attorney.

6. The Phase I Environmental Site Assessment

The Phase I Environmental Risk Assessment is commonly referred to by environmental consultants as a preliminary environmental site assessment (ESA) and is designed to identify areas of potential soil or groundwater contamination.
The Phase I ESA generally will include a review of public and private records to ascertain the present and past regulatory and operational history of the site, as well as a site reconnaissance. It should be performed on any of the following types of properties that a purchaser is contemplating acquiring or that a lender is considering relying on as collateral:

- Industrial properties including iron and steel, petrochemical, pharmaceutical, plastics, paper, glass, mining, metal finishing, electroplating, food processing or canning establishments, as well as properties adjacent to industrial complexes;

- Commercial properties that contained or were close to gasoline service stations, automotive repair shops, dry-cleaning establishments, photographic developers, paint operations, hospitals or medical buildings, or jewelers;

- High-tech and electronic companies such as printed circuit boards and computer component manufacturers who may use solvents, acids and other materials regulated as hazardous substances;

- Properties located next to railroad tracks or pipelines;

- Farm and ranch lands where toxic substances such as pesticides, herbicides and fertilizers may have been applied;

- Sites that were used as or are adjacent to landfills, old town dumps and waste disposal sites;

- Buildings or properties that may contain asbestos;

- Buildings located in regions known to have emissions of radon gas;

- Multi-family or single-family residential properties located within a one-mile radius of a NPL site;

- Shopping malls, restaurants and proposed construction projects that either may contain underground storage tanks or be contaminated from prior uses.

The environmental assessment should include the following:

- Title Search-Records should be reviewed to reconstruct the chain of title as far back as possible to determine if the property was previously used for on-site generation, storage or disposal of hazardous materials. This information can be obtained from title abstracts, tax records, subdivision maps, building or land use permits and interviews with local officials. However, if the owner was not the operator of the site, this may not reveal prior operating history or uses of the site.

- Facility Records-Valuable historical information can be obtained from the seller or borrower, including site plans, plats, engineering surveys, blueprints and aerial photographs, which will locate structures, underground storage tanks, PCB transformers or capacitors, floor drains, sewer lines, lagoons, settling ponds, trenches, railroad tracks, areas of hazardous waste storage and the presence of asbestos.

- Regulatory Compliance Records-Businesses subject to environmental regulation are required to maintain a variety of records on the site and are obligated to file reports with state and regional EPA offices. These will include environmental permits and applications, MSDS, hazardous waste manifests, monitoring and discharge reports, spill reports, EPCRA or RCRA notifications, registrations for underground storage tanks, environmental consultant reports and correspondence, notices of violations, consent decrees, financial reports indicating expenditures for pollution control equipment or reserves for environmental liability, insurance policies, records and procedures for compliance with right-to-know, training and other health and safety requirements of OSHA. When reviewing permits, the examiner should confirm that the transferee is the permit holder and that the permit has not expired. As explained earlier, all contacts with regulatory agencies must be handled with extreme care to avoid triggering reporting obligations.

- Neighboring Properties-Because nearby properties can be a source of contamination and can drastically affect the value of mortgaged property, property use within a one-mile radius should be reviewed. There are several state and federal databases such as CERCLIS, SEC filings, and the ATSDR registry of sites and persons affected by NPL sites that will prove useful.

Site Reconnaissance-The following areas should be examined during the plant tour.

- Floors and Walls-In manufacturing and processing operations and any machinery using hydraulic fluids or solvents, check for staining, cracking or deterioration, which may indicate spillage or careless handling of hazardous materials. The location and condition of floor drains, sink drains, floors,

exposed pipes and sumps should be noted and compared against the blueprints since these can serve as collection or discharge points for hazardous materials. It is also important to determine where the conduits drain.

- Air Emission Sources-Inspect the fossil fuel burning equipment and incinerators, and the pollutants that are emitted. Ducts and ventilation equipment should be inspected for signs of improper emissions, as well as the air pollution control equipment, to determine that it is in compliance with the air pollution permits. Not only must the cost of installing new pollution control equipment be evaluated, and any fines or penalties for non-compliance, but also the costs of the air quality impact and health assessment studies that will be necessary in the event additional equipment or permits are required.

- Wastewater Treatment-Facilities generally discharge waste into POTWs, although some may discharge into non-contact heating or cooling waters into local waterways. The wastewater treatment facilities and outfalls should be inspected and checked for compliance with permit effluent limitations and any local pretreatment requirements. Frequent excursions of permit limitations can be particularly troublesome in view of the dramatic increase in citizen suits.

- Storm water Runoff-Discharge and collection points for the storm-water sewers should be located. Determine if the stormwater runoff is discharged into the municipal sewer system, onto a wetland, into a subsurface disposal system or into surface waters or if it comes into contact with process or wastewater prior to discharge. The collection points, spill control or containment structures should be inspected to see if contaminants are mixing with the stormwater. If the stormwater conduits discharge into surface water, it is also important to determine if that stream suffers from impaired water quality which could result in more stringent discharge requirements. Also determine if the facility is subject to the Stormwater permit program and if it has obtained authority to discharge stormwater.

- Surface and Groundwater Quality-Locate and note the appearance of all bodies of water on the property, including ponds, streams, lakes, swamps, creeks and wetlands, the discharge sources into those bodies of water and identify drinking water sources such as wells. Also ascertain if groundwater-monitoring wells are present and review results of any prior sampling analysis.

- Asbestos-Examine boiler rooms, ceilings and steel beams for the presence of friable asbestos.

- PCBs-Determine if transformers or capacitors contain PCBs and verify compliance with applicable federal and state PCB regulations.

- Raw Material Storage Areas-These areas should be inspected and the condition and contents of drums, barrels and cans should be verified. Unlabeled, deteriorating or open hazardous waste containers may not only indicate poor housekeeping but possibly may be signs of non-compliance with state and federal environmental, safety and health regulations and codes.

- Waste Storage/ Treatment/Disposal- Improper waste storage disposal may lead to extensive groundwater and soil contamination requiring expensive remediation. Costs may also be incurred to upgrade inadequate storage areas to meet design standards such as impervious lining and dicing. Accordingly, locate and examine the condition of the waste management facilities such as lagoons, impoundments and holding ponds. Tanks and drum storage areas should be evaluated. Note signs of spillage from overloading or leakage from poor construction. Also look for discolored soil, stretches of bare soil, or dead or distressed vegetation, which may indicate the site of former waste storage units.

- Underground Storage Tanks (USTs) -Leaking underground storage tanks can be a major source of soil and groundwater contamination. The location of all buried tanks, and the age, construction and contents of the tanks should be ascertained. Pay particular attention to caps or fill-pipes, which may indicate the presence of abandoned UST. Determine if the UST have been registered and if they must be upgraded to meet state or federal design standards.

- Fuel Storage and Vehicle Maintenance Areas- spillage from fuel transfers or poor waste oil management can lead to soil and groundwater contamination. Look for signs of staining or deterioration of pavement or concrete and determine the purpose and discharge point of all drains located in these areas. If there is an oil/water separator, ascertain its capacity, age, construction and review all permits and any inspection reports. Malfunctioning oil/water separators will often result in surface water or soil contamination.

- Loading Docks, Shipping Areas and Railroad Sidings- spills of hazardous materials commonly occur in these areas when raw materials or products are transferred.

7. Phase II Investigation

A Phase II site investigation is a more extensive investigation involving soil sampling, groundwater, and surface water monitoring, as well as stack emission sampling. The purpose of the Phase II site investigation is to further investigate the areas of potential environmental concern identified in the Phase I ESA. Many times when heavy industrial properties are involved, the parties to a transaction automatically perform a Phase II site investigation.

A second scope of work will be prepared that will generally provide for preliminary subsurface investigation that may include soil or groundwater sampling in areas of suspected contamination. Because many sources of contamination cannot be visually observed, the Phase II subsurface investigation may begin by using noninvasive screening methods such as metal detectors to identify buried metal structures, like storage tanks, as well as a volatile organic analyzer that can "sniff" gases evaporating through the soil from buried storage facilities or plumes of contamination.

If groundwater contamination is suspected, one or more groundwater monitoring wells may be installed. The construction of the wells will depend on the kind of suspected contaminants. If the wells are to be sampled for gasoline or other lighter-than-water liquids, the wells should be built with screens placed at the top of the water table so that the floating contaminants may be collected. However, if the contaminants are believed to be chlorinated solvents or other "sinkers" that settle at the bottom of an aquifer, the wells must be designed to allow sampling from the lower portion of the aquifer.

If groundwater contamination is confirmed, additional wells will have to be installed to define the extent of the contamination and also determine the direction of groundwater flow. The groundwater flow can be particularly important because it may turn out that the contamination is flowing onto the site from an adjacent property so that the site may not be the source of the contamination.

As with the Phase I report, the environmental consultant should first communicate the results of the investigation orally and then prepare a draft report for review by the attorney.

Delineating the extent of soil and groundwater contamination can be extremely costly, especially for transactions in the $1 to $10 million range. The sampling and analysis that may have to be performed so that a prospective purchaser or lender may preserve its innocent purchaser's defense, as well as any resulting cleanup, may make some deals economically unviable. However, the costs of a Phase II can be controlled by performing the work in stages and understanding the regulatory requirements. It is important to remember that the goal is not to collect all possible information about a site but simply to make an "appropriate inquiry" so that the potential liability can be evaluated and the statutory defenses may be preserved.

8. American Society for Testing and Materials Standards for Due Diligence

The American Society for Testing and Materials (ASTM) was commissioned by a consortium of private interests to develop uniform environmental due diligence requirements. It was hoped that the ASTM product would establish the standard for what constitutes CERCLA's "good commercial and customary practice" as well as to satisfy the "all appropriate inquiry" contained in CERCLA's innocent purchaser defense.

In May 1993, the ASTM published two standards for conducting environmental

assessments on commercial real estate. The two standards essentially split the traditional Phase I approach into two separate tasks. The first standard is known as a Transaction Screen (ASTM designation E 1528), which is a limited review that is based on the results of a questionnaire completed by an owner or operator of a facility, a cursory site visit based on the responses provided in the questionnaire, and a limited review of government records. The second standard, the Phase I Environmental Site Assessment (ASTM designation E 1527), is a more extensive examination that is similar to the Phase I approach discussed earlier.

While the ASTM standards are useful to the extent that they provide the regulated community with consistent definitions, the standards fail to achieve their objective of creating uniform procedures for performing environmental due diligence for a number of reasons. At the outset, it must be pointed out that the ASTM standards are only designed to satisfy the requirements of the CERCLA innocent purchaser defense. The ASTM does not address requirements of other federal or state environmental laws. Furthermore, non-CERCLA liability issues such as asbestos-containing materials, lead-based paints, lead in drinking water supplies, or wetlands are not covered.

Perhaps the major flaw of the ASTM standards is that they still determine "appropriate inquiry" on a case-by-case basis. This is because the ASTM attempted to balance the need for obtaining information about commercial properties against the cost and time involved in obtaining such data. As a result, the level of "appropriate inquiry" varies depending on the nature of the transaction and the kinds of properties involved in the transaction.

Furthermore, the ASTM practices continue to give parties to a transaction too much discretion in developing the scope of due diligence. The ASTM does not indicate when a Transaction Screen should be used in lieu of an ESA. Instead, the user is given complete discretion in determining what approach to follow. In addition, the ASTM allows a party such as a seller who is not concerned about qualifying as an innocent purchaser to perform an ESA that will fall below that standard established for "an appropriate inquiry." Accordingly, purchasers and lenders should not blindly rely on environmental audits that were based on the ASTM standards. Instead, these parties should independently review the scope of work to determine if the investigation was adequately designed to assess conditions at a particular site. Undoubtedly, users will want to consider scopes of work that go beyond the ASTM requirements.

Furthermore, both the Transaction Screen and the ESA are only required to identify "recognized environmental conditions." While the definition of this term includes the presence of hazardous substances indicating that a release has or may have occurred in the past, it is not intended to include de minimis conditions that do not present a material risk of harm to public health or the environment and that generally would not result in any enforcement action if brought to the attention of governmental agencies. This definition may not necessary comport with requirements of various state cleanup and reporting laws. In addition, it is difficult to predict if a particular level of contamination may set off an enforcement action. De minimis concentrations of hazardous substances

might trigger enforcement actions if there are environmentally sensitive areas, local drinking water wells, or the site is located in a residential community. It would have been preferable if the standards simply referred to state cleanup levels.

Another major weakness is the kind of information that owners or operators of facilities are required to disclose. The person answering the Transaction Screen is only required to provide information in his or her actual possession. Respondents are not required to research answers not in their possession. Likewise, the investigator is not required to conduct an exhaustive search of company records but simply those that are "reasonably ascertainable" or information that is "practically reviewable." Reasonably ascertainable information is data that may be obtained "within reasonable time and cost constraints" while information that is practically reviewable refers to information that does not require extraordinary analysis. The ASTM suggested that records that are sorted or filed according to limited geographic areas would be considered "practically reviewable" while large data bases that are not organized by zip code or other geographic designation would not be considered practically reviewable.
Another illustration of the limited nature of the ASTM standards is that the only source of physical information about the site that the investigator is required to examine is the USGS topographic map. The ASTM leaves other sources that describe groundwater, soils, and geology to the discretion of the investigator.

For past uses of the property, the investigator is only required to describe past uses or conditions that are visually or physically observable during the site reconnaissance or that are identified from reasonably ascertainable records. This leaves a lot of "wiggle" room to parties who are not interested in uncovering information about prior practices at a site.

The Transaction Screen may be a useful device for deciding which sites to investigate in a multi-parcel transaction but it is at best an issue-identifying device and should not be used in lieu of a full-fledged Phase I investigation.

PART VI
NEGOTIATING AND ALLOCATING ENVIRONMENTAL LIABILITIES IN CONTRACTS

Parties in corporate and real estate transactions often fail to give themselves sufficient time to meaningfully examine the environmental liabilities associated with these transaction. The process of identifying environmental liabilities that are associated with complex chemical plants is a time-consuming process. Moreover, it is usually not possible to estimate what the likely liabilities may be until after a cleanup plan has been approved by a governmental agency which can take place months or even a year or so after the closing. Unfortunately, the time pressures of a particular transaction often force the contracting parties to try to allocate environmental liabilities before they are completely understood. As a result, environmental liabilities may often times be inadvertently assumed by the one of the contracting parties. This section discusses the risk management techniques that parties to a corporate transaction may use to avoid some of these liability pitfalls.

A. DRAFTING THE ENVIRONMENTAL PROVISIONS-

CERCLA does have some limitations on the freedom parties to a transaction may have to allocate their liability. Most courts now reject "as is" clauses or the doctrine of caveat emptor as a defense to CERCLA liability. These cases hold that the "as is" clause simply bars a breach of warranty action. However, the existence of the breach of warranty may be an equitable consideration in the allocation of response costs in a contribution action. In addition, the majority rule is that while contracting parties can allocate liability among themselves, contractual indemnifications or releases cannot be used as a defense to liability in a government cost recovery action.

When contracting parties try to allocate liabilities in a contract, the language that is used is often ambiguous and may conflict with other sections of the contract. Such unclear language not only can lead to confusion between the contracting parties but if a dispute ends up in court, the parties will be placed in a position of having a judge try to guess how the parties intended to allocate certain environmental liabilities. This section will discuss the environmental issues that must be addressed in contracts and how parties may clearly resolve those issues.

1. ENVIRONMENTAL DEFINITIONS- One of **t**he best ways to reduce ambiguities in contracts and reduce the possibility of litigation arising out of confusion or misunderstandings from unclear language is to draft careful definitions. By using definitions, parties can avoid excessive verbiage in the rest of the contract. Following are recommended defined terms that should be used to help allocate environmental liabilities.

- **Environmental Claims**- This term should encompass administrative and litigation proceedings, notices of violations, administrative orders and other written

communications involving the government and private parties.

- **Environmental Conditions-** This term will address the kinds of environmental conditions that the parties are intending to allocate and which will trigger the obligations under the contract. For example, will the mere presence of contaminants be sufficient or must there be a release of hazardous substances exceeding a reportable quantity? Must the contaminants be in excess of state or federal cleanup levels? Are the environmental conditions limited to a particular site or does the term encompass properties no longer owned or operated by the seller or disposal sites that may have received wastes generated by the business?

One way to address these issues to use the environmental issues identified in the pre-acquisition due diligence as the environmental baseline of existing environmental conditions. To use this approach, a purchaser will have to be extremely confident in the thoroughness of its environmental due diligence. However, because of cost and time concerns, it is not possible to sample every possible area of concern at large chemical plants for all possible contaminants that might exist at a site. Generally, the sampling will be targeted at areas where there is visual or historical information indicating that there is a possibility of contamination. There may have been former disposal areas that are no longer obvious because they may now be covered by a parking lot or building. Thus, purchasers should be cautious before using the results of assessments to define the environmental conditions. The parties can consider using a set of presumptions that certain kinds of contamination found in certain areas or associated with certain processes will be presumed to have been caused by the seller.

- **Environmental Laws-** The key issue here is the definition should include laws that do not normally deal with the environment such as OSHA and other worker health or safety requirements. These safety laws may address indoor environmental issues that may not be covered by traditional environmental laws such as indoor air pollution. In addition, the buyer will want to extend the definition to laws that are enacted after the closing but which may apply retroactively. The seller will naturally want to limit the definition to those legal requirements in effect at the time of the closing.

- **Environmental Liabilities-** The parties need to identify the specific categories of liabilities that will be allocated by the contracts such as investigation and cleanup costs, fees of engineers and lawyers as well as fines and penalties. The buyer may also want to have extend the term to personal injury and property damage claims of third parties. Because indemnification clauses will not be construed to apply to damages arising out of strict liability unless expressly stated, the buyer will want to make sure that the recitation of the various kinds of liabilities includes a reference to “strict liability” or some other CERCLA-like language.

- **Environmental Liens-** It should be clear that this term is limited to liens filed by a government authority to recover the remedial and investigatory costs incurred by the governmental agency.

- **Hazardous Materials**- Because CERCLA does not apply to petroleum contamination, buyers will want this definition to specifically refer to petroleum and not just CERCLA hazardous substances. In addition, some waste streams that have been excluded from the definition of Hazardous Wastes can still result in liability if those wastes were sent to a landfill that has contaminated the local soil or groundwater. Thus, buyers will also want the definition of hazardous materials to incorporate solid waste or special wastes.

2. REPRESENTATIONS AND WARRANTIES- A representation is a statement of fact to induce another party to enter into a contract. A warranty is a promise that the statement is true. It is intended to allow the promisee from having to determine if the facts are true.

It is important for buyers to note that a representation or warranty is not a substitute for an indemnity or a specific liability allocation provision. On the other hand, the existence of an "as is" clause in lieu of representations and warranties will only insulate a seller from a breach of warranty claim and will not protect the seller from a CERCLA claim by a buyer or other party.

Representations and warranties can be used to help identify and quantify the environmental liabilities, allocate risks or adjust the purchase price. The representations and warranties can help the seller organize its disclosures and records and help the buyer focus its due diligence. The representations and warranties can also help a buyer get a feel for attitude of management towards environmental issues. If the approach of the seller's management is "don't ask us, we want don't tell you, or kill the messenger", the buyer must be prepared to carefully assess the environmental issues associated with the business. Likewise, if management seems to have been careless or negligent regarding environmental compliance, the buyer should be prepared to perform an environmental compliance-style audit in addition to the traditional environmental due diligence investigation that focuses on liability issues. On the other hand, if management has taken a cautious and forward-looking approach, the buyer can gain some assurances from the representations and warranties.

Some buyers choose to limit their due diligence based on the scope of the representations provided in a contract on the grounds that if the representation is untrue, the purchaser can bring a breach of warranty claim. However, the problem with a breach of warranty claim is that the statute of limitations for claim begins when the statement is untrue . If a purchaser does not discover that the representation was untrue until after the statute of limitation expires, the purchaser will not be able to recover its damages. Thus, relying on representations in lieu of due diligence is not advisable especially where the properties have been operated by a number of entities over the years so that there may not be sufficient information especially about historical liabilities. In addition, purchasers who simply rely on representations and warranties will not be able to assert the CERCLA innocent purchaser's defense since reliance on representations is not a substitute for conducting the requisite "appropriate inquiry". Purchasers cannot rely on investigations

done by others even if that investigation was performed diligently.

A seller will want to qualify or limit the scope of its representations while a buyer will want the broadest representation possible. The final document will usually end up somewhere in between those two extremes depending on the bargaining powers of the parties and the particular facts of the transaction.

For example, sellers will often insist that the representations be qualified by "knowledge". It is not unusual to qualify representations regarding claims filed against third parties or sites no longer owned by a seller but buyers will sometimes accept knowledge qualifiers for all representations. Even when a buyer makes such a concession, the parties must then determine whose knowledge will be imputed to the seller. Will the seller be bound by the knowledge of low-level employees or must a corporate officer have knowledge? In addition, the seller will want to be able to disclose exceptions to the representations on a schedule. The buyer needs to make sure that the scheduled exceptions are not material liabilities that eviscerate the representation.

Regardless of the how broadly worded the representations are, they should cover the following topics:

- **The business or assets being sold or transferred are in compliance with laws-** The seller will not want to make an absolute representation that the business is in complete compliance with law but that there are no material violations. If the buyer agrees to a materiality standard, the parties must still determine how much liability will be deemed to be material. The buyer should remember that in some states plant closings may trigger requirements that are not yet in effect. Thus, the buyer needs to consider its business plans and the environmental laws in the states where plants are located before it feels comfortable relying on this representation. If a plant closing will trigger an environmental cleanup, the buyer should carefully assess the environmental liabilities associated with that plant and try to allocate those liabilities to the seller elsewhere in the contract.

- **The business has obtained all permits required to operate the business and they are in full force and effect-** Since this representation involves the operations of the seller, it should not be limited to knowledge. When considering this representation, the buyer needs to think about issues that may not be important now but may become compliance issues in future. The buyer also needs to take into account its business plans for a particular plant. A representation that the plant has obtained all of the required permits may not be sufficient if the buyer plans to make substantial modifications that will require new permits and/or additional controls.

- **There have not been any releases of hazardous materials at currently or formerly owned or operated property-** This representation is designed to determine if there is any CERCLA owner or operator contamination. Sellers will often insist on knowledge qualifiers for properties no longer owned or operated, and may also want to limit this representation to releases that are "reportable" or that subject the business to

material liability. This provision must be carefully drafted. For example, the mere presence of contamination may not be a breach if it was conditioned on violations of laws. It is also important to specify the business, assets and lands that are to covered by the representation and warranty. The buyer will often want to include properties owned or operated by predecessors in interest so that potential successor liability is also covered.

- **There have not been any releases at disposal sites used by current company or predecessors-** This representation addresses CERCLA generator liability. The buyer will want to make sure that the representation includes wastes that were sent to disposal sites by divisions and business units that are no longer part of the existing business as well as predecessors in interest. Sellers often try to limit the length of time of this representation and insist that knowledge or notice be a condition of the representation. For example, the seller may be willing to say that to the best of its knowledge, it has not received any notice of any releases at any disposal sites used by the business during the past five years. Because most companies do not have waste disposal records that pre-date CERCLA, buyers need to exercise extreme caution before agreeing to limit the time period for this representation.

- **No environmental claims have been asserted against the business or any disposal site used by the business-** This representation addresses liabilities directly associated with the business being conveyed as well as potential generator liability for disposal locations. The seller will want to add a knowledge qualifier for environmental claims not yet asserted and for those related to the generator liability. In addition, sellers often also want a materiality qualifier. Buyers should try to have this representation extended to prior divisions, business units that have been sold or shutdown and corporate predecessors.

- **No Environmental Liens-** Some states have enacted Superlien laws that allow governments to attach liens on contaminated property or the assets of a business in a state to secure payment of cleanup costs incurred by a state. Since this can cloud title and complicate financing, sellers should represent that there are no environmental liens. Like other representations, the seller will often want to condition this representation on knowledge or lack of notice of such a lien.

- **Accuracy of Documents-** As part of the due diligence process, a seller will provide a buyer with relevant environmental documentation. These documents help the buyer assess the environmental conditions of the business and assist in the development of its due diligence program. A buyer will often ask that the seller represent that it has provided all documentation relating to environmental matters. A seller will often want to limit this representation to documents that it has knowledge of and that are in its possession. Sometimes, the parties actually list in a schedule all of the documents that have been furnished to the buyer.

3. Pre-Closing Covenants- A covenant is a promise by a party to take perform certain tasks or refrain from taking certain actions. Agreements will often require the seller to correct environmental problems uncovered during the due diligence period, obtain No

Further Action Letters or other government approvals, close inactive tanks, obtain an approved remediation plan or perhaps even complete a remediation prior to closing. If the remediation will require the establishment of engineering or institutional controls that restrict the use of the property, a seller may require the buyer to covenant that it will maintain those controls and comply with any associated use restrictions.

4. Indemnities - An indemnity is a full and complete shifting of liability to another party. A party may be entitled under common law to indemnify when it incurs the obligations of another or may contractually agree or obtain a right to indemnification. When an on-going business is being sold, the purchaser will often request that the seller indemnify the buyer for all environmental liabilities that existed prior to the closing even where a claim may be asserted against the buyer after the closing. A seller, on the other hand, will prefer to sell assets on an "as is " basis although as explained earlier, an "as is" transaction does not necessarily relieve a seller of CERCLA liability. Environmental indemnities can provide protection to a buyer in the event that a breach of warranty claim is precluded because of an expired statute of limitations. An environmental indemnity is usually one of the most heavily negotiated aspects of a corporate transaction and the final form of the indemnity will usually lie between the two aforementioned polar extremes.

A particularly vexing problem can arise when an older plant has had several different owners who may have contributed to historical contamination at the site. A seller may be willing to indemnify a purchaser for contamination caused by its operations but will be reluctant to provide an indemnity for historical contamination caused by previous owners or operators. This negotiation can be exacerbated when the seller did not obtain an environmental indemnity when it acquired the plant. The seller's argument will be that both the seller and the purchaser are not responsible for the contamination so the seller should not have to absorb all of the liability for contamination it did not cause. Of course, the purchaser's perspective will be that the seller as the current owner is responsible under CERCLA for all contamination associated with the site.

One of the first items that a purchaser should look for when negotiating an indemnity is to determine if there are pre-existing indemnity agreements affecting the assets it is buying. Did the seller agree to assume certain liabilities when it acquired the business it is now selling or were the environmental liabilities retained by the original seller? Some chemical companies have gone through a number of corporate transactions and restructurings over the years. A business may have been sold and become a subsidiary of one company. Some of the product lines of the business may have been discontinued and then it may have been sold again and made into a division of another corporation before being spun out into an independent entity once again. Trying to track the flow of liabilities in such convoluted transactions can be an arduous process. Further complicating this process is that most contracts did not begin to address CERCLA liability until the mid-1980s and earlier contracts may not have even had any specific references to environmental liabilities. Nevertheless, many courts have held that if an indemnification provision of a pre-CERCLA contract has sweeping language such as "any and all liabilities", it may be sufficiently broad in scope to encompass CERCLA liability.

a. Scope of the Indemnity- In drafting an environmental indemnity, it is important to use precise and specific language to describe the environmental liabilities that are being allocated. A clause referring to "Environmental conditions associated with business" is not as effective as a clause which references the contamination identified in the due diligence reports. It is also important that the language of an environmental indemnity be consistent with language used in the general indemnity contained elsewhere in the contract. For example, if the general indemnity states that the seller will indemnify the buyer for liabilities not expressly assumed but the environmental indemnity states that seller only agrees to indemnify buyer for those conditions set forth in due diligence reports, this could create an ambiguity that may force the parties into court.

Some environmental indemnities are linked to a breach of the environmental representations and warranties. From the purchaser's perspective, it is better to have a stand-alone environmental indemnity which states that specific conditions that the seller must indemnity the buyer. These conditions can include violations of law, releases of hazardous substances occurring prior to the closing at the properties being transferred as well liability for the cleanup of contamination at sites that received Hazardous Wastes generated by the company prior to the closing. Purchasers may also want that indemnity to apply to environmental conditions that are unknown at the time of the closing although the seller will want to limit the scope of its indemnity to the environmental issues discovered during the due diligence period. A purchaser may be willing to limit the indemnity in this manner if it is reasonably comfortable with the extent of its due diligence. Another vexing issue will be liability for personal injury and property damage suffered by persons living or working on neighboring properties as a result of contaminants migrating from the manufacturing plants. Since the purchaser will likely be continuing to operate these plants, the sellers will be reluctant to provide an indemnity for such claims that are asserted after the closing. Another issue that may will need to be addressed will be changes in laws or cleanup standards that require a pre-closing condition that does not presently require corrective to be remediation after the closing.

b. Indemnity Triggers- Once the parties decide on what conditions are to be covered by the indemnity, the next issue to be resolved is what events must take place to trigger the indemnity obligation. Sometimes the condition is simply the discovering of contamination but in this era of risk-based cleanups where states are allowing higher residual contamination to be left in place, a seller may feel that this trigger is too broad. Instead, a seller may prefer that the indemnity be triggered by an action required by law such as the purchaser receiving a order or demand letter from a government agency or third party. For example, if a purchaser decides to expand a plant and uncovers contaminated soil that must be excavated to install footings for a new building, the seller will want to make sure that such costs related to the construction project are not included in the indemnity.

Another difficult issue is if the purchaser decides to perform a cleanup under a state

voluntary cleanup program. Since the purchaser was not required to perform the cleanup but decided for business or corporate purposes to undertake the cleanup, a seller will argue that such costs should not be covered by the indemnity since they were not required by law. Moreover, the voluntary nature of the cleanup may preclude insurance coverage for those costs.

c. Notice Requirements- There are often times other conditions that must be satisfied before the buyer can make a claim under the indemnity. Sometimes, the buyer is required to file a claim within a certain period of time or it will forfeit its right to seek indemnity. It may also have to provide the sellers with copies of reports on a periodic basis and furnish copies of any correspondence or reports filed or received from regulators. Failure to comply with these provisions will often result in the forfeiture of the indemnity claims.

d. Appropriate Cleanups-Even after a trigger occurs, the seller will want to make sure that the purchaser is undertaking a rationale cleanup and not using the indemnity to modernize its plant. The parties should establish a mechanism for determining the appropriate cleanup levels and criteria used to develop those standards. For example, the buyer may be required to use the most cost-effective remedy that would have to be developed after investigating certain mandated exposure pathways. The parties also need to specify if engineering or institutional controls must be considered in developing a cleanup standard.

e. Cost-Sharing Arrangements- To make sure that both parties have an incentive to control the costs of a cleanup, most indemnifications have some sort of cost-sharing approach. The are many kinds of formulas that can be used. Some examples are indemnities with deductibles of certain amounts, limiting the indemnity to historical contamination from a certain time period especially where a site may have had a series of owners, responses costs exceeding certain floor or deductible, response costs below a certain cap, a floor and cap with both parties sharing equally thereafter , and sliding scale arrangements.

Approximately 20 states have now established funding mechanisms to pay for certain kinds of contaminated sites. In addition, some states have established trust funds that pay for the cleanup of contamination caused by underground storage tanks. Some indemnity agreements require the buyer to try to tap these government-funding sources before making a claim under the indemnity. Others require the buyer to assign their rights to seek reimbursement from these funds to the seller in the event the seller performs a remediation pursuant to an indemnity claim.

f. Funding the Indemnity- When the seller is conveying all or substantially all of its assets, a purchaser will want to “collateralize” the seller’s promise to pay. Common mechanisms that can be used to provide a buyer with some assurances that the seller will be able to fulfill its indemnity obligations include holdbacks or deferred payments of the purchase price , establishment of an escrow account from the proceeds of the sale, a Letter of Credit, and a bond. There are also some new

insurance products that can help reduce the environmental risks of the parties. These policies can cover cleanup costs that exceed estimates for previously known contamination, regulatory re-openers where a government agency requires additional cleanup after the cleanup has been approved and completed, discovery of new contamination, third party bodily injury and property damage due to off-site migration of contaminants and new releases of contamination from current operations.

g. Termination of Indemnity- An indemnity may terminate on its own terms after an agreed upon period of time or upon the receipt of a governmental signoff when the indemnity is primarily directed to a limited number of identified environmental conditions. The length of the indemnity will vary depending on the kinds of environmental conditions and the bargaining power of the parties. While there is no customary period for environmental indemnities, it is not unusual to see indemnities of three to five years in length. It should be noted that some courts hold that an indemnity with no survival is limited to statute of limitations established for contracts in a particular state or for reasonable period of time.

h. Exclusive Remedy- Many state and federal environmental laws contain statutory rights of contribution or cost recovery. In addition, the common law of many states can be used to recover cleanup costs and other environmental liabilities that may be incurred. As a result, it is increasingly common for sellers to insert in the indemnification that it is the sole and exclusive remedy of the buyer and that the buyer waives any other rights it may have to recover its environmental liabilities. This will prevent the buyer from recovering damages that are not covered by the indemnity such as non-qualified costs and deductibles.

5. ASSUMPTION OF RISK AND RELEASES- Because of the recent changes in accounting rules and increased SEC interest in environmental disclosure, sellers are becoming increasingly reluctant to give broad indemnities since the liabilities associated with these indemnities must be reported on a seller's financial statements. With the availability of new insurance products that can provide coverage for existing and unknown environmental conditions, purchasers are more willing to assume the risks associated with some transactions in exchange for a reduced purchaser price.

Sometimes the assumption agreements will be limited to known conditions but other times they may extend to unknown environmental conditions as well. The purchasers may release the seller from future liability or may assume responsibility for performing the environmental work that has to be done. Sellers may want an indemnity from the purchaser since a release from a purchaser may not be binding on third parties.

6. REMEDIATION AGREEMENTS- Sometimes, parties use a separate remediation agreement in addition to or in lieu of an indemnification. In these agreements, one party commits to performing remediation after the closing . The remediation may be funded out of the proceeds of the transaction, insurance or state cleanup funds.

One of the key issues in these agreements is who maintains controls over the remediation. The seller will be concerned about the buyer performing excessive cleanup (removing soils below regulatory levels) may fear that the Buyer will exacerbate conditions which could enlarge the seller's liability. The buyer may also be concerned that the seller will not perform a sufficiently comprehensive cleanup. If the buyer will be doing the cleanup using escrow funds, the parties will need to create a mechanism to make sure not that the funds are not being improperly used. It would be advisable to build in a dispute resolution mechanism to resolve disagreements over the sufficiency of the cleanup and its costs.

The buyer may also want to specify the cleanup level but this can be difficult in today's era of risk-based cleanup alternatives. It is better to describe exactly the kind of cleanup to be conducted and what is allowable (deed restrictions, institutional controls, residential vs. institutional cleanup standards).

Before a cleanup plan is proposed, it is important for the parties to understand buyer's plans for a facility. For example, if the buyer will be demolishing, expanding or building new structures, it may be advisable to locate the building in less contaminated areas and use a parking lot as a cap for the more heavily contaminated areas.

If institutional or engineering controls will be used as part of the remedy, it is important that these controls do not interfere with the buyer's construction or expansion plans. For example, the buyer may want to expand or modify a building but may be prohibited from digging up soil or laying new utility lines. The parties also need to reach an understanding on who will be responsible for maintaining the controls. In some states, purchasers who qualify for the innocent purchaser defense can lose their immunity from liability if they fail to maintain existing engineering or institutional controls. Thus, purchasers need to carefully review their plans for a facility to make sure the controls will not be disturbed and to establish adequate procedures for monitoring the integrity of those controls. Moreover, purchasers who could assert the CERCLA third party defense to liability may also forfeit their immunity from liability if they allow controls to fall into disrepair since the purchasers could be deemed to have failed to exercise due care regarding the hazardous substances on the property.

Parties should consider contacting state regulators before entering into a remediation agreement. It may be possible for a purchaser to enter into an order on consent that will set forth the scope of the cleanup that must be performed. In addition, the consent order could provide for the issuance of a release and covenant not to sue to the parties upon the completion of the required work .

The parties can also try to enter into a brownfield or Voluntary Cleanup Program ("VCP") agreement. Approximately 40 states have established VCPs. While the VCPs vary from state-to-state, they generally provide volunteers who agree to remediate contaminated sites with releases from liability, provide for relaxed cleanup standards and streamlined Cleanup Procedures, grant contribution protection to the volunteers and provide for the issuance of No Further Action ("NFA") Letters and Covenants Not to

Sue (“CNTS”) from the state environmental agency.

VCP agreements can be used to expedite transactions and provide parties to a transaction with objective standards for allocating environmental liabilities. The parties can agree that the seller’s environmental obligations will be limited to those tasks set forth in a VCP agreement. The remediation obligations at a site can be governed by the cleanup standards contained in the VCP agreement. Moreover, the parties could also agree to limit the environmental conditions subject to an indemnity to the contamination covered by the VCP agreement. Finally, the VCP can provide the parties with an exit strategy for the cleanup. The indemnity obligations can be terminated upon the receipt of a NFA and CNTS. Sometimes, the VCP agreements can also be used in lieu of indemnity agreements.

One drawback of these VCP agreements is that while the cleanups may be able to progress at a faster pace, they may not comply with the requirements of the federal National Contingency Plan (“NCP”) which is the blueprint that site investigations and cleanup must follow under CERCLA. Parties that do not comply with the NCP will not be able to recover their cleanup costs from other PRPs. As a result, some VCP participants will still perform NCP-quality cleanups to preserve their rights to recover their costs.

PART VII

Using the Bankruptcy Code To Minimize Environmental Liability

The primary objectives of the federal Bankruptcy Code (the "Code") are to preserve the assets of a debtor so that they may be equitably distributed to creditors and to provide deserving debtors with the opportunity to make a fresh economic start. 11 U.S.C. 101-151326 The Code's goal of protecting debtors sometimes clashes with state and federal environmental laws designed to protect public health and safety. Corrective action directives under RCRA or response actions under CERCLA can drain capital from a company struggling to continue operations under Chapter 11 or can deplete assets otherwise available for distribution to creditors in a liquidation proceeding. Moreover, the priority structure of the Code may be altered when the government performs a cleanup or obtains an injunction ordering a debtor to clean up a site because the government will be a creditor within the meaning of the Code for the amount expended to clean up the property and may seek to have its claim satisfied out of the liquidation proceeds due secured creditors.

In the late 1980s and early 1990s, debtors tried to invoke the Code to avoid complying with cleanup orders, injunctions and cost recovery or contribution actions filed by EPA or other PRPs. Sometimes, EPA was unable to recover its costs because it failed to file claims until after the bankruptcy plan was confirmed and the debtor discharged from pre-bankruptcy liabilities. As a result, EPA established a National Bankruptcy Lead Region Work Group to ensure that the agency would timely file claims for response costs and that that environmental liabilities of debtors are adequately addressed in reorganization

plans or liquidation proceedings

A. Automatic Stay- When a bankruptcy petition is filed, section 362 automatically imposes a stay on the commencement or continuation of proceedings based on pre-petition claims and on the enforcement of judgments seeking recovery on pre-petition claims. 11 U.S.C. 362. The purpose of the automatic stay provision is to halt all collection efforts by creditors and give the debtor a breathing spell" so that it can reorganize or develop a plan for equitably distributing its assets among creditors.

Congress did carve out certain exceptions to the automatic stay that may be commenced or enforced notwithstanding the initiation of bankruptcy proceedings. 11 U.S.C. 362(b). One such exception contained in section 362(b)(4) allows actions or proceedings brought by the government to enforce police or regulatory powers. The legislative history of this particular provision specifically indicates that it was intended to exempt actions to prevent or stop violations of environmental laws. A second important exception to the automatic stay appears in section 362(b)(5) and permits governmental units to enforce non-money judgments against a debtor. It is important to note that these exceptions do not apply to private party actions or citizen suits.

Many DIPs and trustees have argued that the "exceptions to the exception" preclude government agencies from assessing and collecting fines for regulatory violations occurring prior to the bankruptcy filing or from enforcing pre-petition injunctions requiring debtors to expend funds to abate hazardous conditions because doing so would constitute enforcement of a money judgment. Their argument has particular appeal when the injunction seeks cleanup of past contamination as opposed to ordering the debtor to cease on-going discharges or pollution activities. As a result, courts addressing this issue have split over how broadly to interpret these exceptions. A majority of courts have ruled that these proceedings are exempt from the automatic stay and have compelled the expenditure of funds from the bankruptcy estate for purposes of environmental law compliance.

B. Discharge of Claims- The primary guiding principle behind the Code is that the debtor will be released or "discharged" from all pre-bankruptcy liabilities which the Code refers to as "claims." A discharge has the effect of voiding any judgment obtained against the debtor that relates to the discharged debt and also acts as an injunction against the commencement or continuation of an action related to the discharged debt. 11 U.S.C. 524(a). The timing and scope of the discharge is also the chief battleground where the clash between the goals of the Code and environmental statutes is waged.

1. What is a Claim?

Courts will have little difficulty finding that cost recovery actions brought by environmental agencies or private parties seeking reimbursement of cleanup costs qualify as claims. The treatment of administrative orders or injunctive relief is more vexing. There is also little dispute that negative orders or injunctions that simply direct a debtor to cease polluting should fall outside the definition of claim. However, the courts are

divided when there is an affirmative order or injunction instructing the debtor to take corrective action such as installing pollution control equipment, replenishing wetlands, or restoring a strip mine.

Some courts have found that the order is not a claim even though it will require the debtor to spend money because the government has no right to payment. For example, in In re Chateaugay Corp., 944 F.2d 997 (2d Cir. 1991) the Second Circuit found that injunctions requiring debtors to stop current pollution or discharges would fall on the non-claim side. If an injunction contained both elements, the court ruled that this "dual objective" order would not be a "claim." The court reasoned that the government could not accept payment in lieu of compliance with the portion of an order directing a debtor to stop or ameliorate current pollution. Thus, it was not an order for the breach of an obligation that created a right to payment.

It appears that LTV may only apply to orders covering sites presently owned or leased by the debtor. The LTV court said that because 28 U.S.C. 959(b) required DIPs and trustees to manage and operate a property in compliance with environmental laws, the LTV court could not see how an injunction requiring cessation of on-going pollution could be dischargeable. However, this rationale would not appear to apply to a waste disposal facility that simply received waste generated by the debtor nor to a property previously sold by the debtor since the debtor would not be operating or managing in any way this facility. Such a result would also be consistent with the U.S. Supreme Court decision in Ohio v. Kovacs decision ,469 U.S. 274, 105 S. Ct. 710 (1985), where the debtor had been stripped of control over its property and the only way it could comply with the order was through the payment of money. Thus, if the government issues an order compelling a debtor to clean up a site that received hazardous wastes generated by the debtor or to remediate a site that it sold prior to the bankruptcy, the order should be dischargeable since (1) it would not be seeking to remedy "on-going pollution" but, instead, the cleanup or removal of wastes that were deposited in the past, and (2) the only way that the debtor could comply with the order was by a monetary payment. LTV also suggests that when a debtor is sitting on historical contamination and it may be difficult to distinguish between cleaning up current or historical pollution, a court may require the debtor to clean up the entire mess.

2. When does a Claim Arise?

The Code does not expressly indicate when a claim is deemed to arise. However, courts will generally try to select the earliest possible date when the claim could have arisen in order to give as full a discharge as possible and to honor congressional intent that claims be broadly construed so that all legal obligations of the debtor no matter how remote can be addressed in the bankruptcy proceeding. Most courts appear to hold that an environmental claim occurs when the conduct giving rise to the claim took place. Under this view, a claim will exist if all the elements that are necessary for creating a legal obligation exist even if the cause of action itself has not yet ripened or accrued. When the debtor faces potential CERCLA liability, the courts that use conduct to measure the time when a claim arises have ruled that an environmental claim occurs when there has been a

release of hazardous substances or the debtor has arranged for the disposal of hazardous substances. For example, in LTV, the Second Circuit found that pre-petition releases or threatened releases of hazardous substances gave EPA a contingent claim.

Other courts, however, equate a claim with a cause of action and have ruled that a claim will not arise until a cause of action accrues (i.e., the creditor has a right to payment). Under this approach, a claim based on CERCLA liability will not arise until the creditor incurs response costs or, even more remotely, is found liable under CERCLA. Some courts have even gone as far as holding that claims based on CERCLA liability will not be discharged if the confirmation of the reorganization plan took place before the enactment of CERCLA. The rationale for these decisions is that since the statutory basis for liability did not exist at the time of the confirmation, there was no legal relationship between the debtor and creditor that could lead to the creation of a contingent claim. In re Duplan Corp., 212 F.3d 144 (2d Cir. 2000).

Recently, another line of cases has emerged which hold that where a debtor fails to give notice of its environmental liability to potential PRPs, the contribution claims of those creditor PRPs will not be discharged. United States v. Union Scrap Iron & Metal, 123 Bankr. 831 (D. Minn. 1990).

3. Disallowance and Estimation of Claims-

Under section 502(e)(1)(B), a debtor may bring an adversary proceeding to have a contingent claim for contribution or reimbursement disallowed when the creditor is liable as a joint tortfeasor with the debtor. 11 U.S.C. 502(e)(1)(B). This section was meant to exclude claims of parties who are secondarily liable with the debtor to a third party and was intended to prevent competition between the creditor and debtor for the limited proceeds of the bankruptcy estate. The disallowance procedures can be a powerful tool that can be used against landlords and other PRPs who are jointly or severally liable with the debtor. If their claims are disallowed, the creditors will be precluded from participating in the distribution.

The other important tool for debtors is the section 502(c) estimation proceeding. Under this section, a debtor may compel estimation of contingent or unliquidated claims if the fixing of the claim would unduly delay the administration of the bankruptcy estate. Unlike section 502(e), the estimation proceeding can be used to reduce government claims. The bankruptcy court may exercise broad discretion when estimating contingent claims. The estimation proceeding can be a particularly effective tool where a debtor is a PRP at a site where the RI/FS has not yet been completed. With little information available about the extent of the contamination, the court may set an artificially low value for the allowable claim which cannot be subsequently adjusted upward because most courts have ruled that the 502(c) estimation is a "cap" on the allowed cap. For example, in In re Dant & Russell, Inc., No. 89-35422 (9th Cir. Dec. 30, 1991) the landlord of the debtor sought $1 million in past response costs and another $13 million in anticipated response costs attributable to contamination caused by the debtor's operations. The bankruptcy court declared the debtor liable for 52% of the past and future cleanup costs

but the Ninth Circuit ruled that the debtor could only be responsible for the cleanup costs that had actually been incurred to date.

4. Priority of Claims

Once an environmental claim has been deemed to be an allowable claim, the next question to be resolved is how that claim will be treated or classified for purposes of participating in the distribution of the debtor's assets. Generally, creditors who have perfected liens on property of the debtor prior to the filing of a bankruptcy petition are given the broadest protection. These secured claims are satisfied out of the proceeds of the attached collateral up to the value of the collateral and may only generally be subordinated by the claims of more senior secured creditors. Unsecured claims, which may include trade debt, tort claims, and contract rights, share pro rata in the proceeds of the estate after the secured creditor claims are satisfied.

Under section 503(b)(1)(A) of the Code, administrative expense priority may be given to post-petition claims for necessary expenses that are incurred in order to preserve the estate. Debtors generally will want to have environmental claims treated as general, unsecured claims because of the potential impact on the confirmation plan. Administrative claims must be paid in full on the effective date of the confirmation plan, and, if the environmental claims are classified as administrative claims, the debtor may not have the cash to satisfy these claims. As a result, the plan may not be confirmable because it may no longer be feasible under section 1129(a). If the claims are classified as general, unsecured claims, the debtor might be able to negotiate the amount of the claims or to make payment over time.

For cleanup costs associated with discharges occurring post-petition in a chapter 11 reorganization, the trend seems to be that these costs should be afforded administrative expense priority as necessary expenses for preserving the estate. The rationale is often that 28 U.S.C. 959(b) requires trustees to comply with environmental laws. Administrative expense priority is also awarded when a trustee is not allowed to abandon property

A more difficult question for the courts is the treatment of cleanup costs that are assessed post-petition but that relate to pre-petition releases. Some courts have ruled that these claims should be treated as unsecured claims either because the release or the claim for indemnification occurred pre-petition. In re Dant & Russell, Inc., 853 F.2d 700 (9th Cir. 1989). However, the trend would appear to be to grant administrative expense priority for cleanup costs assessed post-petition regardless of when the discharge took place, especially when the government is the claimant.

When the unencumbered assets of the debtor are insufficient to cover the environmental claims and the debtor is located in a state that does not have a "superlien" statute, the government has tried to have its claims afforded super-priority status under section 506(c). This section provides that a trustee will be given a super-priority lien over previously perfected security interests in order to recover reasonable costs that are

necessary to preserve the secured property to the extent the money spent benefits the holder of the secured claim. Most of the cases that have been decided under this section involved the sale of personal property, and in each case the court denied the government's request on the basis that the cleanup of real property did not confer a benefit on the holder of a security interest in personal property.

If a debtor is compelled to undertake a cleanup and lacks the resources to finance the work, the debtor can try to use the cash collateral of a secured creditor under section 363(b) to fund the cleanup. Under section 363(f), the debtor may use the cash collateral only if the lender consents or is provided with "adequate protection. What constitutes such protection is unclear, but it may be in the form of guarantees or additional liens. The use of cash collateral is an extraordinary remedy and should be used only in situations that pose an imminent danger to human health or the environment. In re Grimland, 243 F.3d. 228 (5th Cir. 2001).

C. Abandonment-

Code section 554 authorizes a trustee to abandon property that is "burdensome and of inconsequential value" to the bankruptcy estate. Debtors-in-possession ("DIP") in a chapter 11 reorganization proceeding can also abandon property. While the abandonment property is broad, it is not unlimited. The United States Supreme Court ruled in *Midlantic National Bank v. NJDEP* (474 U.S. 1986) that a trustee court may not abandon of property that would violate laws that are reasonably designed to protect human health and safety. The ruling went on to say that a bankruptcy court may not authorize abandonment without formulating conditions to make sure that the abandonment would not pose an immediate and identifiable harm to public health and safety.

Immediately after the Midlantic decision, a number of bankruptcy courts refused to approve abandonment. However, the overwhelming majority of decisions since the mid-1990s have not only authorized abandonment but have often done so without imposing any conditions on the abandonment. In nearly all these cases, there was some level of contamination and frequently the contamination was above cleanup levels. However, because the state had either not taken any action to abate the contamination or bring an enforcement action against the debtor, or because the debtor lacked sufficient funds to remediate the site, the court authorized the abandonment.

Abandonment is a more viable option when there is a chapter 7 or chapter 11 liquidation proceeding since the property will usually be abandoned to an insolvent debtor or a creditor. However, abandonment is more problematic in a chapter 11 reorganization since after the bankruptcy case is completed, the estate of debtor will be merged with the reorganized company. Thus, property abandoned in a chapter 11 reorganization to the debtor would end up owned by the reorganized property.

This strategy may now become more useful to chapter 11 DIPs or trustees since the passage of the CERCLA 2002 Amendments. Under this scenario, the debtor could sell off profitable assets to reorganize its business and abandon contaminated properties to a

creditor who would then utilize the Bona Fide Prospective Purchaser defense to avoid liability and find a third party to develop the site. Another strategy that has been used is to abandon property to a trust.

D. Rejection of Leases-

Section 365 of the Code allows the debtor or a trustee to reject executory contracts. 11 U.S.C. 365. The Code does not define what constitutes an "executory contract" but it is commonly understood to mean a contract where obligations of the parties are unperformed so that the failure of either party to perform would constitute a material breach that would excuse the other from performing. This section can be used to terminate unexpired leases, a contract with a negative covenant and an acquisition agreement where the debtor has an outstanding indemnity obligation. When an executory contract is rejected, the contract will be deemed to have been breached and the other contracting party will have a general, unsecured claim.

This power is somewhat akin to the abandonment power and is a concern of landlords since a DIP or trustee may be able to vacate premises that have been contaminated with hazardous wastes or abandoned underground storage tanks that have to undergo closure and leave the landlord with the burden of remediating the property. Moreover, the landlords often are unable to have their cleanup costs afforded administrative expense priority but instead are treated as general, unsecured claims

For example, in In re Circle K Corp., No. B-90-5052-PHX-GBN (Bankr. D. Ariz. April 5, 1991), a debtor was permitted to vacate property containing underground storage tanks as part of a Chapter 11 reorganization. In that case, the debtor had elected to close numerous unprofitable stores containing leaking tanks as part of its reorganization plan. The debtor complied with the temporary closure requirements but did not take the tanks through permanent closure. Because rejection of unprofitable leases was fundamental to the success of the reorganization plan and because the court felt that tanks did not pose an immediate threat to the environment, the court authorized the lease rejection.

Parties who have contracted with the debtor should also argue that the contracts are not executory and has expired upon its terms. For example, if the debtor has defaulted under a contract and the cure period has expired, the non-debtor can argue that the contract has terminated. Some courts have held that the automatic stay will generally not toll the running of the cure period but that the debtor has 60 days from the order for relief under section 108(b). However, other courts have held that the debtor may cure a default any time prior to the confirmation of the plan. Thus, it will be important for the non-debtor to have the executory issue adjudicated by the bankruptcy court or request that the automatic stay be lifted to allow a state court to resolve the issue

Before a DIP or trustee can assume a lease, the debtor must cure any defaults. Thus, if the other contracting party fails to assert a default and the contract is then assumed, the non-debtor will be precluded from later asserting a breach of a contract. This can be particularly important in leases where the debtor may have violated covenants to comply

with environmental laws. If the landlord fails to raise the default, it may only be able to obtain damages for environmental liability arising post-petition activities. Likewise, a federal appellate court allowed a debtor/landlord to reject leases since the debtor was not relieved of the obligation to comply with local housing codes. In so doing, the court noted that private leases may contain covenants that go beyond the services required by local law. To the extent the leases contained such covenants, the rejection of the leases would relieve the debtor of those contractual obligations.

E. Free and Clear Sales- Section 363(f) of the Code permits a court to approve sales of property "free and clear of any liens and interests". the federal courts are divided on whether a sale of assets free and clear pursuant to section 363(f) can insulate the asset purchaser from environmental liabilities associated with those assets. Some federal district courts have held that environmental liability does not fall within the meaning of "liens and interests" or that the bankruptcy court does not have the jurisdiction to alter the CERCLA liability scheme or cutoff the rights of parties under federal environmental laws. Other courts, though, have ruled that sales pursuant to section 363(f) includes environmental liability particularly where the asset being acquired is real property.

In some instances, courts have expressly referred to environmental liabilities as among the interests cutoff by the sale. There has been some dispute over whether a bankruptcy court had the authority to interfere with the CERCLA liability scheme that would impose liability on the purchaser as a current owner unless it could assert either the third party defense or innocent purchaser's defense. From a practical standpoint, the innocent purchaser defense would not be available unless the purchaser conducted due diligence and was not aware of any contamination. Given this uncertainty, purchasers entered into PPAs as in the foregoing case.

However, with the new bona fide prospective purchaser defense, purchasers may now knowingly acquire contaminated property without incurring CERCLA liability. As a result, 365(f) orders may become a more viable tool in brownfield development. Some developers of brownfield sites believe they can use section 363(f) to avoid liabilities associated with contaminated properties where they might not qualify for an innocent purchaser or prospective purchaser defense and then use the new Bona Fide Prospective Purchaser Defense to eliminate their liability as a current owner of contaminated property.

F. EPA Guidance- In 1997, EPA issued a guidance document "Guidance on EPA Participation in Bankruptcy Cases" which identifies the factors EPA will consider when determining whether to participate in a bankruptcy case, including whether to pursue collection of costs or penalties against debtors who have liability under CERCLA or other environmental statutes.

One factor that EPA will consider when deciding whether to file a proof of claim is the potential amount that may be recovered as well as the priority that will be afforded to the claim. Another factor is the amount of funds available for distribution in the bankruptcy

case and the priority and amount of other claims against the bankruptcy estate.

EPA will also evaluate the resources that will have to be allocated for such things as discovery for substantiating the claim and expert testimony for developing remedial estimates. The agency indicated that the resources should be measured against the potential gain in filing a claim. For example, in a CERCLA case where there are other viable PRPs, or where other viable PRPs are already committed to undertake the cleanup, the guidance document stated that the resources needed to pursue a claim in bankruptcy against a debtor PRP may outweigh any anticipated return. Further, in CERCLA cases where the Agency has not yet selected a remedy, the resources needed to establish the likely remedy and the estimated cost of such remedy before the bankruptcy court may outweigh any anticipated return.

The guidance document also indicated that EPA may consider other factors such as the likelihood that other PRPs may not be able to recover their fair share of costs from the debtor because the contribution action may be considered a contingent claim for contribution and disallowed pursuant to section 502(e)(1). In such circumstances, EPA may elect to proceed with the filing of a claim against the debtor PRP
Finally, the agency will consider the usual factors that are taken into account in deciding whether to take enforcement action in a non-bankruptcy case such as the culpability of the debtor, the strength of the evidence against the debtor, the deterrence value of such action, the precedential value of such action and the interests of justice and equity.

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[1] The guidance does not change the cleanup criteria but clarifies the process for characterizing sites. Some environmental consultants maintain that 50% of the costs of site characterization can be associated with negotiating the procedures to be used to investigate and remediate a site. By establishing a roadmap for site characterization, DER hopes that this process can be streamlined and become less time-consuming.
[2] The DOH may also order a responsible party to cleanup a significant threat under the Public Health Law which will supercede any order issued by DEC. §27-1313.3.a
[3] Because of the present tense of the gerunds used to define a discharge (e.g., spilling, leaking, releasing), it is unclear if the reporting obligations apply to historical petroleum contamination that is discovered long after the discharge took place. Many NYDEC region offices interpret the discovery of any petroleum contamination to be a reportable event.
[4] "Municipality" includes counties, cities, towns and villages as well as local public authorities, public benefit corporations, school and supervisory districts and improvement districts.
[5] The CWSRF is jointly administered by the Environmental Facilities Corporation (“EFC”) and NYDEC.

[6] The Procedures Handbook for Municipal Assistance Environmental Restoration Projects contains suggested formats for the SI/RAR.
[7] Previously, the regulated community has had to rely on speeches for guidance on the scope of the program which we have termed in the past to be "rulemaking by speechmaking."
[8] If a facility is subject to RCRA corrective action or closure requirements, it is not eligible for the VCP.
[9] The VCA will refer to "Existing Contamination" which is the contamination known to exist at the time of the execution of the agreement. Covered Contamination refers to the residual contamination that may remain at a site when the cleanup is completed.
[10] See House Debate on H.R. 85, 96th Cong., 1st. Sess. (1979) (Sept. 18, 1980), reprinted in 2 A Legislative Report of the CERCLA, Senate Comm. On Environmental and Public Works, 97th Cong., 2d Sess., 889,945 (Comm. Print 1983).
[11] P.L. 101-73 (Aug. 9, 1989)
[12] 56 FR 28799 (June 24, 1991)
[13] 57 FR 18344 (April 29, 1992). This rule was vacated by the Court of Appeals for the District of Columbia in 1994 in Kelly v. EPA ,15 F.3d 1101 (D.C. Cir. 1994). On December 11, 1995, EPA and the Department of Justice announced that they would enforce the provisions of the 1992 CERCLA Lender Liable rule that had been invalidated by the DC Circuit (60 FR 63517, December 11, 1995).
[14] 60 FR 46692 (September 7, 1995)
[15] Omnibus Consolidated Appropriations Act of 1997, P.L. 104-208 §§ 2501-2505, 110 Stat. 3009 (Sept. 30, 1996)
[16] 42 U.S.C. 9607(n)(6)(B)
[17] 42 U.S.C. 9601(20)(E)(i)
[18] A lender will not be considered a CERCLA owner or operator if it did not participate in the management of a facility prior to foreclosure, forecloses on the facility or vessel, and then follows certain requirements. After foreclosure, the lender may maintain business activities, wind up operations, undertake a response action in accordance with the NCP or under the direction of an on-scene coordinator, or otherwise take any other actions to preserve, protect or prepare the vessel or facility prior to sale or disposition provided the lender tries to sell , re-lease or otherwise divest itself of the facility or vessel at the earliest practicable, commercially reasonable time, and on commercially reasonable terms after taking into account market conditions and legal or regulatory requirements. Id at. 9601(20)(E)(ii).
[19] 42 U.S.C. 6991(b)(h)(9)
[20] Id. at 6991(b)(h)(9)(B).
[21] Id. at 6991(b)(h)(9)(C)
[22] 15 U.S.C. 2601
[23] These include an insured depository institution, an insured credit union, a bank or association chartered under the Farm Credit Act, a leasing or trust company that is an affiliate of an insured depository institution as well as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Agricultural Mortgage Corporation, or any other entity that in a bona fide manner buys or sells loans or interests in loans. 42 U.S.C. 9601(20)(G)(iv)(I)-(IV),(VI)

[24] Id. at 9601(20)(G)(iv)
[25] 40 CFR 300.1100(a)
[26] 42 U.S.C. 9601(20)(G)(vi)
[27] Id at 9601(20)(F)(ii)
[28] An extension of credit includes a lease finance transaction where the lessor does not initially select the leased vessel or facility, during the term of the lease does not control the daily operation or maintenance of the vessel or facility, or the transaction conforms with regulations issued by a federal banking agency, an appropriate state bank supervisor or with regulations promulgated by the National Credit Union Administration Board. Id. at 9601(20)(G)(i)
[29] Id. at 9601(20)(F)(iv)
[30] Id. at 9601(20)(G)(ii). An "Operational function" is defined as functions performed by a facility or plant manager, operations manager, chief operating officer or chief executive officer. Id. at 9601(20)(G)(v)
[31] 56 FR 28802 (June 24, 1991)
[32] Id.
[33] Id.
[34] 57 FR. 18354 (April 29, 1992)
[35]Id.