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A Newsletter Covering Recent Environmental Developments and Caselaw

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510 King Street, Suite 410, Alexandria, VA 22314 USA 703-549-0977 or 800-966-7445
Editor…….Tacy Cook Telego, APR, VP RTMC.
Author…….Lawrence Schnapf, Esq.

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The Schnapf Environmental Journal is a bi-monthly report that provides updates on regulatory developments and highlights significant federal and state environmental law decisions affecting corporate and real estate transactions, and brownfield redevelopment. The information contained in this newsletter is not offered for the purposes of providing legal advice or establishing a client/attorney relationship. Environmental issues are highly complex and fact-specific and you should consult an environmental attorney for assistance with your environmental issues.

Part 1 of 2

DUE DILIGENCE/ AUDITING/ DISCLOSURE/ ENFORCEMENT

EPA Issues Proposed AAI Rule

EPA proposed its much-anticipated federal standard for conducting environmental due diligence (69 FR 52543, August 26, 2004). The proposed rule establishes specific requirements for conducting an "all appropriate inquiry" (AAI) that is necessary to establish the innocent purchaser, *bona fide* prospective purchaser and contiguous owner defenses under CERCLA. The proposed rule also establishes the scope of activities that recipients of brownfield grants must perform during their site assessment and site characterization. EPA will accept comments on the proposed rule until October 25th.

***Commentary**: When the final AAI rule becomes effective, it will replace the existing interim federal AAI established by the 2002 Brownfield Amendments. In May 2003, EPA clarified that the ASTM E1527-00 Standard Practice for Phase I Environmental Site Assessments would serve as the interim federal AAI standard for transactions that took place after May 31, 1997. For transactions prior to that date, the interim federal AAI standard was the statutory condition in effect prior to the adoption of the 2002 Brownfield Amendments. Until the final AAI standard becomes effective, parties seeking to qualify for the CERCLA defenses and brownfield grant recipients will have to comply with the existing interim federal AAI standard. We will provide a detail analysis of the federal AAI standard when it is finalized.*

GAO Issues Report On SEC Disclosure

The GAO issued its long-awaited report evaluating the adequacy of the environmental disclosure obligations established by the United States Securities and Exchange Commission (SEC). Unfortunately, the report was somewhat anticlimactic.

In "*Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information*", the GAO concluded that it could not evaluate the extent to which companies are disclosing environmental information in their filings with SEC and also could not assess the adequacy of the SEC's efforts to monitor and enforce its environmental disclosure requirements. GAO noted that because the SEC does not systematically track the issues raised in its reviews of company filings, the commission did not have the information it needed to analyze the frequency of problems involving environmental disclosure. GAO also indicated that it could not even evaluate the significance of a low level of environmental disclosure since this could mean that a company did not have existing or potential environmental liabilities, determined that such liabilities were not material, or that it was simply not adequately complying with its disclosure requirements. The report also concluded that SEC and EPA have made sporadic efforts to coordinate on improving environmental disclosure and that EPA currently shared limited information on specific, environment-related legal proceedings.

Corporate Disclosure Developments

The second annual report of the Carbon Disclosure Project (CDP) indicated that companies are facing increasing pressure from financial market authorities and fiduciaries to deal with climate risk. As a result, approximately 59% of the companies responding to the CDP questionnaire consider climate change as a business risk and a business opportunity. Membership in the CDP since then has gone from 35 institutional investors representing $4.5 trillion in assets to 95 groups with over $10 trillion

The World Business Council for Sustainable Development (WBCSD) and the World Resources Institute (WRI) released the second edition of their Greenhouse Gas (GHG) Protocol. This accounting methodology is used to measure GHG emissions reporting, reduction, and trading programs, including the Global Reporting

Initiative (GRI), EPA's Climate Leaders Initiative, the Chicago Climate Exchange (CCX), and the European Union Emissions Trading Scheme (ETS). The International Organization for Standardization (ISO) has also signaled its intent to be compatible with the GHG Protocol. The GHG Protocol Corporate Standard stipulates that it should not be used to quantify reductions from GHG mitigation projects. Instead, the WRI and WBCSD intend to release the GHG Protocol Project Quantification Standard for this purpose.

Climate change resolutions filed by institutional shareholders are drawing record support in 2004. Last year, the highest support for a climate change resolution was the 26.7% voted by American Electric Power shareholders. This year, resolutions have drawn the support of 27% of the shareholders of Marathon, 28% of Anadarko shareowners and 37.1 percent of voting Apache shareowners. The number of climate change resolutions tripled from 2003.

Meanwhile, the Investor Network on Climate Risk (INCR) recently issued its "The Investor Guide to Climate Risk" that identifies actions that pension plans, fund managers and companies can take to address climate risk. It also recommends that investors support government action to reduce investor and business uncertainty on global warming. The Guide identifies three core actions to address climate risk: assessing the risks, disclosing the risks, and investing in solutions. Ten key steps are aimed at three main groups: Plan Sponsors (for pension plans and endowments and their investment consultants) Fund Managers (for "buy side" investment managers and "sell side" brokers and securities analysts) as well as for Corporate decision makers (e.g., boards of directors, CEOs and top executives).

Banks Agree to Implement Sustainability Policies

In the face of a proposed shareholder resolution, JP Morgan Chase Company agreed to establish an Office of Environmental Affairs and a firm-wide committee that will establish global policies and procedures regarding environmental issues.

Bank of America (BOA) also agreed to take steps to reduce GHG emissions of projects it finances as well as those of its customers and suppliers by seven percent by 2008. In addition, BOA will create an environmental council led by its president to ensure that the bank's environmental goals and objectives are met, tracked and reported. BOA will also help fund a project to map intact forest ecosystems, and will not fund resource extraction projects from old growth tropical rainforests or logging operations in old growth forests

Previously, Citigroup announced that it would prohibit investment in any extractive industry such as oil and gas, mining, logging in primary tropical forests and place severe restrictions on destructive investment in all endangered ecosystems worldwide.

Land Use Standards For GHG Sequestration Developed

The Climate, Community and Biodiversity Alliance (CCBA) has drafted a set of standards to certify land use projects that can be used to offset GHG emissions. The Climate, Community and Biodiversity (CCB) Standards are aimed at helping companies, conservation organizations, governments and international funding groups to efficiently identify projects that will reduce or absorb carbon emissions and promote biodiversity through ecosystem restoration, reforestation, agro-forestry as well as develop substitutes for fossil fuels such as bio-energy projects.

Commentary: *The Delaware Department of Natural Resources and Environmental Control (DNREC) plans to inform developers and local governments of the impacts of proposed development on air quality. DNREC has traditionally commented on a development's impacts on natural resources such as wetlands and forests, drainage and stormwater management, and water supply and water quality. DNREC plans to comment on potential emissions increases for volatile organic compounds (VOCs), nitrogen oxides (NOx), sulfur dioxide (SO_2), fine particulate matter (PM2.5), and carbon dioxide (CO_2). The decision to add air quality impacts to its advisory role is fueled in part by Delaware's status of non-*

attainment for ozone and PM2.5 under the Clean Air Act (CAA). According to the DNREC, air quality impacts from residential development can exceed impacts from industrial air emission sources. For example, the DNRECC pointed out that a recent 389-unit residential subdivision would result in an estimated 30 tons per year (tpy) of nitrogen oxides (NOx) from vehicle emissions. In contrast, an industrial facility that generates 25 NOx tpy would be required to be subject to stringent air emissions requirements.

DNRECC will express air quality impacts as pounds per household per year. There are three components to the per household estimate: Direct residential emissions such as fuel combustion, wood combustion, architectural coatings, consumer products that contain VOCs, lawn and garden equipment (engine emissions and evaporation), and portable fuel containers. The second component is increased emissions from residential electricity usage. The final component is vehicle emissions from trips that residents take from home to work, shopping, and other activities.

DNREC indicated that local governments should anticipate air quality impacts from development and incorporate mitigation requirements in their planning process. The mitigation efforts could include smart growth concepts such as limiting large new developments to pre-approved growth areas, concentrating development in areas capable of providing mass transit services, requiring more energy efficient homes that would lessen air quality impacts, and promoting walking and biking within and between developments and town centers.

Owners of Residential Complexes to Perform Cleanup

The owner of the Shore Line Mobile Home Park in Connecticut has to spend approximately $500,000 to remove contaminated soil and place a geo-textile fabric barrier. The contamination is associated with materials transported to the site by an unknown coal-gasification plant.

The developers of a 250-unit condominium complex in Scituate, MA have been given a year to complete investigation and develop a remedial plan. The project would be the town's largest housing complex and contain 63 affordable units. The 50 acre-site was originally part of a farm that was leased to the Army during World War I for use as a weapons testing facility.

In Rhode Island, elevated levels of lead and polychlorinated biphenyls (PCBs) were detected at a residential complex. The state Department of Environmental Management (DEM) and USEPA have determined that the land where 17 homes were constructed had a pond that was filled originally with debris in the 1950s and 1960s. In the 1980s, a developer who wanted to build duplexes filled the depression with used auto fluff -- the remains of a shredded automobile that has had its metal removed with large magnets.

In Michigan, the United States Army Corps of Engineers (Corps) will conduct inspections of residential properties in Claybanks Township along Lake Michigan. Over 400 acres of Lake Michigan shoreline had been used as an anti-aircraft artillery firing range from 1953 to 1958. After some landowners began finding expended and live belts of .50-caliber ammunitions, the Corp determined that a site investigation was necessary to evaluate the possibility of lead contamination and to identify the location of a suspected burial ground for a demolition debris and a rifle range used by officers.

Commentary: *These cases illustrate the importance of performing comprehensive historical investigations before providing financing for residential properties such as multi-family apartment complexes and mobile home parks. Many so-called commodity-style phase I environmental site assessments sometimes do not trace site use past the date that the property was first developed for residential purposes. Aerial photographs can often be useful in determining if property had received extensive fill materials. If fill materials are suspected, lenders should require consultants to render an opinion on whether the prior fill poses a risk to the site or to the borrower's ability to repay its loan.*

Local governments can also play a role in ensuring that adequate environmental investigations are performed at residential developments. Ventura County recently approved an ordinance that will require housing developers to sample soil

and groundwater for perchlorate and trichloroethylene within a two-mile radius of the Rocketdyne field lab in the Simi Hills that is owned by Boeing Corporation. The sampling requirement was prompted by the discovery of perchlorate in a nearby ranch drinking water well and a 461-home subdivision in Runkle Canyon. Los Angeles County is also considering a similar ordinance. However, requiring local government approval is not a panacea. A developer planning to construct a 130-unit housing development on a former apple orchard has been negotiating with the town of Groton, MA on the appropriate cleanup standard for arsenic-contaminated soils at the former 200-acre apple orchard. The developer needs approval from the Board of Health to obtain permits from the Planning Board. Because the source of the arsenic was from a controlled application of a pesticide and not due to a spill, the Massachusetts Contingency Plan (MCP) does not apply. The consultant for the town wants the developer to remediate the top 3 feet of soil to a level of 20 parts per million (ppm) while the developer only wants to remediate the top foot of soil to a level of 22.4 ppm. If the MCP applies, the site would have to be remediated to 30 ppm.

FHA Form Now Includes Radon

Earlier this year, the Department of Housing and Urban Development (HUD) revised the home inspection form (HUD 92564-CN) used for the Federal Housing Administration (FHA) section 203(k) mortgage financing program. The form now addresses radon inspections and advises mortgagees that EPA and the U.S. Surgeon General recommend radon testing. The form is mandatory for all FHA insured mortgages.

Commentary: *Many federal agencies such as HUD and Fannie Mae have their own due diligence requirements that can vary with the ASTM standard for conducting Phase I Environmental Site Assessments as well as due diligence policies established by lenders. When performing due diligence in connection with a property that will be financed by these agencies, it is important to review their requirements, especially for lead-based paint, asbestos, lead in drinking water and radon.*

The Section 203(k) mortgage program is the primary tool used by HUD to rehabilitate and improve single-family homes. The program allows homebuyers to finance the purchase and repair or improvement of a home using a single-family mortgage loan. HUD considers actions to reduce radon levels in a home as an improvement that can be financed through a 203(k) mortgage loan. To qualify, the total cost of the eligible repairs or improvements, including measures to reduce radon levels must be at least $5,000. Homes eligible for 203(k) financing include one to four-family dwellings that have been completed for at least one year, dwellings that have been demolished provided some of the existing foundation system remains, and converting one-family dwelling into multi-family dwellings or existing multi-unit dwelling into a one to four-family unit.

The 203(k) program has been used by lenders to rehabilitate properties through partnerships with state and local housing agencies, and with non-profit organizations. In future issues, we will review the specific due diligence requirements of the HUD and other federal agencies that finance housing or redevelopment projects.

Forest Land Settlement

The Ketchikan Pulp Company (KPC) has agreed to complete cleanup at four sites and to reimburse the United States for response costs incurred at six other sites in the Tongass National Forest where KPC previously conducted logging and associated operations under a long-term timber sale contract with the United States Forest Service. The settlement also requires the Forest Service to undertake operation, maintenance, and monitoring activities for the Thorne Bay Landfills Site and perform any additional activities required to address the seeps containing iron and manganese. Finally, KPC's parent corporation, Louisiana-Pacific Corporation, agreed to guarantee the KPC's obligations including unknown conditions or new information for the four sites through December 31, 2013 and through December 31, 2030 for the Thorne Bay Landfills Site.

Commentary: *The ASTM Phase I ESA for Forestland and Rural Property (E2247-02) is intended to satisfy the CERCLA innocent purchaser defense for rural real estate*

development, transactions involving farmland, land used for cell towers, corridor studies for highways and large holdings of natural resource organizations.

The standard is modeled after the E1527-00 but has some important distinctions. One of the more important differences is the record review requirements. In addition to the records normally reviewed, the proposed standard would include records pertaining to threatened and endangered species and documentation requiring the use of best management practices. Additional local sources of information will include the Department of Natural Resources and Division of Forestry.

The same standard historical sources should be reviewed with the exception of fire insurance maps, since undeveloped areas larger than 120 acres were historically not mapped. Local officials that should be interviewed include property managers, farm managers or ranch managers. Environmental professionals are also required to try to interview occupants of the large tracts such as those involved with hunting clubs, agricultural and silverculture tenants.

One of the problems with large undeveloped tracts of land is that isolated commercial operations could have operated in the past, such as mining operations or waste disposal, but may not be easily observable. As a result, in addition to the site reconnaissance methods used for the E1527-00, the proposed standard also suggests considering statistical plot systems, aerial flyover or other approaches used for large tracts of land. To identify potential problematic areas, the proposed standard suggests that environmental professionals look for caves, ditches, and streams that may have been associated with past disposal or waste generation practices. The proposed practice contains many of the same non-scope items that may be included by the client in the scope of the ESA. Relevant non-scope items for these kinds of properties include conditions that could affect water quality, threatened or endangered species, SMZs and Best Management Practice areas.

Contractor Arrested for Fraudulent Mold Remediation

The owner of an air quality testing and mold remediation firm was arrested for providing unnecessary mold remediation at schools in Easton, Manchester and Bristol, CT. Ronald Schongar of Clifton Park, NY was charged with defrauding Connecticut schools by allegedly generating fraudulent laboratory reports indicating mold was present at the schools and then generating false reports indicating that his services and products had successfully remediated the air quality problems. If convicted of mail and wire fraud, Schongar faces a maximum possible sentence of up to five years in prison and/or a $250,000 fine on each count. If convicted of violating Federal Insecticide, Fungicide and Rodenticide Act (FIFRA), he could receive up to one year in prison and/or a fine of up to $25,000 per count.

Commentary: *Because of the dramatic increase in mold claims, many insurers have increased premiums for commercial and homeowner policies. In addition, 46 states have approved mold-related exclusions in homeowner insurance policies. Mold claims typically cost ten times the average homeowners' insurance claim. According to EPA guidance, homeowners may use a mixture of bleach and water to address mold infestations of less than 10 square feet. However, professionals should be used for mold infestations of at least 50 square feet of building materials. The cost for this work usually ranges from $20 to $30 a square foot.*

LSP Suspended in Rhode Island

The Rhode Island Board of Registration suspended the license of the president of Kaegael Environmental, Inc. (KEI) for allegedly performing substandard assessments and cleanups at four sites. According to the board's Assistant General Counsel, the KEI president routinely disregarded DEP regulations and failed to properly assess the full extent of contamination at four properties. More specifically, the board asserted that he failed to delineate the extent of groundwater contamination at a site with nearby private drinking water wells, did not evaluate indoor

air at two contaminated residential properties, submitted false and misleading information regarding the risks posed by the contamination at two properties, and failed to install a soil and asphalt cap to prevent exposure to lead and PCBs contamination at the site of a future public park.

***Commentary**: A number of states have adopted licensed environmental professional (LEP) programs where contractors can perform site investigations and cleanups with limited site oversight. In this era of constrained state resources, LEP programs can help expedite the cleanup than the traditional remedial process. However, there has always been a concern that LEPs might be vulnerable to pressure from their clients to limit investigations and minimize cleanups. As a result, it is important for purchasers and lenders to carefully review work prepared by LEPs to make sure that it complies with minimum state standards*.

ENVIRONMENTAL CASES INVOLVING CORPORATE AND REAL ESTATE TRANSACTIONS

Jury Finds Fleet Bank Liable for $5 Million for Environmental Non-Disclosure

A Rhode Island Superior Court jury ruled that Fleet Bank was liable for $5.14 million in damages for failing to inform purchasers of a general store that the property drinking water was contaminated. With accrued interest, the total award could be $10.3 million.

According to *Foote v. Fleet Financial Group* (No. 99-6196), Fleet Bank-NH (Fleet) foreclosed on the Old Spofford General Store in 1991 and then conveyed the property to a subsidiary, Industrial Investment Corporation-NH (IIC) that was established to manage commercial real estate for Fleet. After a discharge of heating oil occurred in 1995, the New Hampshire Department of Environmental Services (NHDES) requested that Fleet perform an initial site characterization report. An environmental consultant retained by the Fleet Corporate Environmental Risk Management office found contaminants not commonly associated with fuel oil above the state groundwater quality standards and elevated levels of dichloroethane in the drinking water well. The consultant recommended additional monitoring, removal of fuel detected in the wells and an investigation to determine if the contaminants were originating from an upgradient source.

Approximately 41 days after receiving the environmental report, Fleet advertised the property for public auction with a minimum bid of $30K. According to the plaintiffs, Fleet had originally sought $120K for the property but after receiving the report, the bank vice president managing the property recommended accepting any offer above the minimum bid. The plaintiffs also claim that they asked the Fleet property manager at the auction about rumors of contamination and that he responded that the property was being sold with a “clean bill of health.” The purchasers acquired the property for $45K and lived at the site while operating the general store. The sales agreement contained an acknowledgement that the seller never physically occupied the site and had no knowledge regarding the private water supply, sewage disposal system or other conditions required by the New Hampshire residential property disclosure law. Five days after the closing, NHDES advised Fleet that it should implement the recommendations contained in the environmental report and requested a budget. Fleet did not respond to the request of the NHDES and subsequently requested reimbursement from the state UST trust fund. The NHDES advised Fleet that it would first have to install a vent alarm system before it could be eligible for reimbursement. The plaintiffs said that Fleet never informed them about the

communications with the NHDES, and that they only found about the contamination from newspaper accounts four years later discussing the contamination at the upgradient site. The jury found that Fleet had engaged in intentional fraud, and that it had engaged in wanton, malicious or oppressive conduct.

Commentary: *Like recent scandals, it is the lie and not the underlying acts that get the defendants in trouble. In this case, it turns out that the contamination originated from the upgradient source. However, because the bank failed to comply with the state disclosure law and its agent was found to deliberately mislead the purchasers, the bank was held liable for $5.14 million over a $45K transaction where there was no allegation of personal injury.*

The other lesson of this case is a reminder to banks to make sure that they provide the results of environmental due diligence to prospective purchasers and borrowers at or prior to the closing. In prior issues, we have reviewed cases where banks were held liable for failing to disclose the existence of environmental contamination contained in Phase I reports.

Court Rules Reliance on Seller Report Not "Appropriate Inquiry"

In this era of data rooms and truncated diligence periods, purchasers often face the prospect of relying on environmental due diligence materials provided by sellers when deciding whether to bid on a company's assets. A federal district court recently ruled that this approach might preclude a buyer from asserting the CERCLA innocent purchaser defense.

In *XDP, Inc. v. Watumull Properties Corp*, 2004 WL 1103023 (D.Or. 2004), a commercial real estate company was interested in purchasing property that been used for light industrial and commercial office space from 1979 to 1995. The draft purchase agreement originally contained a seller's rep to the seller's knowledge "after due and diligent inquiry," that there had been no production, storage or disposal of hazardous wastes. The contract also required the seller to provide buyer with a current environmental report. The seller deleted the "diligent inquiry" language and instead provided the buyer with a year old report prepared for the seller's lender. The report indicated that the site was free of contamination. The buyer also conducted a cursory inspection of the property. The buyer also reviewed a six-year-old letter from the Oregon DEQ advising the former owner that groundwater contamination had been detected at other properties in the vicinity and that sampling may be warranted in the future.

After taking title, the purchaser was named as a defendant in a cost recovery action and filed a summary judgment motion asking for a ruling that it was an innocent purchaser. The court denied the defendant's motion because its pre-acquisition due diligence did not comply with the requirements of the CERCLA innocent purchaser defense or the ASTM Phase I standard in effect at the time. The court found that genuine issues of material fact existed as to whether the purchaser had conducted an appropriate inquiry consistent with good commercial or customary practice. For example, the court said the defendant had relied on a report that was older than the 180 days mandated by ASTM, the purchaser did not request a reliance letter even though the report was issued to the seller's lender and stated that it could not be relied upon by other parties, did not update the report, relied on an inspection by an unqualified person, that the DEQ letter had put the purchase on notice of a potential problem, and that a review of reasonably ascertainable DEQ records would have disclosed that numerous environmental investigations had been performed on the property that revealed the presence of groundwater contamination.

Federal District Court Refuses to Dismiss CERCLA Claims Against Lender

Despite the passage of the "Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996," banks still find themselves embroiled in CERCLA litigation. In a recent case, a federal district court found that a bank might be liable under CERCLA and RCRA because of its involvement in a borrower's operations following a default.

In *XDP, Inc. v. Watumull Properties Corp*, 2004 WL 1103023 (D.Or. 2004), Hong Kong & Shanghai Banking Corporation (HSBC) financed the acquisition of manufacturing business in October 1986. The loan was secured by a mortgage and liens on equipment and fixtures. After the borrower had defaulted, HSBC entered into an asset purchase agreement in May 1989 in lieu of foreclosure where the bank took title to the property in an "as is" condition and assumed certain liabilities. HSBC then transferred the assets to a newly created subsidiary, MPI, to operate the business. In May 1991, MPI sold the property to another HSBC subsidiary, XDP. The bank also created a third subsidiary, Tayside, as the parent of XDP. After contamination was discovered, XDP filed contribution claims against various predecessors who filed cross-claims against HSBC as an operator or successor of the responsible parties. The parties asserted that HSBC's corporate veil should be pierced because it had inadequately capitalized its subsidiaries, not adhered to corporate formalities and had commingled accounts and properties of its subsidiaries.

HSBC asserted that it was entitled to the secured creditor exemption because it never participated in the management of MPI, and that XDP made commercially reasonable efforts to sell the property. However, based on the totality of facts, the court concluded that there was a question of fact as to whether HSBC was merely protecting its security interest or if it was controlling and managing the facility from 1989 to 1995 when the property was sold to the general manager and CEO of MPI. The court said there was sufficient evidence for a reasonable finding of fact to conclude that the bank formed the subsidiaries as sham corporations to evade liability. The court pointed out that the sole director, president and secretary of XDP was the manager of HSBC's Portland office, was the only employee of XDP, his salary was paid by HSBC and he did not receive any compensation for serving in official XDP capacities. The court also found that XDP did not have its own office and relied on HSBC's accountants in the Portland office to maintain its records. In 1991, XDP's net interest income as a negative $22 and it operating income was $58. Likewise, Tayside was found to have no business purpose except to serve as a holding company for XDP. In addition, Tayside sent and received faxes from HSBC's Nassau office and the bank's legal counsel prepared documents for Tayside even though the company was not his client. The court also found that Tayside received and owed more than $1 million in loans to HSBC and that the loans were listed as assets on Tayside's records. The court also noted that MPI allegedly sold the property to XDP because HSBC was considering selling the assets of MPI and wanted to isolate the environmental liabilities in XDP.

The court also found that there were material issues of fact as to whether HSBC could be liable as a successor. The court observed that after the acquisition, MPI continued to use the same facility, substantially the same workforce, machinery, equipment, methods of production, name, logo, and product as well as the same customer base. The court also found that because HSBC might also be liable as a successor because it had agreed to assume all liabilities and obligations related to the XDP property.

Commentary: *The secured creditor exemption provides that a lender will not be liable under CERCLA if its holds indicia of ownership primarily to protect a security interest without participating in the management of a facility. The bank may have thought its was acting to protect its security interest but the court could not get to the question of the bank's motive because of its excessive entanglement with the operation of the facility. In the court's view, once the bank entered into the asset purchase agreement with the borrower and assumed the liabilities associated with the operation, it ceased acting as a bank and became just another investor in a company.*

The case illustrates the danger banks face during loan workouts and the need for lenders to rely on environmental counsel when developing exit strategies for non-performing loans. Rather than proceed to workout, some banks will sell mortgage notes at a discount to real estate investors who hope to take advantage of brownfield programs and then sell the notes at a profit.

Courts Rule Prior Settlements Do Not

Cut-off Future Liability

One of the key incentives for parties to enter into settlements to remediate contaminated property is the protection from subsequent contribution actions that may be filed by PRPs. Two cases illustrate the importance of examining the scope of the contribution protection during due diligence.

Norfolk Southern Corp. v. Chevron U.S.A. Inc., (No. 03-14473) involved the successors of two companies who had entered into a 1977 settlement. In 1977, St. Johns River Terminal Company was ordered by the United States Coast Guard to remediate an oil spill from storage tanks constructed by the tenant of the property, Gulf Oil Corporation. The parties entered into an agreement releasing Gulf from liability for damages incurred by St. Johns for oil contamination at the Talleyrand Terminal. Twenty-two years later, the plaintiff discovered that sludges from the storage tanks had leaked into an adjacent salt marsh and sought reimbursement from Chevron as the successor to Gulf. The district court granted summary judgment to Chevron on the grounds that the claim was barred by the 1977 settlement. The federal Court of Appeals for the Eleventh Circuit ruled that the 1977 settlement was limited to the oil spill at the terminal facility and therefore did not prevent the plaintiff from seeking reimbursement of its costs to remediate tank bottoms in the salt marsh adjacent to a terminal.

In *American Cyanamid Co. v. Capuano*, (No. 03-2143), the U.S. Court of Appeals for the 1st Circuit ruled that the plaintiff could bring a contribution action for the costs attributed to the groundwater remediation because an earlier settlement entered into by the defendant only granted contribution protection for the soil remediation.

Landlord May Seek Cost Recovery From Tenant

The United States District Court for the Northern District of New York ruled that the existence of a lease did not bar a landlord from bringing a cost recovery action against its lessee. In *Emerson Enterprises LLC v. Kenneth Crosby Acquisitions Corp.* (No. 03-CV-6530), the current tenant was clearing brush when it discovered a drywell that was contaminated with hazardous substances. The New York DEC removed the dry well and placed the site on the state superfund list in January 2002. After DEC demanded that the plaintiff conduct a response action that was estimated to cost $500K, the plaintiff brought an action against the defendant and its predecessors seeking reimbursement of its costs under a variety of theories, including a CERCLA cost recovery action.

In March 2004, the defendant filed a motion to dismiss the complaint on various grounds. In particular, the defendant argued that because the lease constituted a contractual relationship, the plaintiff was barred from asserting the third party defense. As a result, the defendant said the owner was a PRP who could only bring a contribution action. The court held that the landlord could assert the CERCLA third party defense because the purpose of the lease was not to dispose of hazardous substances but instead to enable the defendant to operate its business. The defendant argued that the existence of an environmental indemnity was evidence that the lease contemplated the handling of hazardous substances. However, the court found that there was no evidence of nexus between the leases and the hazardous substances and there was no evidence that the leases gave the plaintiff any control over the operations of the tenant.

Commentary: *To assert the third party defense, a party must establish that (1) the release was solely due to the act or omission of a third party (2) it did not have a direct or indirect contractual relationship with the third party (3) it exercised due care in dealing with the hazardous substances and (4) it took precautions against foreseeable acts or omissions of any third party and the foreseeable consequences of those acts or omissions. The majority of courts have broadly construed the meaning of the phrase "contractual relationship" so that it encompasses nearly every contractual arrangement. However, a line of cases has emerged in New York that narrowly construes the phrase. Under this view, the underlying contract must be for the purpose of disposing hazardous substances to prevent a party from asserting the defense. The Emerson case followed this analysis*

and found no evidence that the purpose of the lease was to allow the tenant to dispose of hazardous substances on the property.

Parent Corporation Not liable for Contamination By Subsidiary

The federal district court in Delaware held that a parent corporation could not be liable for releases of hazardous substances at plants operated by its subsidiary where there was no evidence that the parent's involvement with its subsidiary beyond the "norms of corporate behavior." In *BP Amoco Chemical Co. v. Sun Oil Co*. (D. Del., 00-82), the plaintiff argued that Sunoco, Inc. should be liable because its predecessor company, the Sun Oil Co., had effectively operated its subsidiary's polypropylene plant because of oversight by Sun's chief environmental manager. However, the district court found that the plaintiff had failed to show that the manager's actions were "eccentric under accepted norms of parental oversight of a subsidiary facility."

Commentary: *In U.S. v. Bestfoods, 524 U.S. 51 (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 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. 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 plaintiff to rebut this presumption and establish that a particular officer may have been acting as an agent of the parent and not the subsidiary.*

Court Upholds WWII Government Indemnity

In a ruling that will likely will have broad ramifications for companies that operated government-owned plants during World War II, a federal appeals court found that the United States agreed to indemnify Dupont for cleanup costs associated with an ordnance plant the company operated in Morgantown, WV during World War II. In *E.I. du Pont de Nemours & Co. v. United States* (No. 03-5137), Dupont constructed and operated the facility under a 1940 contract with the United States War Department. Dupont ceased operating the facility in 1945 and a variety of other companies leased the plant until 1958 when it was shutdown. After the site was placed on the federal superfund list in 1984, EPA sought to hold Dupont liable for the remediation. The company sought indemnification from the Department of Defense under the 1940 contract. The Justice Department argued that the Anti-Deficiency Act prevents the government from making commitments to pay indeterminate sums of money in the future. However, the court ruled that the indemnity the government gave Dupont and other World War II contractors were exempt from the Anti-Deficiency Act.

Bankruptcy Settlements Pose Trap for Unwary Purchasers

During the economic downturns of the 1980s and early 1990s, many companies filed for bankruptcy and were able to discard environmentally challenged properties because regulators failed to file timely objections. To ensure that debtors adequately address their environmental obligations, EPA has established a bankruptcy response team that tracks bankruptcy filings and make sure that federal and state governments are involved in the bankruptcy negotiations. Several recent bankruptcy settlements illustrate the implications of these settlements on purchasers of debtors' assets or successors of debtors emerging from bankruptcy.

In the Chapter 11 proceeding for *In re Kaiser Aluminum Corp.* (No. 02-10429), the bankruptcy court for the District of Delaware issued an order approving the sale of a 25-acre facility located in Mead, Washington. Unlike many bankruptcy orders that provide the buyer is acquiring the property "free and clear" of existing liens and interests, this order provided that the

approval of the sale did not release the buyer from any liability but that it had no effect on any defenses that the buyer could assert, including the *bona fide* prospective purchaser defense. The consent decree approved by the court provided that the adjacent 25-acre parcel that was contaminated with hazardous substances would be conveyed by a quitclaim deed to a Custodial Trust funded with a $2,250,000 payment that would be treated as Qualified Settlement Funds pursuant to section 468B of the Internal Revenue Code. The debtors were also required to pay a premium of $4.6 million to purchase an $18 million dollar cost cap insurance policy. The Custodial Trust will be required to implement certain response actions set forth in an approved workplan and any required institutional controls. The consent decree also provided that the insurer was a party to the agreement solely to provide financial assurances and would not be deemed to be an operator of the site. The Custodial Trust would also not be considered a successor to the debtors unless the Custodial Trust exacerbates existing conditions in which case EPA or the State of Washington may elect to take over the work and would be entitled to the benefits of the insurance policy. In exchange for the payments and distributions, the debtor, the Custodial Trust and their successors received a covenant not to sue (CNTS) from the United States and the State of Washington under CERCLA, RCRA, the state superfund law and common law but only to the extent any alleged liability is based on its status as a successor or representative of the debtors or the Custodial Trust. The CNTS did not apply to liability arising from future conduct at the site or natural resource damage claims. Representatives of the Custodial Trust would not incur personal liability unless they are found to be grossly negligent, or engaged in willful misconduct or fraud. The debtors and Custodial Trust also received contribution protection.

In the Chapter 11 proceeding for *In re: Franklin Environmental Services, Inc.* (No. 02-17897) the United States Bankruptcy Court for the District of Massachusetts approved a settlement agreement providing EPA with an allowed Unsecured Claim in the amount of $346,737.17 for response costs incurred at the Beede Waste Oil Superfund Site. The United States had alleged that Franklin was liable as a transporter at the site. In exchange for the payments and distributions, the debtor and its successors received a covenant not to sue for liability at those sites (excluding natural resource damage claims) as well as contribution protection.

The United States Bankruptcy Court for the District of Delaware approved a plan of reorganization for *In re BII Liquidation*, Inc., f/k/a Burlington Industries, Inc., (No. 01-11282) treating EPA claims for reimbursement at four superfund sites as allowed general unsecured claims. Under the settlement, EPA will receive $5,000 for the Industrial Pollution Control Superfund Site in Mississippi. At the J Street Site in North Carolina, EPA will receive $160,038.50 and the debtor shall be relieved of any further obligations to comply with the unilateral administrative order issued for that site. EPA will receive $665,381.32 for operable unit (OU) 1 of the FCX Statesville Site in North Carolina. However, one of purchaser's of some of the debtor's assets, El Paso Natural Gas Company, agreed to be responsible for all response costs incurred by EPA for OU3. In exchange for the payments and distributions, the debtor and its successors received a covenant not to sue for liability at those sites (excluding natural resource damage claims) as well as contribution protection.

In the Chapter 11 liquidation proceeding in *United States v. Keysor-Century Corporation*, (No. 04-2823), the federal District Court for the Central District of California approved a consent decree providing the United States with an allowed administrative claim of $307,000 a subordinated allowed general unsecured claim of $735,420 and of an allowed general unsecured claim of $168,855 to resolve numerous alleged environmental violations. In addition, the debtor is will be required to cease discharges of pollutants from its facility; certify that its vinyl chloride plant was shut down, and that it will not bank or trade any reduced air pollution emissions at the facility as emission reduction credits to offset new emissions from other facilities in the District.

In a Chapter 7 settlement

agreement for *In Re Lockwood Corporation* (No. 93-80133), the United States Bankruptcy Court for the District of Nebraska approved the transfer of certain hazardous waste management units and the remaining funds in the bankruptcy estate to an escrow account established under a companion administration order on consent (AOC) with the current owner of the Lockwood Corporation and Agromac International, Inc. Superfund Site located in Gering, NE. In 1976, Agromac International, Inc. (Agromac) acquired the 80-acre site from Lockwood and leased a portion of the site to Lockwood. In 1989, Lockwood obtained a RCRA Post Closure Permit from the State of Nebraska for an evaporation pond and a RCRA Corrective Action Permit from EPA for six solid waste management units. Under the AOC, Agromac agreed to pay $65,000 to EPA under the agency's ability to pay guidance policy and perform the final removal action at the Site. In addition, if Agromac sells the property above its book value, 40% of the excess proceeds will be paid to EPA. In return for the commitments by the Lockwood trustee, Lockwood received a CNTS. If the removal action costs less than funds received from the bankruptcy distribution, the remaining proceeds from the distribution will be paid to EPA. In return for the commitments by the Agromac and the Lockwood Trustee, the parties received a CNTS under CERCLA and RCRA.

The current owners of a parcel of the Portland Cement Superfund site agreed to pay EPA $75,000 in exchange for a CNTS and contribution protection. In 1994, the former owner and operator of the site, Lone Star Industries, entered into a settlement with EPA for all five parcels comprising the Superfund site. EPA subsequently performed response actions at an undeveloped 16.5-acre parcel known as Site 5 to remove cement kiln dust and refractory brick that had been generated by the former Portland Cement Plant in Salt Lake City. Under the AOC, the two trusts holding title to Site 5 agree to the cash payment and to pay a percentage of the net sales proceeds of any sale of the property.

In the Chapter 11 proceeding for *In re GenTek, Inc.* (No. 02-12968), the United States Bankruptcy Court for the District of Delaware approved a settlement agreement that will provide EPA with an allowed general unsecured claim of $352,437 for unreimbursed response costs at the Allied Chemical Corporation Works Site located in Front Royal, VA (Allied Site) and allowed claim of $36,000 for EPCRA violations by debtor General Chemical Corporation at its Delaware Valley Works in Claymont, DE. The debtors also agreed to comply with UAOs for removal action at those sites. In exchange for these commitments, EPA agreed not to issue environmental cleanup orders for non-owned sites based on the pre-petition conduct of GenTek, Inc. and its affiliated debtors and debtors-in-possession but may recover response costs and natural resource damages based on such conduct in amounts approximately equivalent to the amount the United States would have received if its claims had been treated as allowed unsecured claims under the reorganization plan. However, the debtors will not receive any discharge for any CERCLA or RCRA liability at any owned sites.

SUPERFUND/BROWNFIELDS

EPA Awards New Brownfield Grants

EPA awarded a total of $75 million brownfield grants to fund 265 grants in 42 states. The brownfield awards include 155 assessment grants totaling $37.6 million, 92 cleanup grants totaling $16.9 million, and 18 revolving loan fund grants totaling $20.9 million. Earlier this year, 16 communities received job training grants totaling $2.47 million to teach environmental cleanup job skills to 1,080 individuals living in low-income areas near brownfields sites. EPA estimates that more than 60% of the trainees have obtained employment in the environmental field with an average hourly wage of $12.84.

HUD also announced it was accepting applications for its Brownfields Economic Development Initiative (BEDI) Program (69 FR 27331 May 14, 2004/). HUD expects to award approximately $25 million in BEDI grants. The BEDI funds may be used for new investments at brownfield sites or to improve the viability of existing brownfields economic development projects financed with Section 108-guaranteed loan so long as the projects directly result in new business or job creation, increases in the local tax base or produces other near-term, measurable economic benefits.

Commentary: *The BEDI funds represent one of the largest pools of federal funds available for brownfield sites. A BEDI grant award must be used in conjunction with a new Section 108-guaranteed loan commitment. The BEDI grant funds and the 108 proceeds must be used to support the same eligible BEDI project. BEDI grant funds and Section 108 loan guarantee funds may be used only for activities listed at 24 CFR 570.703 (including mixed use projects with housing components). A local government may re-loan the Section 108 loan proceeds and provide BEDI funds to a business or other public entity eligible to carry out a specific approved brownfields economic development project, or the public entity may carry out the eligible project itself.*

BEDI grant funds may also be used by units of general local government eligible for assistance under HUD's Community Development Block Grant (CDBG) program. Under this program, communities pledge their continuing CDBG allocations as security for the Section 108 loans guaranteed by HUD. BEDI grant funds are intended to reduce a grantee's potential loss of future CDBG allocations by strengthening the economic feasibility of a project financed with Section 108 funds (and thereby increasing the probability that the project will generate enough cash to repay the guaranteed loan), directly enhancing the security of the Section 108-guaranteed loan, or employing a combination of these or other risk mitigation techniques. The BEDI funds may only be used for activities authorized by CDBG requirements at 24 CFR 570.200.

Mining Sites Pose Obstacles to Local Communities

EPA estimates that 40% of the headwaters streams in the western United States are impaired by as many as 500,000 abandoned hard-rock mines. In Colorado alone, Trout Unlimited estimates that acid mine discharge (AMD) from 7,000 abandoned mines has impacted 1,600 miles of rivers and streams in Colorado.

Much of the problem originates from century old mines that were abandoned with massive tailing piles and mine tunnels that flooded after mining operations ceased. The exposed ores became oxidized and then reacted with groundwater or rainwater to create acidic water that leaches metals from the tailings and old mine tunnels. This acidic, metal-laced water then seeps into groundwater drinking supplies or flows into mountain streams resulting in crystal clear streams that are devoid of life.

Unlike coal-mining operators, hardrock mines are not required to contribute to a federal trust fund. The principal source of federal funds for addressing AMD is the federal Superfund, but it is reserved for the larger sites that are placed on the National Priorities List (NPL) and is not available for the thousands of smaller mines that affect watersheds and drainage areas in the West. The task of addressing the impacts from these smaller sites often falls on local communities.

The problem is not limited to western states, though. Pennsylvania estimates that it has an estimated 2,000 abandoned and flooded mines that discharge polluted water from about 5,000 known points. While much of the AMD is from former coalmines, Pennsylvania receives proportionately less federal funds for coal mining-related impacts that western states because the federal trust fund is based on revenues from current coal operations. At current spending levels, Pennsylvania estimates it will take 350 years to cleanup the AMD impacts.

Such mine-scarred lands are eligible for brownfield funds and the funds can be useful if they are leveraged with private redevelopment funds. For example, Virginia, MN was awarded a brownfields assessment grant in May 1999 that was used to leverage approximately $28 million in redevelopment funding to restore three former mining sites. The transformation of

the former mine sites created jobs and housing opportunities for local citizens. Two developers purchased a portion of one property and established an assisted/independent living facility and an office/showroom for construction equipment. These facilities represented a total of $12 million in cleanup and redevelopment funds and will create 115 permanent jobs when completed. At another site, a developer is constructing a golf country club and residential units while single-family housing units are being constructed at the third site.

However, Trout Unlimited, a non-profit based in Arlington, VA, estimates that the cost to address these smaller sites could range from $36 million to $72 billion. As a result, the group has proposed creating partnerships between local activists, private organizations and government agencies to target AMD sites and then pursue grants from the U.S. Forest Service, EPA or even philanthropic groups.

One innovative approach is the creation of a $19.9 million trust fund by ISG, Inc. to finance continual treatment of AMD in Cambria, Somerset and Butler counties in Pennsylvania. The trust fund was established from assets of bankrupt Bethlehem Steel Corp. acquired by ISG in 2003. Under the agreement, Pristine Resources, a subsidiary of ISG, established a trust fund to provide for perpetual treatment of the AMD. Pristine Resources had already been treating the AMD since ISG purchased the sites from Bethlehem Steel Corp. and its BethEnergy Mines Inc. subsidiary, using treatment systems left behind by the former owners.

Innovative EPA Settlement Illustrates Use of Eminent Domain

In prior issues, we have discussed how local governments can use their power of eminent domain coupled with their CERCLA liability defense to stimulate brownfield development. A recent EPA settlement involving the General Color Company Superfund Site in Camden, NJ property is another example. Under the agreement, the City of Camden will take title to six acres through a condemnation proceeding. A developer, Westfield Acres Urban Renewal Associates II, LP will then acquire the site from the city and construct 73 low-income housing units as part of an on-going project that will result in 119 home ownership units and 151 rental units, including senior citizen housing. EPA has excavated over 56 tons of soil contaminated with paint pigments and petroleum. The developer will demolish the buildings and foundations at the site and address contaminated soils beneath those structures at an estimated cost of $1 million. The lead cleanup levels will be 400 ppm for the top two feet of soil and 1200 ppm for deeper soil. Deed restriction will be imposed that will limit the property for low-income housing for 45 years. In addition to a covenant not to sue, EPA agreed to waive any liens it might have under Sections 107(l) and 107(r) of CERCLA.

In another interesting local government action, the City of Brewer, ME agreed to take title to the former Eastern Pulp and Paper Co. mill. The plant was shutdown following the bankruptcy of its owner, Eastern Pulp. First Paper Holding, LLC purchased the assets of Eastern Pulp and while it agreed to reopen a mill in Lincoln that would employ 360 workers, the company did not plan to restart the Brewer facility. As part of the court-approved sale, creditors of the defunct company sold their rights to the equipment and inventory at the plant to First Paper Corp for use at the Lincoln mill. The city then took title to the plant and asked the Maine DEP and USEPA to conduct remove actions that will cost an estimated $500K. The city hopes to use the 41-acre site for a variety of uses including light manufacturing, retail and office space and municipal use. The plant has been designated as a Pine Tree Zone, which will provide tax incentives to businesses that want to locate there.

***Commentary**: Using eminent domain as a tool for developing brownfield sites is becoming increasingly controversial, particularly where the local government condemns land and then transfers it to private developers. In most cases, local community groups oppose the condemnation proceedings, sometimes on environmental justice grounds. However, prior owners or operators of these sites who may be held responsible for remediation also have a stake in these actions, especially where the local government*

seeks to build a residential development on a former industrial site. Indeed, in Housing and Redevelopment Authority of the City of St. Paul v. ExxonMobil Corp. (Minn. Dist.Ct., No. C6-04-1291, 7/9/04), a state court stayed a petition to condemn petroleum-contaminated land that is one of the largest tracts of available land in downtown St. Paul. The court ordered the city to determine if the contamination made residential development infeasible. The city began condemnation proceedings property in 1997 to use the land for a proposed development that would include more than 850 housing units. The city maintained that taking the property would serve a valid public purpose in that low- and moderate-income housing would be developed. The city also contended that its redevelopment would reduce blight in St. Paul. The city was able to purchase most of the tract but ExxonMobil refused to sell its 30 acres because of the contemplated residential use. The company offered to donate its land to the city if it was used for commercial or industrial purposes but the city refused and commenced the condemnation proceeding. ExxonMobil objected, asserting that the site cannot be adequately remediated for residential purposes and that the city's building design failed to account for the risk of vapors wafting up through the soil. In staying the condemnation petition, the court found that while the city's plan fell within the realm of public necessity, the city's diligence in investigating the feasibility of remediation for residential development had been "dangerously lacking." The court found that that the city was so focused on having the development constructed that it had not adequately addressed concerns that the site could be remediated to a level safe for residential development.

Some Governments Accused of Abusing Brownfield Programs

A related controversy is the growing tendency of local governments to designate entire swaths of dilapidated downtown areas as brownfield districts. In the past, local governments were concerned that properties would become stigmatized if they were identified as being potentially contaminated. In contrast, local governments now seem eager to designate large areas as brownfield to take advantage of much needed state or federal economic development resources that are being targeted towards brownfield sites.

Many brownfield advocates are increasingly questioning this liberal approach to brownfields on grounds that these policies are directing precious development resources away from truly depressed areas and towards projects that would have probably been developed regardless of the brownfield incentives. These critics claim that developers are being allowed to "game the system".

For example, Orlando, FL has proposed to designate its entire downtown central business district as a brownfield. To be considered a brownfield, the reuse or redevelopment must be "complicated" by the presence of contamination. Yet critics charge that only two sites in the area are contaminated. Others charge that just three of the 93 designated brownfield sites in Miami-Dade County actually are contaminated. Brownfield supporters also point to an office tower under construction in downtown Orlando that will generate more than $1 million in brownfield job creation incentives despite the absence of contamination. They argue that limited brownfield funds should be conserved for true brownfield sites located in disadvantaged neighborhoods.

Likewise, environmentalists have criticized New Jersey's officials for awarding brownfield incentives to sites that fail to meet urban needs or that do not require public funding. For example, the Standard Chlorine site in Kearny is one of the most heavily contaminated sites in the state. Critics charge that the site should have been nominated for the federal Superfund list but was kept off the list so that it could qualify as a brownfield and enable a developer to build warehouses. The critics claim the cleanup will not sufficiently address the dangers posed by the site. Another plan to cap four landfills in the Meadowlands and build four golf courses, homes and hotels has come under criticism after a DEP internal memo was leaked suggesting that the proposed development could pose health-related concerns to the future residents. Meanwhile, in Jersey City, local community organizations are complaining that city's brownfields are being turned into luxury high-rises, big-box retail stores and golf

courses instead of affordable housing.

Cleanup Indecision Delays Redevelopment of New Milford Brownfield Site

Local Governments often lack the expertise to effectively use their brownfield funds. The cleanup of the former Century Brass Mill property in New Milford, CT illustrates some of the obstacles faced by local governments.

The plant was built in 1957 and the town acquired it in 1999 through foreclosure. The New Milford Economic Development Commission (EDC) received a $1million revolving loan from EPA to remediate and redevelop the 72-acre site. However, EDC has encountered unexpected costs and a disagreement between the Connecticut DEP and the town Inland Wetlands Commission on final remediation of former wastewater lagoons has delayed marketing of the site. Liffey Van Lines was interested in purchasing the site for a potential storage facility but has not been able to inspect the facility because of asbestos and PCB contamination within the 320,000-square-foot building.

The town had been funding the cleanup from the brownfield revolving loan and a $2.6 million a letter of credit. However, the town may need another $500,000 to complete the cleanup. Further complicating the cleanup is a dispute involving former wastewater lagoons. The EDC had submitted an application to the wetlands commission to fill the lagoons to maximize future development options for the property. The commission approved the application based on the information that filling the lagoons would not impact wetlands. CTDEP wants additional testing and cleanup that could cost an additional $700,000. As a result, EDC has delayed final grading and has not purchased clean fill in order to use the remaining funds for other remediation; however, EDC said CTDEP would not allow the $400,000 remaining in a letter of credit for these other purposes. In addition to the $700,000, EDC said it would have to spend an additional $1 million to remove roof asbestos and repair the roof. Finally, EDC is concerned that demolishing a clarifier could cost more than estimated and that the town could be responsible for remediating contaminated sediments at the facility outflow to the Housatonic River.

EPA and PA Enter Into Brownfield MOA

Pennsylvania entered into a Memorandum of Agreement (MOA) with EPA Region III that will allow sites remediated under the state's brownfields program to satisfy federal cleanup requirements under the Resource Conservation and Recovery Act (RCRA), the Comprehensive Environmental Response Compensation Liability Act (CERCLA) and the Toxic Substances Control Act (TSCA). State officials hope that removing the threat of federal legal action once a site meets Pennsylvania's stringent cleanup standards will encourage more redevelopment of old industrial sites

The PADEP also announced it had accepted the first Brownfield Action Team (BAT) application for the Bethlehem Commerce Center on the former Bethlehem Steel Corp. site in Bethlehem, Northampton County. The Lehigh Valley Industrial Park, Inc. plans to redevelop 1,600 acres of the Bethlehem site with a mix of commercial, manufacturing, office and warehousing spaces. Developers expect the site eventually to employ 6,000 workers with an annual payroll of $210 million.

Projects qualifying for BAT assistance will be assigned a PADEP project manager who will serve as a centralized contact for all environmental issues at the site. The project manager will expedite permit reviews by PADEP and other state agencies, and also facilitate funding requests. In the case of the Bethlehem site, the BAT expedited the development of an approved assessment and cleanup plan, helped develop a brownfield agreement, and streamlined approvals for erosion and sedimentation controls and stormwater management measures for this site.

NJ Enacts New Brownfields Tax Credits

Earlier this year, Governor James McGreevey signed legislation freeing up $45.8 million for brownfields redevelopment. The law will allow an estimated $15-$20

million in Corporation Business Tax revenues to be used for brownfield cleanups. Previously, the funds could only be used for UST remediation. Since January 2002, New Jersey has awarded nearly $100 million to fund about 260 brownfields projects across the state.

One of the largest brownfield projects will be the Meadowlands Golf Redevelopment Project that will develop the 785 acres of former landfills that drivers on the New Jersey Turnpike pass by everyday. The New Jersey's Economic Development Authority (EDA) has provided $150 million in tax-exempt bond financing to remediate the landfills. When completed, the project will result in two public 18-hole golf courses, 750 hotel rooms, 750,000 square feet of office space, 100,000 square feet of retail space, 1,130 active adult residential units and 850 open market residential units. Two additional golf courses will be added in a second phase of the Golf Village, producing a total of four golf courses in the Meadowlands District. The project is expected to create 2,400 full time jobs and 500 construction jobs and will generate $19.1 million in property taxes.

Vermont and Delaware Enact Brownfield Legislation

Vermont Governor James Douglas signed legislation to improve the state's brownfield program. The measure will provide funds to conduct environmental assessments and establish an innocent purchaser defense for new developers

In Delaware, Governor Ruth Ann Minner signed the Brownfields Development Program law in August. The legislation authorizes matching grants through the Delaware Economic Development Office for environmental assessment and remediation of certified brownfields. The grants may be made only to facilitate brownfields redevelopment projects that will help retain and expand existing firms, recruit new firms, or form new businesses. The law also exempts brownfields developers from liability for existing contamination provided they conduct an appropriate inquiry and obtain a state-approved cleanup plan.

Shopping Center to Be Built on Former Chemical Site

Missouri has approved plans to construct an expansion of a shopping center on the site of a former chemical manufacturer. Under the agreement, the owner of Maplewood Commons shopping center has agreed to fund remediation of soil contamination at the 20-acre parcel that will house Lowe's store and three chain restaurants. The developer will not be responsible for addressing TCE and vinyl chloride groundwater contamination that may have migrated off-site. They agreed to post a $500,000 bond for the soil remediation, incorporate a vapor barrier in the construction, to record deed restrictions preventing use of groundwater for drinking water and will donate $25,000 to Washington University for its environmental engineering and interdisciplinary law program.

The agreement is somewhat controversial because the state believed that the bond would cover the cost to enhance the existing groundwater treatment system that was installed by the former site owner. However, recent groundwater samples from off-site wells detected vinyl chloride at concentrations of 2,000 ppb in ground water --1,000 times what is considered safe to drink.

EPA Issues Ready for Reuse Determination

EPA and the Louisiana Department of Environmental Quality (DEQ) issued a "ready for reuse" (RFR) determination for the Shell Chemical LP/Motiva Enterprises, LLC in Norco, LA. The 826-acre property is the first refinery to receive a RfR certificate. From 1997-99, Shell/Motiva performed a facility-wide investigation and completed corrective actions for all impacted areas of the site. The company is now free to sell off portions of the site for commercial/industrial use.

EPA Announces PPAs

EPA has continued to enter into prospective purchaser agreement (PPAs). The Fairmont Coke Works Site Custodial Trust entered into a PPA for the Fairmont Works Property in Marion, WV, which is adjacent to the Big John's Salvage Site. In exchange for a Covenant Not to Sue and the removal of EPA's Lien, the Trust agreed

to provide access to EPA, exercise due care regarding the hazardous substances at the property, and implement the obligations set forth in the Memorandum of Agreement between the State of West Virginia Department of Environmental Protection and the United States Fish and Wildlife Service. In addition, the Trust agreed to abide by the Stakeholder Involvement and Redevelopment plan.

EPA proposed to enter into a PPA with a number of parties for the 300-acre Mineral County Memorial Airport in Creede, CO. The Site is currently owned by Creede Mines, Inc. and is comprised of five parcels that have been impacted by historical mining activities upstream of the City of Creede. Under the proposed settlement, John Parker, Navajo Development LLC, Navajo Development Company, Inc. and the Mineral County Fairgrounds Associations (MCFA) will implement the cleanup plan approved pursuant to the Colorado Voluntary Cleanup Program and impose land use controls on the Property. After completing the cleanup, the purchasers plan to redevelop this idle property for a mixture of uses that may include low income housing, commercial development and a bike trail.

EPA executed a PPA for the Whitmoyer Laboratories Superfund Site in Myerstown, PA. Under the agreement, the Jackson Township Recreational Authority agreed to acquire the site for recreational green space, to comply with land use restrictions and carry out certain monitoring, maintenance and reporting obligations.

EPA proposed a PPA with the Target Corporation for the Denova Environmental Superfund Site in Rialto, CA. In 2002, EPA spent $3 million to remove 275 tons of explosives that had been abandoned at the site. Target Corporation plans to acquire the 20-acre parcel and use it for a distribution center. In exchange for a covenant not to sue, Target agreed to pay $100,000 to EPA and to complete cleanup of the site. In a separate agreement, prior owners and operators of the site agreed to pay EPA $640,000 from the proceeds of the sale of the property to Target. EPA projects that the value of Target's cleanup work and the reimbursement from all parties will be approximately $1 million. Target estimates the development will create 1,000 temporary jobs, and the center will create 1,300 permanent jobs with an estimated $40 million annual payroll.

Colorado Adopts Interim TCE Indoor Standards

Colorado Department of Public Health and Environment proposed an interim poliicy for screening and remediating trichloroethylene (TCE) in indoor air. The state is proposing a screening level of 0.016 micrograms per cubic meter of air with a proposed cleanup level 1.6 micrograms of TCE per cubic meter of air. If TCE levels range from 0.8-1.6 micrograms per cubic meter of air, the department would conduct further study to determine whether remedial action would be required. This investigation could include such things as testing for background levels of TCE in indoor air that can result from products or building materials residents may bring into their homes and determining whether the elevated levels are a result of a contaminated groundwater plume in the area. Results from investigations in the Denver metropolitan area have shown that typical TCE background levels in tested homes range from 0.2-0.5 micrograms per cubic meter of air. Those background levels result from some common household products as well as from adhesives and paint removers.

Commentary: *Vapor intrusion cases are fast becoming an issue of concern for brownfield developers. States are increasingly concerned about the possibility that TCE and other volatile organic compounds may migrate from soil or groundwater into homes. In the past, state regulators did not focus on vapors as a potential exposure pathway unless the contamination was fairly close to the surface. In fact, some agencies did not even consider soil gas as a media of concern. However, some states are now requiring analysis of vapor in the soil if groundwater is as deep as 30 feet. As a result of several high-profile cases in New York, the state Department of Health is now almost routinely requiring indoor air sampling. Some states appear to be revisiting vapor issues at sites where remedial plans have been approved or are already been completed.*

Colorado Orders Air Force to Remediate Asbestos

The Colorado DHE recently issued a compliance order to the US Air Force to remove asbestos-contaminated soil at a 1,866-acre residential development project under construction at the former Lowry Air Force Base. The dispute has taken some of the luster off a redevelopment project hailed as a national prototype for converting aging military bases to new uses. A dozen private developers and the quasi-public Lowry Redevelopment Authority have already complied with state requests to sample for and remove asbestos-tainted soil. State regulators are targeting a 22-acre parcel that is part of a residential area at Lowry known as the Northwest Neighborhood. The Air Force owns land and buildings at the site, but has ignored a state request issued in April 2003 to sample soils and remove it if contamination were found. The Colorado Department of Public Health and Environment has determined that even trace levels of asbestos--less than one percent by weight--in soil pose a threat to human health and has demanded soil removal in cases where trace levels are found. The scientific uncertainties and the lack of a previous state or federal health standard that requires asbestos cleanup at levels below one percent have led the Air Force to balk at the job. Instead, it wants to collaborate with the state, the EPA and other experts to more thoroughly assess the risks at the site. Experts say there is emerging evidence that such low levels of asbestos are potentially harmful because even tiny amounts of the material can release millions of microscopic fibers that can become lodged inside the lungs, sparking diseases that can take decades to develop. At Lowry, regulators worry about people inhaling asbestos after it it is kicked up from soil by driving, excavation, gardening, tilling or children playing on the ground, especially in piles of excavated dirt.

In other asbestos soil contamination cases, PacifiCorp entered into an Administrative Order on Consent to remediate asbestos contamination at PacifiCorp's power substation in downtown Salt Lake City. PacifiCorp will excavate and dispose approximately 3,900 cubic yards of asbestos-contaminated dust and soil from the site. The source of the asbestos is believed to be ore from the Vermiculite Mine in Libby, MT that was processed on a parcel immediately adjacent to the substation from the early 1940s until the early 1980s. Process residues remain scattered across the substation's ground surface.

EPA completed a $1.2 million cleanup of asbestos-contaminated soil at the Oak Ridge High School in El Dorado Hills. The work consisted primarily of landscaping the school grounds to prevent dust that may contain asbestos fibers from getting airborne. The EPA has also decided it will not hold the school district liable for the agency's costs.

Nashua, NH received a $200,000 brownfield cleanup grant from EPA to help fund the removal of asbestos beneath the site of the proposed new Senior Activity Center. Some of the asbestos on the property goes down at least 35 feet deep. The Senior Activity Center will include 43 affordable-housing units.

***Commentary**: Asbestos is classified as a CERCLA hazardous substance but so long as it is part of a building structure, releases of asbestos fibers are not subject to CERCLA liability. However, once a building is demolished, the cleanup of asbestos debris can be covered by CERCLA. One of the problems with asbestos in soil is that government regulators are now concerned that the mineral can become more easily dislodged from soil than previously thought and may create a dangerous airborne exposure in the process. Thus, the one percent threshold used for regulating asbestos-containing materials may no longer be protective of human health.*

Some states have established specific procedures for managing asbestos in soil. For example, the Massachusetts policy establishes different management approaches depending if the asbestos is associated with asbestos-containing debris that has been buried or if there are unconsolidated asbestos fibers in the soil. The policy establishes different notification requirements for these types of asbestos in soil. For example, separate notification is not required for unconsolidated asbestos in soil that does not pose an imminent risk and non-friable asbestos containing material

(ACM) that is buried more than three feet unless it is to be disturbed or moved. However, debris that contains regulated ACM (RACM) from non-friable sources (roof tiles, shingles, caulking putties, etc) at the surface or in the first three feet of soil that could release asbestos if the debris becomes weathered or damaged would be subject to a 120-day reporting obligation. Surface debris with friable RACM that is located within 500 feet of receptors is subject to a 2-hour release reporting requirement while other friable RACM at any depth or on the surface and more than 500 feet from receptors is subject to a 120- day reporting requirement regardless of where it is located. Unconsolidated asbestos in soil is considered a "special waste" that must be managed using best management practices (BMPs) without state oversight.

ENVIRONMENTAL INSURANCE

Transactional Insurance Products

Allocation of environmental liabilities is a key issue in corporate and real estate transactions. Common risk allocation tools include survival of seller representations and warranties after closings and seller indemnities; however, if the seller is conveying its principal asset or is not financially healthy, these remedies may prove to be illusory.

As a result, purchasers are increasingly turning to new insurance products known as Representation and Warranties Insurance or Warranty and Indemnity Insurance. These policies are designed to act as credit enhancements that can backup environmental representations, warranties and indemnities made by parties in a transaction. The coverage is also increasingly being used as a primary risk allocation tool in transactions in lieu of warranties or indemnities. For example, a seller of a business may make certain representations and warranties concerning the compliance with environmental laws. Often times, the buyer will insist that the representations survive the closing so that it would have a claim for breach of contract or indemnity if the representations prove to be inaccurate. The scope, triggers, limits and time period for an indemnity are often intensely negotiated. Even where the purchaser is satisfied with its contractual protection, it still runs the risk that the seller may be unable to pay for any losses suffered by the purchaser. This policy can shift some or all of the risk to the insurer in return for premium that can be funded either by the buyer or the seller, depending on the transaction.

Another interesting transaction-related product is the loss mitigation policy. Because of the fast pace at which transactions are now being completed, purchasers may not have enough time to fully evaluate the value or risk of pending litigation or other known existing issues. Typically, a purchaser's counsel or consultant will estimate the likely costs. Because of unknowns or incomplete information, these are at best "soft" estimates that do not have a high degree of confidence or probability. For example, with pending litigation that has the potential to have a material financial impact, the purchaser must weigh both the chance of successfully defending the case on the merits as well as the likely range of damages in the event the claimants are successful. Likewise, a purchaser may know that a site is contaminated but cannot accurately estimate the cleanup costs because the site investigation has not been completed or the seller did not adequately characterize the extent of the contamination. The purchaser may also be unable within the timeframe for the transaction to determine if the site would be eligible for financial incentives under a state brownfield program that reduces the impact of any cleanup.

An insurance policy such as a cost cap policy can shift the risk of cleanup overruns to the insurer in return for premium. The cost cap or stop loss policy provides the buyer with insurance to cover the cost of remediation above a negotiated retention and up to a negotiated limit, enabling the purchaser to close the deal despite environmental uncertainties. Other popular coverage enhancements that are also being used in transactions include Natural Resources Damages, Non-Owned Disposal Site, UST coverage for states with insolvent trust funds, and reopener or land use control coverage for sites with risk-based cleanups.

Insurers Concerned About Silica Claims

In our last issue, we discussed how asbestos claims have continued to proliferate decades after the use of products with asbestos-containing materials was sharply curtailed. Now, in the wake of a recent report issued by rating agency Standard & Poor's (S&P) the insurance industry is becoming concerned that silica may become the "new asbestos."

The report noted that CNA added $81 million to its reserves for mass torts in the third quarter of 2003 and that other

insurers are building reserves to address future cases. According to the Insurance Information Institute (III), silica-related exposures have not been routinely excluded from general liability, products liability and commercial umbrella policies. However, the Council of Insurance Agents & Brokers (CIAB) quarterly market index for first-quarter 2004 suggested that insurers are beginning to exclude silica from renewal policies.

Report Discounts Mold Health Impacts

During the past few years, media reports have touted mold as the next asbestos. A new report from the Institute of Medicine of the National Academies has found that while mold exposure can produce asthma-like symptoms, an exhaustive review of scientific literature has failed to link mold to the range of toxic health effects that have been alleged in the thousands of mold-related lawsuits.

The report found sufficient evidence to conclude that mold and damp conditions are associated with asthma symptoms in asthmatics who are sensitive to mold, and to coughing, wheezing, and upper respiratory tract symptoms in otherwise healthy people. However, the evidence did not meet the strict scientific standards needed to establish a clear, causal relationship. An uncommon ailment known as hypersensitivity pneumonitis also is associated with indoor mold exposure in genetically susceptible people. Likewise, the presence of visible mold indoors may be linked to lower respiratory tract illness in children, but the evidence is not as strong.

The report noted that some studies on animals and cell cultures in labs have found toxic effects from various microbial agents, raising concerns about whether these same agents growing in buildings can cause illness in people. The report also said that molds that are capable of producing toxins do grow indoors, and bacteria that flourish in damp conditions can also cause toxic or inflammatory effects. The report found that there were very few studies that had examined if mold or other factors associated with indoor dampness are linked to fatigue, neuropsychiatric disorders, or other health problems that have been attributed to indoor fungal infestations. While the existing scientific evidence does not support a cause and effect association, the report said it could not conclusively dismiss the possibility of such health effects because of the dearth of well-conducted studies and reliable data.

The report also found that wetness might cause chemicals and particles to be released from building materials. However, little information exists on the toxic potential of chemicals or particles that may be released when building materials, furniture, and other items degrade because of wetness.

The report concluded that indoor moisture was a prevalent problem that needed to be addressed. The report said that while there is universal agreement that promptly fixing leaks and cleaning up spills or standing water substantially reduces the potential for mold growth, there is little evidence that shows which forms of moisture control or prevention work best at reducing health problems associated with dampness. As a result, the report recommends development of national guidelines for preventing indoor dampness and that building codes be revised as necessary to reduce moisture problems. Other suggestions included producing training curricula on why dampness occurs and how to prevent it as well as examining the use of economic incentives to spur adherence to moisture prevention practices such as bonuses for facility managers who meet defined goals for preventing or reducing problems or fines for failing to timely correct problems.

The report said it was hampered by the lack of standards for determining an appropriate level of dampness reduction, or a safe level of exposure to organisms and chemicals linked to dampness. The report recommended that current animal studies of short-term, high-level inhalation exposures to microbial toxins be supplemented with new research that evaluates the effects of long-term exposures at lower concentrations.

Commentary: *Mold litigation claims are expected to increase three to five times over the next three years. While negligence actions continue to be the most popular form of lawsuit, an increasing number of class action lawsuits and strict liability lawsuits are being brought against manufacturers of*

products, such as window and wood processed sealants, as well as against local government agencies for failing to assess mold. Link to ERRA.org for more information on mold and mold claims.

District Rules Insurance Does Not Cover Voluntary Cleanup

State brownfield programs provide incentives for private parties to voluntarily remediate contaminated properties, but a string of court decisions have been removing a key incentive for such cleanups--the availability of insurance to reimburse the volunteer for its cleanup costs.

The latest adverse decision for policyholders was *American Motorists Insurance v. Stewart Warner Corp.*, No. 01-C-2078, (N.D. Ill., 6/25/04). In this case, the defendant manufactured and assembled machined metal parts from 1935-1989. EPA advised the defendant in 2000 that it would be issued a RCRA corrective action order unless it entered into a voluntary cleanup agreement. In September 2000, the defendant signed a corrective action agreement to perform additional investigation and remediation at the site but terminated the agreement in December 2001. EPA then issued an administrative order for corrective action that required the defendant to implement the same investigation and remediation tasks as the voluntary agreement. The company then withdrew from a cleanup agreement so its insurer would not characterize its cleanup costs as voluntary and thus it would not be entitled to indemnification for those costs under Illinois law. A later administrative order that paralleled the voluntary agreement did not transform those response costs into legal damages, the court said. In May, the federal district ruled that AMICO had no duty to defend or indemnify under its policies because no suit had been filed. On a motion for reconsideration, the court ruled that while some of the policies did include a duty to indemnify provision, the claim was nevertheless barred because the defendant was seeking indemnification for sums that it never became "legally obligated to pay." The court said that a policyholder does not become legally obligated until a judgment or settlement is reached between the parties. The court pointed out that the defendant had admitted that it terminated the voluntary cleanup agreement with EPA to prevent the plaintiff from characterizing the cleanup as “voluntary” and that the administrative order contained the same requirements as the voluntary agreement. The court held that it would be against public policy to allow a recalcitrant policyholder to use delays to transform response costs into legal damages.